

## Russian Pipeline Diplomacy: A Lithuanian Response

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The period 2006–2007 could possibly mark the beginning of a new stage in the development of international relations and the international system. While it would be difficult to identify an event as distinct and significant as September 11, 2001, there was a series of less significant occurrences, which, having been lined up in succession, do produce another emerging image of the world and Europe, where an ever-increasing role is played, not by terrorism, but by threats to energy security.

In recent years, this problem has become particularly urgent in Europe because of a change in the policy of Russia. Russia's conflicts with its nearest neighbors, Belarus and Ukraine, over gas and oil prices, show its aspirations to eliminate transit countries from participating in oil and gas processing and transportation. Russia's attempts to hinder, in every way possible, the implementation of alternative pipeline projects, which circumvent Russia, the development of a more uniform European Union energy policy, and many other less significant factors, testify that energy issues in modern Europe are becoming a part of their new agenda. It is not so much of an economic policy of the states, but a part of Russia's foreign and security policy.

In my opinion, this change is illustrated by Mr. Vytautas Naudužas, vice minister of the economy and former Lithuanian ambassador to Turkey, when he suggested, at one of the numerous conferences on energy issues in Vilnius, on May 10, 2007, that in the case that political slogans were removed from the foreign policy of the European states, its essence would truly become competition for energy security.<sup>1</sup>

It is quite natural in Lithuania for those who are closely associated with energy supplies from Russia, where these political changes are significantly felt, to openly discuss them. While many European countries still cherish certain illusions about Russia, the Lithuanian politicians and the general public do not. Due to specific historical experiences, Lithuanians do not harbor any doubts whatsoever that Russia will make attempts to employ its new advantages that have emerged because of a considerable increase in energy source prices. Not for economic development, not for the welfare of its people, but for political dominance and revenge for the lost Cold War. Consequently, the energy and pipelines business developed by Russia during recent years is seen in quite a different context.

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1 Vytautas Naudužas (Vice-minister of economy, former Lithuanian Ambassador to Turkey), "EU Enlargement and Energy Security," *Presentation at the International Conference "Enlargement of European Union and Energy Supply Security,"* Vilnius, 10 May 2007.

A separate discussion could be held on the causes and the probable consequences of such changes in the policy of Russia. However, we will leave this for another study since the primary objective of this paper is not Russia, but Lithuania and its response to the current reality. Right now, we will only point out that the response of Lithuania is analyzed with the assumption that the country should be ready for the worst scenario, i.e., for interruption of the supply of any energy sources from Russia. Therefore, this paper focuses primarily on the Lithuanian energy infrastructure in the three key energy areas: the oil, gas, and electricity sectors. First, the paper surveys the genesis of the Lithuanian energy infrastructure and the infrastructure qualities predetermined by it. Then, how this infrastructure changed throughout the past fifteen years is examined. Finally, the challenges in the concrete sectors and the response, generated by the government of Lithuania and society in this change-affected situation, are identified.

In addition, it is important to keep in mind Lithuania's efforts to develop and increase the share of indigenous and renewable energy resources (solar, wind, biofuel etc.) in the total energy balance of the country. However, this type of energy resource in 2005 constituted only 10.8 percent of the total balance. The target of the recent Lithuanian National Energy Strategy is to reach a share of nearly 20 percent in the primary energy balance by 2025.<sup>2</sup> Because of the rather limited size of this kind of energy supply and its still-limited importance for national energy security, the paper deals exclusively with oil and gas supply from Russia, as well as the closely associated electricity generation.

## OIL

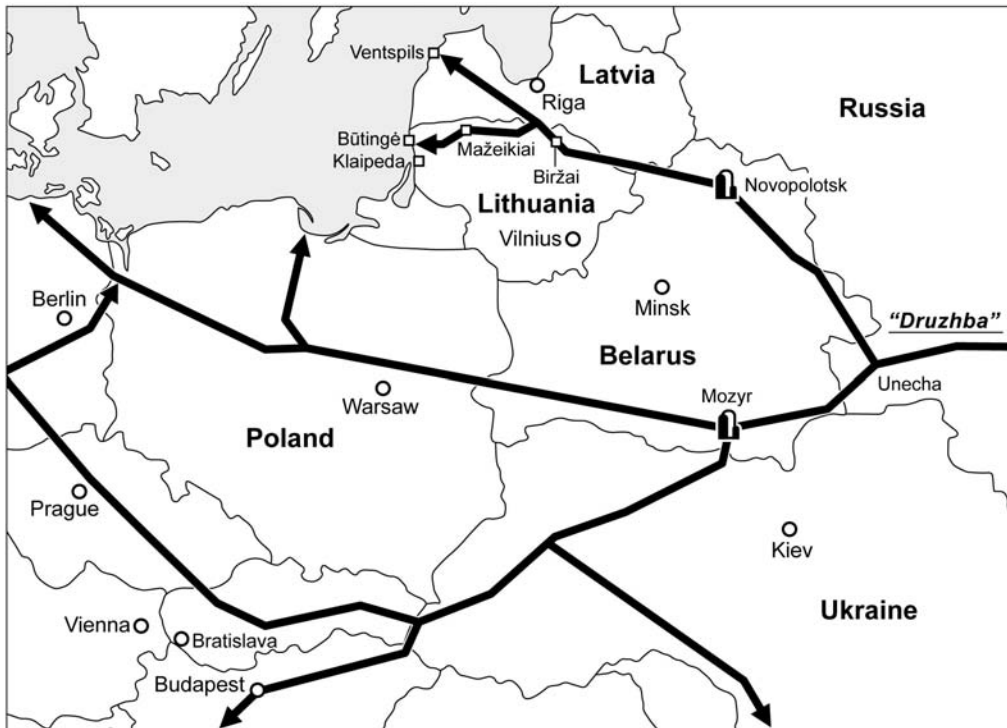
After the collapse of the Soviet Union, the ownership of former state property passed to individual Soviet republics that became independent. In Lithuania, all of the most significant objects of energy infrastructure passed to the government, who, in turn, established public companies to manage this property. This is how the company Lietuvos energija was established and came to administer the entire electric economy, including the Ignalina atomic power plant. The newly established company Lietuvos dujos took over all gas supply and distribution infrastructure. The third company was the oil-processing enterprise, Nafta, situated in Mažeikiai. This was the starting point from which further reforms and reorganizations ensued. Now, we will discuss each sector separately.

The main infrastructure of the oil sector in present-day Lithuania was essentially developed during the years of Soviet occupation. In 1964, the State Oil and Chemical Industry Committee of the USSR started to consider the idea of an oil refinery in Lithuania. In 1970, a location in the northwest of Lithuania

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2 National Energy Strategy approved by Resolution No X-1046 of the Seimas (Parliament) of the Republic of Lithuania of 18 January 2007 [[http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc\\_l?p\\_id=292522, 27/03/2008](http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc_l?p_id=292522, 27/03/2008)].

Figure 1. Oil pipeline Druzhba



about ninety kilometers from the Baltic Sea ports Klaipėda and Ventspils was approved as the site for the refinery. After a long construction, the first refining complex was put into operation in 1980.

The design capacity of the Mažeikiai refinery is 15 million tons of crude oil per year. In order to utilize the refining capacities more efficiently, the Mažeikiai refinery was also designed to process other feedstock including gas condensate, fuel oil, and middle distillates. The primary refinery feedstock was supposed to be the crude oil shipped either by the trunk pipeline system or by railway from Russia. For this reason, as early as 1966, the construction of trunk crude oil pipelines in Lithuania started. Finally, in 1979, the year before the refinery came into operation, the Novopolotsk – Biržai – Mažeikiai crude oil pipeline and the Biržai pumping station on the Novopolotsk – Ventspils crude oil pipeline were completed. This pipeline, crossing Lithuanian territory, became the northern branch of the world's longest oil pipeline, Druzhba. The diameter of this pipeline was either 1,020 mm or 1,220 mm.

"Druzhba" means "Friendship," alluding to the fact that the pipeline was intended to supply oil to the energy-hungry western regions of the Soviet Union, to its "fraternal socialist allies" in the former Soviet block, and even to Western Europe. It was constructed in 1964 to transport oil from central Russia to points in the West over a distance of some 4,000 km. Today, it is the largest principal artery for the transportation of Russian (and Kazakh) oil across Eu-

rope. The pipeline begins in Samara in southeastern Russia, where it collects oil from western Siberia, the Urals, and the Caspian Sea. It runs to Mozyr in southern Belarus, where it splits into northern and southern branches. The latter branch runs south into Ukraine, Slovakia, the Czech Republic, and Hungary. The northern branch crosses the remainder of Belarus to reach Poland and Germany. The Mažeikiai refinery in Lithuania and Ventspils oil terminal in Latvia is connected to the main pipeline by the branch pipeline from Bryansk Oblast.

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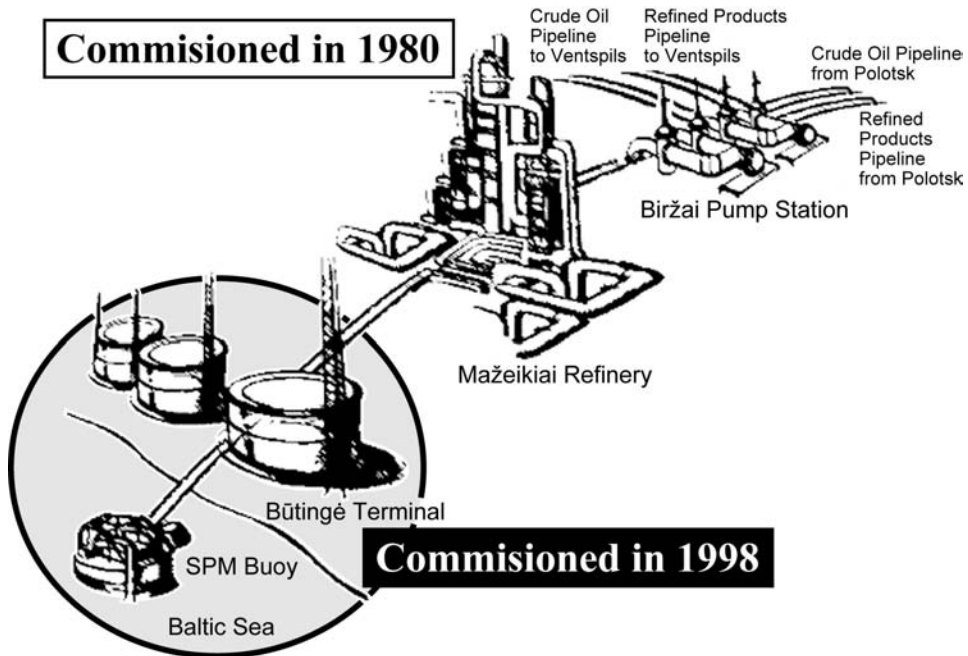
The Lithuanian public experienced the weaknesses characteristic of the Lithuanian energy infrastructure right after the decision of March 11, 1990, by the parliament of Lithuania. They declared the restoration of the independent state and its separation from the then still-existing Soviet Union. Since Mikhail Gorbachev was not interested in open military aggression against the disobedient republic, he resorted to an energy blockade, thus making the Lithuanian parliament revoke its decision. On April 18, 1990, Moscow interrupted the supply of energy resources and raw materials to Lithuanian industry and transport, although the population could still buy these products in small quantities for their personal needs in neighboring Latvia, Belarus, and the Kaliningrad Region. The Mažeikiai oil processing enterprise was forced to stop operation and suffer the ensuing consequences for the industry, particularly for the transport system.

The energy blockade against Lithuania lasted only three months, coming to an end due to the ever-increasing political struggle and competition in Moscow itself. Yet this short blockade left an indelible print on the Lithuanian political elite, as if programming them to seek, at all costs, for Lithuania to obtain oil in other ways, without depending on Russia who at whim could resort to an energy blockade again.

Developing an alternative possibility to supply oil to the Mažeikiai oil processing enterprise became the first implemented energy project of the independent Lithuania. It was the beginning of the operation of the Būtingė oil import/export terminal. According to the project, the complex of the Būtingė terminal would consist of a crude oil pipeline, which connects the facility with the Mažeikiai refinery, onshore terminal equipment and tanks at Būtingė, an offshore pipeline, and a single-point mooring buoy. These units form the onshore and offshore parts of the terminal.

Although the significance of the project was unarguable, its implementation was very complicated for several reasons. First of all, it was necessary to persuade the political opposition and a doubting populace that it was a good idea. After the collapse of the Soviet Union, relations with Yeltsin's Russia became decidedly better, and the supply of oil to Mažeikiai was renewed. Therefore, many people doubted whether it was still advantageous to take up

Figure 2. Lithuanian Oil Complex



Source: AB Mazeikiu nafta [<http://www.nafta.lt/en/content.php?pid=5>].

such an expensive project. Still others proposed reconstruction of the Klaipėda small-capacity oil export terminal or make an agreement with Latvians in case of the necessity to pump oil to Mažeikiai through Ventspils, instead of building a new and expensive infrastructure. Finally, the Latvian “Greens” loudly voiced their opposition to the construction of the oil terminal in Būtingė on the grounds that, in case of an emergency at the terminal, the Latvian seaside would be the most affected.

Another major obstacle was the concentration of sufficient financial resources for the implementation of the project. However, in the end, after the government made the decision to finance the construction at the expense of the Mažeikiai oil processing enterprise, work on the terminal began. It was a particularly risky decision since, during the next two years following the construction of the terminal that started in 1995, the Mažeikiai oil processing enterprise not only worked very inefficiently, but was almost at the point of bankruptcy. Just a decade ago, with comparatively low world oil prices, import through the Būtingė terminal would have been detrimental; therefore, many people believed that with the decreased probability of an oil blockade by Russia, the construction of the terminal was a dead loss.

Obstacles and high cost notwithstanding, the project was finally completed. In 1998, the marine terminal in Būtingė was completed and put under the ownership of the Mažeikiai refinery. The first tanker was loaded in Būtingė in the summer of 1999, and it took onboard a shipment of crude oil from the Rus-



sian company Yukos. The terminal can export up to 14 million tons of crude oil per year. As an import and export terminal, it is capable not only of exporting crude oil but also of accepting import cargoes. The Mažeikiai refinery, by taking over the ownership of the marine terminal, also committed itself to maintaining the environmental safety of the facility.

Yet the successful implementation of the Būtingė project dictated its own price. The government had to decide on selling the shares of the Mažeikiai oil processing enterprise. As early as 1995, the state-owned enterprise was reorganized into the joint stock company, Mažeikių nafta, with approximately 90 percent of shares remaining in the hands of the government and the other 10 percent distributed among the employees.

However, after the government decided to sell a portion of the Mažeikių nafta shares, it turned out that the decision was not easy to carry out. Even though the government wanted to sell the enterprise, because it had yet to be profitable, it did not want to sell the facility (or rather give it away) to just anyone. It especially did not want to sell it to the Russians because of the consequences of the aforementioned blockade. Selling shares to the Russians would have defeated the entire purpose of the construction. Because if the Russians had control of the Būtingė terminal, the construction of which required so much effort, they would control the network of oil pipes running through the territory of Lithuania and connected to Mažeikių nafta since 1998 as well. Finally, at the end of 1999, 53 percent of the total shares of the Lithuanian oil complex and the rights of the enterprise operator were sold to a U.S. company named Williams.

Unfortunately, expectations of revival and profitable operation of the Mažeikių nafta, associated with the coming of Americans to the Lithuanian oil sector, were met only in part. Although Williams undertook modernization of the enterprise, they failed to ensure a sustainable and uninterrupted supply of oil via the current pipe network from Russia. The Russian company Lukoil, whose proposal to buy Mažeikių nafta the government of Lithuania had rejected, did everything in their power to essentially impose on Lithuania an undeclared oil supply blockade. The long-lasting negotiations between Williams and Lukoil bore no fruit. Russians and Americans failed to find a common language, and Williams decided to withdraw and sell their portion of the Mažeikių nafta shares.

In the end, it was a Russian company that became the buyer of the shares in 2002. Yet it was not Lukoil, but a company named Yukos who bought the shares. Strange as it might seem, the Lithuanian government decided not to oppose this transaction. Today, however, when the story of Yukos relations with the Kremlin is common knowledge, this occasions no surprise. Yukos managed to manifest itself as a company independent of the Kremlin and demonstrated that its foreign investment was aimed at economic benefit only and not at any political objectives. As was demonstrated by further events, Williams consistently kept to this standpoint. Thus, in 2002, Yukos purchased 53

percent of Mažeikių nafta shares from Williams and also took over the rights of the enterprise operator alongside the commitments. Since Yukos had its own oil resources and could supply the enterprise with raw material, the Mažeikių nafta, after a long interval, in 2003 began to operate profitably, and became one of the key taxpayers to the budget of Lithuania.

Yet those in power in Russia ruined the successful activity of the enterprise because of repressions against the operational command of the Yukos company. In 2003, the Russian authorities detained and imprisoned the head of the enterprise, the liberally disposed businessman Mikhail Khodorkovsky, having accused him of tax evasion and cheating. Finally, the accounts of the company were seized; the assets of the enterprise were sold (or, to be more exact, requisitioned) in Russia. Thus, by false means, Yukos was brought to bankruptcy and had to sell its assets also including Mažeikių Nafta abroad since the conflict with the power bodies of Russia precluded a sustainable supply of raw materials to the enterprise.

At the close of 2005, several enterprises clashed in the competition for Yukos and Mažeikių nafta shares belonging to the government of Lithuania: the Russian and British enterprise TNK-BP, the consortium of Russian Lukoil and American ConocoPhillips, the Kazakh-owned KazMunaiGaz, and the Polish PKN-Orlen. Finally, the Polish company who had offered the highest bid won the competition. Although the then government of Lithuania, and personally Prime Minister Algirdas Brazauskas, were skeptical about the Polish investor having no owned oil resources, the Yukos decision to sell the enterprise to the buyer offering the highest price came out on top.<sup>3</sup> Meanwhile, Russian companies, using political pressure, had expected to acquire the enterprise for a very low price, as was the case with Yukos assets in Russia. The success of the transaction can be attributed to the determined position of the Polish authorities who consistently sought to ensure energy-related independence from Russia. Present-day Poland is the only country in the region that did not permit Russian companies to break into its energy markets. Therefore, the takeover of the Mažeikių nafta was strategically important for Poland in order to restrict the impact of Russian companies in the region.

The response from Russia was not long to come, however. This happened well before the completion of the sale and purchase transaction. Since August of 2006, Russian pipeline monopoly Transneft suspended supplies to Lithuania's Mažeikių nafta refinery and the Butingė export terminal. The official reason for the oil supply suspension was a pipeline leak. Transneft's president denied that the shutoff had any political element. However, the halt in oil supplies came just weeks after the Polish company PKN Orlen sealed a deal with the going-bankrupt Russian oil group Yukos to buy the Mažeikių nafta complex, apparently to the annoyance of Moscow who wanted this facility to

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3 Audrius Bačiulis, "'Mažeikių nafta': Trečias kartas nemeluos? ['Mažeikių nafta': Will the Third Try Bring Success?]," *Veidas* 51 (21 December 2006), p. 30. (in Lithuanian)

be sold to a Kremlin-loyal Russian company. The international rating agency Fitch Ratings noted that Russia's move to cut oil supplies to a major Lithuanian refinery could be political. However, the Lithuanian government was clearly wary of antagonizing Russia and creating a worse situation. Therefore, it initially rejected reports that Russia would seek to retaliate for the halt in oil supplies to Mažeikių Nafta and PKN Orlen. Nevertheless, Russia's intentions at this point remained uncertain, but the fact of the matter was that regardless of the motive behind the supply disruption, the status quo was in neither Lithuania's nor PKN Orlen's favor. Since that time, the Mažeikių nafta refinery has been buying oil from world markets with deliveries through a sea terminal, but this dramatically reduces profits. Since 2006, the Mažeikių nafta refinery has incurred losses of 55 million Euros.<sup>4</sup>

In October 2006, Lithuania offered Transneft help in fixing the pipeline, but the offer was rejected, with the Russians insisting they were on schedule with the repairs. "The schedule stipulates that the technical investigation should be completed by February or March next year. After we understand what caused the problem, we can determine how to fix it," the Transneft vice president said at the time. However, nothing has really happened until now.

Finally, Lithuania decided to use EU leverage in order to solve the issue. Despite the fact that the government did not join Poland in blocking Russia-EU negotiations on the Partnership and Cooperation Agreement, Lithuania openly appealed to the European Commission to step up pressure on Russia concerning the Druzhba pipeline. "We believe that there will be a possibility to use stronger wording about the supplier's reliability within the context of Druzhba blockade," said Lithuanian prime minister Kirkilas. "It is our opinion that the wording must be about 'a reliable supplier'," noted the PM. According to him, the wording that the EU leaders have now is not very strong. It looks as though his appeal was heard.

During his visit to Lithuania in March 2007, the president of the European Commission, Jose Manuel Barroso, told the Lithuanian parliament that he shared the country's concern over Russian supply of crude oil. "I want once again to tell you that the Commission fully shares the concerns that the position, with respect to the stopping of oil supplies through the Druzhba pipeline to the Mažeikių nafta refinery that ceased in July last year, is not clear, and the flows have not been re-established. I strongly uphold the principle that energy trade must follow normal commercial practices only, and this is very important to underscore, and in fact, I have been saying this to the Russian authorities. I am ready to raise this issue again in the next European Union and Russian summit on 18 of May, if necessary, and we hope this matter will be properly addressed by all the parties involved."<sup>5</sup> However after a cold and unsuccessful bilateral summit in Samara, Barroso was even tougher. He stressed, "Once

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4 Stratfor, "Lithuania: Tied to Russia by a Breakable Pipeline," 31 July 2006 [[http://www.stratfor.com/products/premium/read\\_article.php?id=271075,06/04/2007](http://www.stratfor.com/products/premium/read_article.php?id=271075,06/04/2007)].



again, regarding the problem with Lithuania over the Druzhba pipeline – it is not the EU that created this problem! **We are telling the Russians we can repair it, we can pay for it, but it is not happening.**<sup>6</sup>

Whatever the outcome of the next Mažeikių nafta blockade by Russia, even the most adamant opponents of the marine terminal Būtingė, which was completed a decade ago, now acknowledge that though it was then very expensive, the decision adopted was strategically good because it essentially resolved the problem of energy security in the area of oil economy. Although it remains uncertain how long Russia is going to play its political games and whether it will in general channel all oil flows through its own ports, it is possible for Mažeikių nafta to obtain raw material from other sources and remain operational. Unfortunately, this cannot be said about the gas sector.

## GAS

Natural gas “business” within the territory of Lithuania dates back to 1961. Since that time, Lithuania was connected to the Soviet pipeline system by the two gas pipelines from Belarus Invariantsevichy – Vilnius and Minsk – Vilnius. Since that time, the gas supply to the entire country has been carried out systematically. Branches of gas pipelines were laid leading to Kaunas in 1962, to Šiauliai in 1964, to Klaipėda in 1968, etc. On the eve of the collapse of the Soviet Union, the length of the laid gas pipelines exceeded 1,000 km and the network of gas pipelines covered two thirds of the entire territory of Lithuania (Figure 3).

As was mentioned above, after the collapse of the Soviet Union, the Lithuanian gas sector became the property of the state but, naturally, it remained a 100 percent dependent on supplies from Russia. As long as Yeltsin’s Russia did not set imperial objectives for itself and followed a rather liberal foreign policy, gas supply to Lithuania experienced no major problems. This was also positively facilitated by the beginning market economy reforms. Alongside the main supplier Gazprom, other enterprises, including intermediaries established in Lithuania, engaged in supplying gas. Those intermediaries would buy gas from Gazprom, yet they did this in Russia and could therefore get gas cheaper, at average Russian prices. Afterwards, the intermediaries sold the gas in Lithuania at slightly higher prices. Notwithstanding, the price offered by them was by 1–2\$ lower than that of the public company Lietuvos dujos. Thus, businessmen, who used their private initiative and managed to find a common language and evidently to share their profits with tough and powerful Gazprom managers, soon amassed great riches and became well-known and

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5 José Manuel Barroso (President of the European Commission), “We are all new Europeans now, Lithuanian Seimas (Parliament),” Vilnius, 29 March 2007 [<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/211>], 2008.3.26.

6 EuroActive network, “EU to aim for energy-savings agreement at G8 [<http://www.euractiv.com/en/energy/eu-aim-energy-savings-agreement-g8/article-164033?Ref=RSS>],” 27.3.2008.

Figure 3. Map of the Lithuanian Gas Grid



Source: AB Lietuvos dujos [<http://www.ldujos.lt/admin/files/get.php?id=34>].

influential people in Lithuania, though with doubtful reputations.

Probably the most typical example of such a businessman was the founder of the populist Labor Party, Viktor Uspaskich, who had recently applied for political asylum in Russia. His offshore company Jangila, established in 1993 would buy gas from the Gazprom \$8 cheaper than it sold the same gas to Lietuvos dujos. Among other intermediaries trading in natural gas, it is necessary to mention such enterprises as Stella Vitae, established in 1996, through which two thirds of Russian gas used to be supplied. This enterprise used to buy gas from the Gazprom \$2.50 cheaper than the selling price. Thus, Stella Vitae would earn approximately 30 million dollars a year just for mediation.<sup>7</sup> Mr. Rimandas Stonys and partners established the private company Dujotekana that currently remains the strategic partner and intermediary of Gazprom in 2001. At present, in the Lithuanian press, Stonys is considered to be almost a key figure in ordering and organizing all political scandals that have broken out in the country during recent years.

<sup>7</sup> Jonė Kučinskaitė, "'Gazprom'o' vietininkas [The Vicegerent of the 'Gazprom']," *Veidas* 47 (3 November 2006), p. 42. (in Lithuanian).

Thus, the business of gas trade became one of the least transparent, hardly manageable situations in Lithuania because businessmen of doubtful moral reputation turned into too-influential backstage actors who, having surplus money and financial levers of uncertain origin, can exert influence on political parties, their election campaigns, and finally the decisions adopted by legislators. Although during recent years, the Lithuanian press abounds in reports on illegal activity of this type, no court cases or legal prosecutions have taken place so far.

In 2002, in order to make the gas sector more transparent and to attract new investment, the government of Lithuania decided to privatize the state-owned enterprise Lietuvos dujos. Bearing in mind the complicated privatization experience of Mažeikių nafta, the government of Lithuania decided not to reject a Russian investor this time, but to follow the precedent that all interested parties should be evaluated and that the interests of Western, Eastern, and Lithuanian capital should be taken into consideration while seeking maximum benefit for the state. Finally, these shareholders became the owners of Lietuvos dujos: 38.9 percent – **E.ON Ruhrgas International AG (Germany)**; 37.1 percent – OAO Gazprom (Russia); 17.7 percent – the Lithuanian National Property Fund; and 6.3 percent – individuals and legal entities.

The model chosen in Lithuania for the privatization of Lietuvos dujos was followed by different commentaries, but it was met by no strict opposition, even to sell to Gazprom. Everyone understood that a refusal to sell part of the shares to Gazprom on the political grounds that this company was too closely associated with the state power in Russia would be too risky since, unlike the oil business, Gazprom after Vladimir Putin came to power became a monopolist in the gas supply business and any intermediary companies would have been to no avail. It is also known that after Putin's protégé Alexei Miller was appointed to Gazprom, he eradicated corruption in the Russian concern and instituted an order that gas was to be sold to all Gazprom customers at the same price. Therefore, the business of intermediation was destined to fail. On the other hand, the injection from Gazprom was partly balanced by German capital, which at least theoretically had to outweigh the influence of Gazprom and be more interested in the economy than politics.

In part, these expectations were met because, since the privatization of Lietuvos dujos, gas supply to Lithuania was uninterrupted with the exception of the disorders that surfaced during the conflict between Russia and Belarus in 2004. At that time, after Russia cut the gas flow to Belarus, Lithuania did not receive any gas either, because the gas pipeline link with Latvia had not yet been arranged.

But, on closer scrutiny, it is easy to notice that in the opinion of certain mass media, the impact of Gazprom on Lithuania obviously abuses business interests. The first example of this is the enterprise intermediary of gas trade Dujotekana headed by the aforementioned Stonys. The very existence of Dujotekana is an oddity that can hardly be grasped by common sense because

Dujotekana purchases gas in Russia at the same price as Lietuvos dujos and earns its profit from the 30–32 percent of the mark-up applied to Lithuanian users. Yet, with Gazprom support, Dujotekana not only acquires huge profits but also has large finances that it can use for lobbyism or some other influence on the political process. Attempts of individual politicians or political forces to curb the excess profit of Dujotekana have been unsuccessful so far and have often turned into political scandals during which initiators of the amendment of the Natural Gas Law used to be compromised.<sup>8</sup> **This was widely discussed** in the Lithuanian press though all generalizations should be accepted with strong reservation; however, even from the officially published campaign finance information, it is possible to learn that Stonys is one of the most generous supporters of the political parties and political leaders, making it reasonable to think that those schemes are not altogether concocted.

On these grounds, the conclusion could be drawn that although Gazprom precluded the possibility of different intermediaries benefiting from reselling gas and then gaining sufficient resources to create confusion in political life, and later, at a higher level, Gazprom itself took over this scheme for profiting and concentrating of excess profit resources in order to later actively meddle in the political life of the country. Thus, it seems that at this point, energy security should be forgotten and the simplest counter-intelligence should take over. Therefore, one way or the other, it seems that so far, only the independent mass media are seriously engaged in protecting Lithuania from the realization of corrupt schemes.<sup>9</sup>

Certainly, the political confusion associated with the gas sector had an inevitable negative impact on the possibility of making strategic decisions related to gas supply diversification solutions or on Lithuania not only as a gas user, but also as a state seeking and consolidating the status of a gas transit intermediary. After Gazprom was included among the shareholders of Lietuvos dujos and became the entity controlling the pipe supplying gas through the territory of Lithuania to the Kaliningrad exclave, it is hard to believe that a project beneficial for Lithuania but detrimental to the interests of Gazprom<sup>10</sup> could be implemented in Lithuania. A good example of such an attempt is the so-called “Amber Pipeline” project (Figure 4).

It is common knowledge that as early as 2004, at the initiative of the Polish national gas company PGNiG, an idea was born to connect the gas pipelines of the Baltic countries into a common network Amber Pipeline, which had to become a straighter, cheaper, and more rational alternative to the gas pipe-

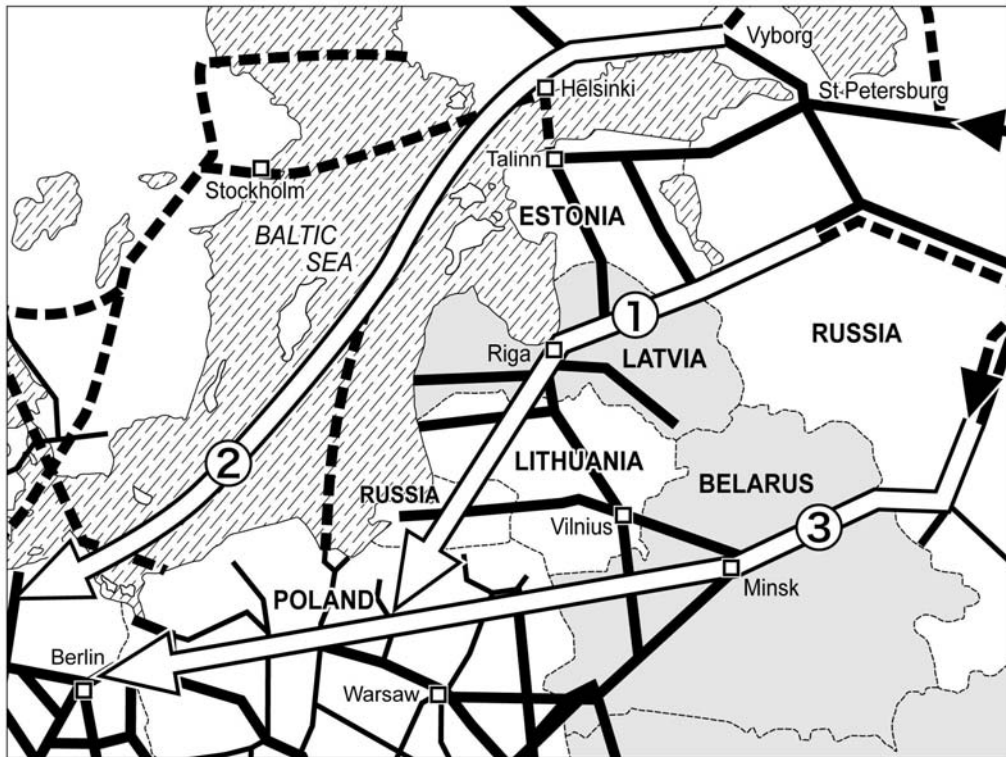
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8 Ibid.

9 Audrius Bačiulis, “Privatizuota valstybė [The Privatized State],” *Veidas* 13 (29 March 2007), pp. 22–23. (in Lithuanian)

10 See more: Tomas Janeliūnas and Arūnas Molis, “Energy Security in Lithuania: Challenges and Perspectives,” *Lithuanian Political Science Yearbook 2005*, pp. 200–223 [[http://www.tsp-mi.vu.lt/public\\_files/file\\_1204535979.pdf](http://www.tsp-mi.vu.lt/public_files/file_1204535979.pdf)], 25.3.2008.

Figure 4. "Amber" Project



- ① The Amber pipeline, proposed by Poland and the Baltic countries
- ② The Nordstream pipeline, planned by Russia and Germany
- ③ The existing gas pipeline

Source: *Veidas* 28 (13 July 2006), p. 27.

line that Putin's Russia and Schröder's Germany planned to build on the Baltic seabed circumventing the Baltic States and Poland. In the spring of 2006, the prime ministers of the Baltic States approved this four-state project, alongside the centralized gas depository/storage facility to be built in Latvia, and the possibility of building a liquid natural gas import terminal, most probably in Latvia as well. Poland planned to build a similar terminal in Gdansk. Yet the project, for whose implementation attempts were made to obtain the support of the European Union, encountered a boycott of the major gas companies of the Baltic States whose shareholder is Gazprom. These companies refused to contribute even as much as the financing of the preparation of the project feasibility study, which would also have been in part financed by the European Union. Without the participation of these companies, the project is hardly conceivable.

Although the Lithuanian Ministry of Economy has not yet altogether discarded this idea, it believes that at present, when Russia and Germany have al-



ready agreed on laying the gas pipeline on the Baltic seabed, the project Amber Pipeline has no chance of being implemented in the near future. According to the director of the Lithuanian Energy Institute, Jonas Vilemas:

At present, the most feasible plan for ensuring energy security in supplying ourselves with gas is to cooperate with Latvia, to make arrangements concerning the joint gas depository/storage and start serious discussions on whether it is worth building a gas import terminal. If a terminal is built, laying of the gas pipeline through the Baltic countries would not be so important. However, the provisional estimate indicates that this terminal would cost about 200 million Euros. It is doubtful that some private company would agree to invest without firm state guarantee. On the other hand, the presence of such a gas import terminal would preclude Russia from endlessly increasing prices of the gas supplied and blackmailing countries by threatening to cut supply. In essence, the terminal would be a back-up facility, but at the same time, it would be paying for energy security. Therefore, it is understandable that the state will have to pay for safeguarding from such a political risk, just as was the case when the Būtingė terminal was being built.<sup>11</sup>

This is the standpoint of one of the Lithuanian energy think tank leaders. The government seems to be ready to accept this standpoint because in its own opinion, it regards the joint Russian and German project Nord Stream, designed for laying gas pipelines on the Baltic seabed, particularly negatively. It is well known that on November 30, 2005, the North European Gas Pipeline Company was created in Switzerland by Gazprom (51 percent), BASF AG (24.5 percent), and E.ON AG (24.5 percent) to engineer, construct, and operate the offshore part of the pipeline. But the official Lithuanian as well as Polish stance on the Nord Stream gas pipeline is negative. According to the Lithuanian government, the pipeline does not improve security of supplies or integration of isolated markets, let alone serious environmental risks. Concerning the environment, it is important to keep in mind that the Baltic seabed is littered with dumped chemical weapons, other munitions, and ship wrecks dating from the Second World War and is home to sensitive submarine defenses built during the Cold War. Corresponding concerns were expressed by Sweden, Finland, and Estonia.

The concerns of Lithuania and the other countries mentioned above are understandable. Look at the Figure 4. It is obvious that the construction of Nord Stream would give Russia the ability to put pressure on transit countries (for lower transit charges or for other reasons) by threatening to switch gas volumes from the pipelines passing through their territory to Nord Stream. However, none these concerns was supported by the European Commission. The Commission says that Russia, of course, may blackmail transit countries like Poland or Lithuania, but this could occur if both pipelines Yamal-Europe and Nord Stream are not being used to their full capacity. Since there have

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11 Quoted from Audrius Bačiulis, "Gintarinio dujotiekio mirażas [Mirage of the Amber Gas Pipeline]," *Veidas*, 28 (13 July 2006), p. 27. (in Lithuanian)

been no suggestions to date that the Russians would do this, the Commission is supporting the project and still thinks that environmental issues could be settled by careful investigation of the seabed in detail.

Thus, in the gas sector, Lithuania and other Baltic States and also Finland remain totally dependent on Russia. Therefore, this sector is the most vulnerable. As opposed to the oil sector, where the situation is better, the gas sector not only remains as the link causing the most problems, but also has no realistic hope of change for the better.

## ELECTRICITY

Excluding all small electric power plants, the first major project of electricity energy in Lithuania was the Kaunas hydro-electric power plant built in 1959. With a total capacity of the four generators of 101 MW, the hydro-electric plant put an end to the large spring floods that used to cause extensive damage to Kaunas. Yet a rapid increase in the consumption of electric energy in the 1960s indicated that neither medium-size thermal, nor diesel-powered electric power plants, nor the Kaunas hydro-electric power plant, already in operation then, would be able to satisfy electric energy needs.

Therefore, a decision was made to build between Vilnius and Kaunas a large thermal electric power plant that was later called Lietuvos elektrinė. This structure became the largest and main thermal electric power plant in Lithuania. Unit #1 of the plant was launched in 1962, and the last one, Unit #8, in 1972. When its construction was completed in 1972 with the eighth unit, the power plant reached its full capacity of 1,800 MW. In 1973, the plant produced 90 percent of the total annual electric output generated in Lithuania. The fundamental fuel for Lietuvos elektrinė was crude oil; the back-up fuel was natural gas.

With the rapid expansion of the industrialization of Lithuania, a shortage of energy was felt again. Therefore, the Soviet government decided to build a powerful atomic power plant of regional significance in Lithuania in order to satisfy the needs not of Lithuania only, but also those of Belarus and Latvia. The site chosen for the construction was in Ignalina, an area near the intersection of the administrative boundaries of Lithuania, Latvia, and Belarus.

It was planned to equip the power plant with RBMK-1500 water-cooled graphite-moderated channel-type power reactors. The Soviet-designed RBMK-1500 reactor is the most powerful reactor in the world with an electrical power capacity of 1,500 MW. These are the same type of reactors as used at the Chernobyl power plant.

Preparations for the construction started in 1974. Unit #1 came online in 1983. Unit #2 was completed in 1986; however, even though it was originally scheduled for launch in 1986, its commissioning was postponed for a year because of the Chernobyl accident. Also, the construction of Unit #3 was suspended. Thus, though it was originally planned to build four reactors, only

two were built and launched. Construction of the final two was interrupted by the start of the democratization process in the Soviet Union and the emergence of the green movement. This movement put up fierce opposition to further expansion of the plant immediately. Therefore, the third reactor, though completely built and needing just filling up with fuel, stopped short of launching. In 1989, it started to be dismantled. As for the fourth generating unit, it was discarded with the beginning of the foundations.

Notwithstanding these circumstances, the Ignalina atomic power plant, even with only two reactors, became the most powerful electric energy generator in the entire region. The total capacity of the two reactors of the Ignalina atomic power plant was 2,700 MW. At that time, Ignalina could produce much more electricity than was regularly necessary and was only fully utilized during rush hours. Therefore, it was planned to solve that problem by building a special back-up pumped storage plant.

The construction of Kruonis Pumped Storage Plant started in 1977 and was not completed until 1992, already after the collapse of the Soviet Union. The Kruonis Plant was designed to work in pump mode and by using surplus electricity, to pump water from the lower water body to the upper one. At present, the capacity of the plant is 800 MW. When the water reservoir is full, the plant can generate 800 MW for five hours.

These are the main electricity generating capacities of Lithuania. In addition, the parallel electric network links should be mentioned as well. Joining electric power plants by electric networks produces a considerable economic effect because, in an energy system, in order to ensure its reliable functioning, it is necessary to maintain a relatively smaller reserve than in an individual electric power plant. A larger number of electricity consumers, receiving electricity from the common network, ensure more stable loading for electric plants and they can thus operate more economically in comparison with an individual plant. In electric power plants of a large energy system, electric units of a greater capacity can be installed, as they are considerably more economical than small ones. This is how the energy system ensures a reliable supply of electricity at a lower price.

The largest Lithuanian electric power plants were connected with high-voltage electric transmission lines as early as 1960. In 1962, when the first 330-kV Šiauliai – Jelgava (Latvia) electric supply line began operation, the Lithuanian energy system was interconnected with the Latvian energy system. In 1964, the 330-kV Vilnius – Minsk electric supply line and the 330-/110-kV Vilnius regional substation also began operation. Consequently, the Lithuanian power system was interconnected with the Belarus power system. Finally, when the 330-kV electricity supply line Kaunas – Sovetsk began operation, the Lithuanian power system was interconnected with the Kaliningrad power system by a 330-kV line. As a result of these projects, the Lithuanian energy system became fully and completely incorporated into the Soviet Unified North-West Energy System, which was controlled by the Unified Administration Post in Riga.

In 1991, during the collapse of the Soviet Union, the heads of the energy and electrification industrial corporations of the republics of Lithuania, Latvia, and Estonia declared that the energy systems of the Baltic countries refused to be economically subordinate to the Soviet North-West joint energy system and would participate in common operational work only. Certainly, it was only a formal juridical act and not a practical measure that in any way changed the current situation. Both the economic and technological logic meant that it was senseless to destroy a functioning reliable energy system for the sole reason that the territories connected to it have become separate states.

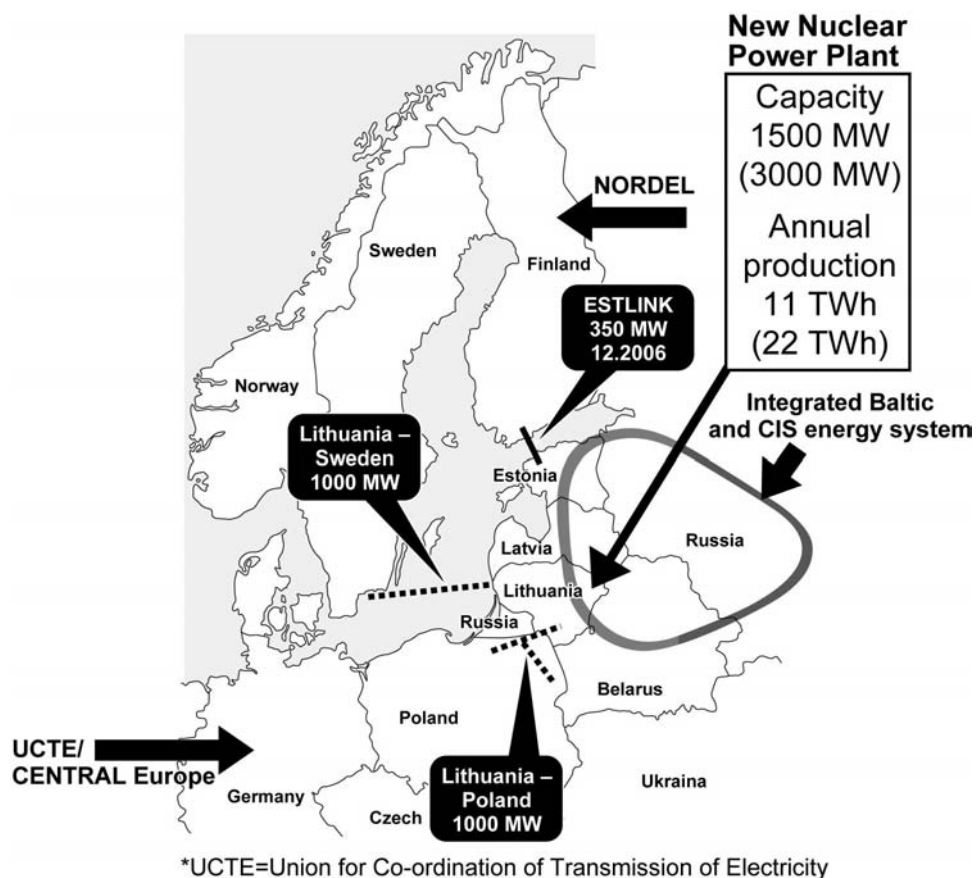
On the other hand, from the point of view of energy security, the situation was obviously ready for correction because Lithuania, by further participating in the common technological process of the unified energy system of the Baltic States and the CIS, not only lost the possibility of selling surplus electricity to other countries of the European Union, but was also too dependent on the political and technological processes of other Eastern European countries. Consequently, the first problem that needed to be solved was the building of electricity links with Poland and the Scandinavian countries, thus joining the electricity network of Europe and of Scandinavia.

Despite how it may seem, the joining turned out to be far from easy. Even fifteen years after the restoration of independence in the Baltic countries these links are non-existent. A myriad of reasons can account for this, starting with the inability of decision makers to ensure sufficient political and financial support for the implementation of these expensive projects, and finishing with the lack of interest of separate interest groups in Scandinavia and Poland to open their electricity markets for cheap electricity energy from the Baltic States, or even from the entire energy system of the former Soviet Union.<sup>12</sup> **Therefore, on one or another pretext, crucial decisions would be postponed whereas projects already under implementation would mysteriously collapse.** The final result was, from the point of view of the energy system, that the Baltic States, though having become members of the European Union in 2004, still remained in the old post-Soviet space. The issue started to be addressed only after it was acknowledged as a problem of the entire European Union and given the necessary impetus by the European Commission, which in the “Green Paper – A European Strategy for Sustainable, Competitive and Secure Energy” published on March 8, 2006 claimed that the Baltic States “remain an ‘energy island,’ largely cut off from the rest of the Community” and urged the states to solve

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12 Jacekas Komaras, “Lenko pozicija: kodėl nėra elektros tilto į Vakarus? [The Position of the Pole: Why **There is No Electricity Bridge to the West?**],” *Lietuvos rytas*, 14 April 2006 [<http://www.lrytas.lt/?id=11422625581141696756&view=4>], 2008.3.27 (in Lithuanian); Ramunė Sotvarienė, “Energetinę laisvę smaugė ir Rytai, ir Vakarai [Energy Freedom was throttled by both – East and West],” *Lietuvos rytas*, 11 June 2007. (in Lithuanian)

Figure 5. Baltic Electricity linking Strategy



Source: Lithuanian Ministry of Economy

these problems in order of priority.<sup>13</sup>

Due to the support of the European Commission, as many as three electricity link projects of the Baltic States were planned: Estonia – Finland, Lithuania – Poland, and Lithuania – Sweden. These projects are now in different stages of implementation. The first and the smallest was implemented at the beginning of 2007 when the small 350-MW-capacity link of Estonia with Finland, Estlink, came into operation. The Estlink submarine cable connected the Harku 330-kV converter station outside Tallinn and the Espoo 440-kV converter station near Helsinki, linking, for the first time in history, the electricity markets of the Baltic States and the Nordic countries. Partners in the Estlink project are Lietuvos Energija (Lithuania) and Latvenergo (Latvia), with each owning 25 percent of the joint venture shares, Eesti Energia (Estonia), owning 39.9 percent of shares, and Finnish companies Pohjolan Voima and Helsingin

13 European Commission, "Green paper – A European Strategy for Sustainable, Competitive and Secure Energy," Brussels, 8.3.2006 COM (2006) 105 final, p. 7 [[http://ec.europa.eu/energy/green-paper-energy/doc/2006\\_03\\_08\\_gp\\_document\\_en.pdf](http://ec.europa.eu/energy/green-paper-energy/doc/2006_03_08_gp_document_en.pdf)], 2008.3.27.



Energia owning the remaining 10.1 percent.

Meanwhile, the second link project Poland – Lithuania is still in the initial stage of implementation and according to preliminary evaluation, the project can be finished by 2012–2015. Interconnection of the power grids involves construction of a 154-km high-voltage (400-kV) double-circuit power transmission line from Alytus (Lithuania) to Elk (Poland). Project implementation is estimated to cost 237 million Euros of investment: 71 million Euros in Polish territory and 166 million Euros in Lithuanian territory. In order to ensure transmission capacity and cross-border flows, it is necessary to reinforce not only Lithuanian but also Polish domestic power grids. This will require additional investments: 371 million Euros in Poland and 95 million Euros in Lithuania. Reinforcement of domestic grids must be self-financed by the project parties. Reinforcement of domestic power grids in Poland and Lithuania will be conducted in stages. The project has been included in a priority list of European Union projects. The European Commission has designated a coordinator responsible for the project's implementation – Professor Wladyslaw Mielczarski.<sup>14</sup>

And finally, the third project Lithuania-Sweden is still in its early stage. In February 2008, Lietuvos Energija (Lithuania) and Swedish transmission system operator Svenska Kraftnät completed a feasibility study for construction of a power interconnection between Lithuanian and Swedish power grids. The results of the study show that interconnection between systems is feasible and would be economically reasonable in terms of technical, economical, and legal aspects. According to preliminary evaluation, investments in the project would approximately total 516 million Euros if a 700-MW cable was to be constructed or 637 million Euros if a 1000-MW cable was to be constructed. The project could be implemented until 2015. The feasibility study for interconnection of Lithuanian and Swedish power systems has evaluated the possibility to interconnect transmission grids of both countries by the construction of a 350-km submarine cable across the Baltic seabed. The study results note that if a wind park was to be constructed in the Baltic Sea, it would be possible to connect it to the cable, but in this case, the cable capacity should reach 1000 MW. Otherwise, the cable capacity could be 700 MW. The 1000-MW power bridge Lithuania – Sweden would create possibilities not only for interconnection of power systems, but also for development of renewable power sources in both countries.<sup>15</sup>

Thus, the issue of the electricity links of the Baltic States with the energy systems of Scandinavia and Europe has finally moved from a dead end. This

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14 Lietuvos energija, "Shareholders Agreement Signed in Warsaw for Joint Venture to Implement Interconnection Project of Lithuanian and Polish Power Systems," Press Release, 12 February 2008 [<http://www.le.lt/en/main/news/press?ID=640>], 27.3.2008.

15 Lietuvos energija, "Interconnection between Lithuanian and Swedish Power Systems – Feasible," Press Release, 6 February 2008 [<http://www.le.lt/en/main/news/press?ID=636>], 27.3.2008.

achievement is particularly important when keeping in mind that the largest energy-generating object in Lithuania, the Ignalina atomic power plant, is scheduled to be completely closed by 2009. This is provided for in the Act on the Accession of Lithuania to the European Union. The underlying reason for this agreement is the fact that the Ignalina atomic power plant employs reactors of the same type as the atomic power plant in Chernobyl. Although both Lithuania and the international community had made considerable investments in ensuring the safety of the plant, during Lithuania's accession negotiations, the European Union adopted a particularly categorical attitude and refused to make any concessions in regards to the Ignalina atomic power plant, even though it generates as much as 80 percent of the electricity of the country and considerably reduces the energetic dependence of Lithuania on oil and gas imports. Therefore, in spite of a certain political opposition in Lithuania, the first reactor of the Ignalina atomic plant was closed in 2004 and the second will follow in 2009.

The closure of the Ignalina atomic power plant is not such a great catastrophe if the electricity sector of Lithuania is treated in an isolated manner. The head of the largest thermal power plant Lietuvos elektrinė, Pranas Noreika, claims that Lithuania inherited from the former Soviet Union a much more powerful electric energy production system (5,450 MW) than it needs right now. So, even if the Ignalina atomic power plant is stopped (loss of 2,700 MW), Lithuania would still retain 3,540 MW of the capacity. A total of 1,800 MW would come from Lietuvos elektrinė, 800 MW from the Kruonis hydro-accumulative electric power plant, and 940 MW from other smaller electric power plants. Consequently, after the closure of the first unit of the Ignalina atomic power plant, the country did not experience any major changes; only electric energy export decreased. In the worst scenario, i.e., if the second unit is closed, Lietuvos elektrinė would take over the job of the Ignalina plant in sixteen hours.<sup>16</sup>

However, it should be kept in mind that, although the electricity generated at Lietuvos elektrinė would ensure a stable and reliable supply of electric energy and would compensate for the closure of the Ignalina plant, the electricity produced there would be more expensive and would completely depend on an uninterrupted supply of gas. Therefore, the government of Lithuania, taking this into consideration as well as the inevitable growth of electric demand in the future, has started the groundwork for the construction of a new atomic power plant according to the new National Energy Strategy adopted by the Seimas (parliament) of the Republic of Lithuania.<sup>17</sup> **Certainly, Lithuania** by itself would not be able to carry this financial burden, but the economies of

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16 Pranas Noreika, "Lietuvos elektrinė pasirengusi iššūkiams [‘Lietuvos elektrinė’ is ready for challenges]," *Mokslas ir technika*, 1 (2005), [<http://neris.mii.lt/mt/straipsniai/20051/liet.doc>], 25.3.2008.

the three Baltic States could cope with the project. Furthermore, this is highly feasible because Poland has expressed an unambiguous interest in joining the project.

## CONCLUSIONS

The Lithuanian energy infrastructure was essentially established in the '60s, '70s, and '80s of the last century. This infrastructure was rather impressive and had quite a few advantages. Among the advantages, impressive capital investments should be mentioned, which made it possible to easily transport oil and gas from Russian enterprises to Lithuania, to process oil, produce marketable oil products, and to control the surplus of electric energy that could be used for export.

Yet alongside the advantages, the infrastructure created had a number of drawbacks. The underlying reason for these was the fact that in one way or another, it was meant to serve the interests of the Soviet Union and not those of Lithuania. Those key drawbacks continue to manifest themselves even today. These are gas dependence on Russia's supply, the absence of electricity network links with other European countries, and finally, serious problems because the system was designed to function under the conditions of planned but not market economy.

Certainly, today's developments make it possible to think that if the energy infrastructure had been created under conditions inherent to the independent state and not under occupation, it would have been more rational and better balanced. This is in part confirmed by the implementation of new infrastructure development projects during the several past years.

The greatest progress in this respect has undoubtedly been made by the oil sector. This sector, in spite of the undeclared blockade pursued by Russia, is continuing to successfully function due to the Būtingė marine oil import and export terminal built in 1995–1998. The investment that was once politically risky and had painful financial repercussions for the Lithuanian budget today has proven to be a success from both the financial and geopolitical standpoints and it guarantees a large portion of the energy security of Lithuania.

The electric energy sector should rank second as to the progress made. Although many problems should have been solved a long time ago, the building of electric networks links in 2006 and 2007 between the Baltic States, Scandinavia, and Poland should be considered a substantial achievement. A similar reason for optimism is the construction project, which is gaining momentum, of a new atomic electric power plant, the significance of which for the energy security of the Baltic States region can hardly be overestimated.

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17 Seimas of the Republic of Lithuania, "Resolution on the Approval of the National Energy Strategy 18 January 2007 No X-1046 [[http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc\\_l?p\\_id=292522](http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc_l?p_id=292522)]," 25.3.2008.

Finally, as proven by this study, the gas sector remains the one causing the most political problems. In this case, a complete dependence on the Russian Gazprom's supplies is the weakest link in the chain of Lithuanian energy security. Certainly, it is possible to expect that the gas supply from Russia will not be cut due its shareholding in Lietuvos dujos itself. Yet the circumstance that Lithuania and other Baltic countries cannot purchase gas from other sources makes them dependent on Russia's dictates and whims. Keep in mind that, in the energy arena today, power and influence, but not profit, are of the utmost importance. The situation remains unfavorable, whereas the projects (the "Amber Pipeline," the liquefied gas terminal in Latvia, or linking with Polish gas pipelines), as a way out of this situation, so far remain solely as theoretical possibilities whose realization is complicated, not only for the objective but also for the subjective reasons resulting from Gazprom's backstage influence on Lithuania's political processes.

It is clear that Lithuania cannot solve its own energy security problems without the participation of its neighbors and the European Union. Therefore, further perspective on the development of Lithuanian energy security will clearly depend on political developments in Russia and also on how the European Union, circumventing Russia, will manage to implement alternative pipeline-laying projects, such as the gas pipeline Nabuco or oil pipeline Odesa - Gdansk.