

# ENERGY SECURITY CONCERNS OF THE BALTIC STATES

Merle Maigre

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## *Introduction*

Energy is an issue of rising importance for the Baltic Sea area. It is at the heart of EU-Russia relations and has become a central element of Russia's engagement in the Baltic Sea region, especially since the formal beginning of the Nord Stream project in 2005. The political dimension of energy security for the EU and individual Member States was reinforced by the 2006 and 2009 Russian-Ukrainian gas crises. It is within this context that the Baltic countries face the complicated challenge of balancing national, regional and European interests in their energy policy choices, while exploring measures against dependence on Russia.

This study looks at the main factors shaping the regional energy security concerns of the Baltic states - Estonia, Latvia and Lithuania – and aims to find answers to questions such as: what policies are the Baltic states adopting in the light of current energy security concerns? What is the role of the European Union in Baltic energy security field? And what are the main challenges to the Baltic energy policy making?

The research method combines analysis of various official documents and regional energy studies with a number of semi-structured in-depth interviews with stakeholders of the Baltic energy community. In order to encourage the candid expression of opinions during the interviews, the author agreed to subscribe to the principle of non-attribution in this paper.

The analysis is divided into three main parts. Firstly, the paper discusses regional energy specifics, energy cooperation and Baltic interconnections with the EU Member States. This discussion is followed by the analysis of two sets of problems of Baltic energy security, one of them external and the other internal. The first set deals with the ever dominant and expanding presence of Russia on the Baltic political and economic scenes. The second set of concerns arises from the lack of domestic energy expertise and deficiencies in strategic energy policy planning.

## **1. Baltic Energy Specifics**

National energy consumption in the Baltic states depends on country-specific energy production means, established supply routes and infrastructure, and on specific economic and political considerations. In the primary energy supply, each of the Baltic states has a specific feature that distinguishes it from the other two and makes it unique. We discuss Estonia's oil shale issues, because Estonia is the only country in the world in which oil shale serves as the main fuel for power generation.<sup>1</sup> In 2008, 94% of Estonia's electricity was produced from oil shale. Yet, mining and burning oil shale involves a number of negative environmental impacts.

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<sup>1</sup> Raukas, Anto (2004), "Opening a new decade", *Oil Shale. A Scientific-Technical Journal*, Estonian Academy Publishers, No.21 (1), pp.1-2.

In Latvia, the focus is on gas. Natural gas accounts for approximately 30% of Latvia's energy resources and this share is expected to increase. Latvia has the third largest natural gas storage facilities in Europe and *Latvijas Gāze* is planning even to double these. Latvia's natural gas storage facilities currently cover the gas storage needs of all three Baltic countries and the Pskov region in Russia. Yet, Latvia is not autonomous in managing the development of its gas sector. All of Latvia's gas is supplied by Russia. Gazprom also owns blocking share packages in the Latvian gas-distribution company *Latvijas Gāze*.

Since Lithuania regained independence in 1990, it had relied increasingly on nuclear energy. By 2008, the Ignalina Nuclear Power Plant supplied 78,4% of Lithuania's total electricity production.<sup>2</sup> Among several of Lithuania's neighbours, Latvia also depended on nuclear power from Ignalina. In December 2009, however, Ignalina was closed and Lithuania has been facing difficult choices about where to find new sources of electricity.

### **1.1. Estonia and Oil Shale**

In 2005, Estonia's primary energy supply consisted of 55,1% oil-shale, 17,5% oil products, 15,1% natural gas, 11% wood, 0,8% peat, 0,2% coal and 0,2% other sources.<sup>3</sup> Solid fuels from domestic production dominated. However, this energy mix will have to undergo significant changes very soon. Today, about 60% of Estonia's domestic energy production comes from domestic oil shale, but this share will have to drop by 30% in order to conform to new EU directives.<sup>4</sup> The production of electricity from burning oil shale generates high levels of CO<sub>2</sub>, SO<sub>2</sub> and NO<sub>x</sub> emissions, as well as huge amounts of ash waste destined for landfill.<sup>5</sup> This level of pollution does not comply with the stricter environmental standards on emissions set out in the EU Climate and Energy Package.

The EU requirements for reducing emissions mean that fossil fuels, and especially solid fuels, will be forced out or will require expensive auxiliary technologies. All this will have a significant impact on the price of electricity. Phasing out the use of oil shale may turn Estonia from being a relatively self-sufficient country to one dependent on electricity imports, possibly from Russia. Estonian government officials are quick to dispel these fears. "Although from the purely economic standpoint, the use of oil shale in the production of electricity could be stopped, it is extremely important for Estonian energy security that production of electricity using such a guaranteed resource continues," claims the Secretary General of Energy of the Estonian Ministry of Economic Affairs and Communications.<sup>6</sup>

If Estonia wishes to continue using oil shale, it has to make expensive investments and to renovate its oil shale power stations before 2016. As of today, about two power units of 430 MW out of the total 2380 MW of Estonia's oil shale power plants have been modernised. Two possible new units for generating electricity from oil shale at the Baltic Thermal Power Station would cost up to 8 billion EEK (over 0,5 B EUR).<sup>7</sup> The new Electricity Market Act adopted by the

<sup>2</sup> International Energy Regulation Network country statistics, [http://www.iern.net/portal/page/portal/IERN\\_HOME/COUNTRY\\_FACTSHEETS](http://www.iern.net/portal/page/portal/IERN_HOME/COUNTRY_FACTSHEETS)

<sup>3</sup> Data of the Ministry of Economic Affairs and Communications of Estonia.

<sup>4</sup> Press release, Ministry of Economic Affairs and Communications of Estonia, 26.02.2009.

<sup>5</sup> "New Epoch in Estonian Oil Shale Combustion Technology", *Oil Shale* (2004), Vol.21, No.13, pp.181-182.

<sup>6</sup> Einari Kisel (2008), "Developing Estonian energy policy hand in hand with EU energy packages", in *Estonian Foreign Ministry Yearbook 2008/2009*, <http://www.vm.ee/?q=en/node/8324>

<sup>7</sup> "New Epoch in Estonian Oil Shale Combustion Technology", *Oil Shale* (2004).

Estonian Parliament in January 2010 will guarantee state support for building two new oil shale fuelled power plants.<sup>8</sup>

The Estonian *National Energy Development Plan until 2020*, adopted by the Government and Parliament in 2009, foresees more diversity for Estonia's energy portfolio. According to the Energy Development Plan, Estonia's electricity production will be diversified by building more co-generation plants that use different fuels, wind power farms, and balancing stations.<sup>9</sup> In April 2009, the Estonian government adopted a decision to support the construction of a LNG terminal in order to augment energy diversification in Estonia. At the same time, the door is kept open for a nuclear power plant.<sup>10</sup> The objective is to cover domestic demand at all times. The bottom line is that the EU directives on emissions standards together with new CO<sub>2</sub> trading schemes, make it challenging for Estonia to find an economically viable solution, which does not surrender national energy security interests by increasing dependence on Russia.

## 1.2. Latvia and Gas

Latvia's balance of primary energy resources in 2007 consisted of 35 % oil products, 30,3% natural gas, 22,2% wood, 10% electricity and 2,55% other resources.<sup>11</sup> The proportion of gas in Latvia's energy mix is about one third - the highest of the three Baltic countries. Moreover, the need for gas has increased significantly after the decommissioning of the Ignalina Nuclear Power Plant in Lithuania.<sup>12</sup> In addition, the Latvian government has received a green light from the EU to start the construction of a new 400 MW gas-powered plant that will probably be built 2015-2025.<sup>13</sup> All of Latvia's gas needs are to be provided by Gazprom.

Latvia also possesses extensive underground storage capacity, which could potentially be expanded even more. Plans have been made to enlarge Inčukalns' storage capacity from 2,3 to 3,2 billion cubic metres (bcm) or even up to 5 bcm, as well as to build an immense 50 bcm storage facility in Dobele at Kurzeme (south western Latvia). A feasibility study on expanding the storage in Dobele storage is financed by the EU and should be completed in 2010.<sup>14</sup>

However, questions arise about the motivations for the expensive investments required for the gas storage enlargement project. A significant gas storage enlargement in Dobele would make sense, if it were used for EU strategic reserves. But for that, Latvia's gas pipelines need to be connected with EU systems; currently they are not. Nor is Dobele expansion really needed for the regional consumption of the Baltic Sea states. From the viewpoints of business logic and Latvian national interests, expanding Dobele seems to be a waste of resources. The gas sector is and remains to be the most vulnerable link in Latvian energy.

<sup>8</sup> „Estonian Riigikogu approved Electricity Market Act“, 28.01.2010, <http://www.baltic-course.com/eng/energy/?doc=22993> ;See also the Act, parliamentary debate about it and supportive materials at [http://www.riigikogu.ee/?page=en\\_etapid&op=ems&eid=798036&u=20091130023203](http://www.riigikogu.ee/?page=en_etapid&op=ems&eid=798036&u=20091130023203) (as of 30.03.2010)

<sup>9</sup> Kisel (2008).

<sup>10</sup> Kisel (2008).

<sup>11</sup> Andris Spruds (2009), „Latvian Energy Strategy; Between Structural Entrapments and Policy Choices“, in Andris Spruds, Toms Rostoks (Ed.-s), *Energy. Pulling the Baltic Sea Region Together or Apart*, Latvian Institute of International Affairs, p.224.

<sup>12</sup> International Atomic Energy Agency (IAEA) (2007), *Analyses of Energy Supply Options and Security of Energy Supply in the Baltic States*, Vienna, February , p.8.

<sup>13</sup> „EU to allow Latvia to subsidize construction of new power plant“, 28.02.2010,

<http://www.earthtimes.org/articles/show/306367,eu-to-allow-latvia-to-subsidize-construction-of-new-power-plant.html>

<sup>14</sup> Spruds (2009) in Spruds, Rostoks (ed.-s), p.225.

### 1.3. Lithuania and Nuclear Energy

The gross consumption of primary energy sources in Lithuania in 2007 consisted of 30,9% natural gas, 29,2% oil and oil products, 26,1% nuclear, 11,2% indigenous and renewable energy and 2,6% coal and coke.<sup>15</sup> By now this has changed as Lithuania's Soviet-built Ignalina Nuclear Power Plant, which formed a keystone of the Lithuanian energy sector, was shut down in December 2009 to comply with the EU accession treaty requirements. The closure of the second and last 1500 MW unit in Ignalina, which supplied almost 70% of Lithuania's total electricity production, has left the Lithuanian government to face serious challenges in finding a new balance and in diversifying the sources of imports of electricity.

At present, it is too early to estimate the long term impact of regional energy market fluctuations on Lithuania's economy and politics. The role of major domestic energy producer appears to have been taken by the power plant in Elektrenai (60 km away from Vilnius), powered mainly by gas and, in smaller quantities, fuel oil. According to the forecast for 2010, Lithuania's demand for electric energy will reach approximately 9 TWh.<sup>16</sup> The Lithuanian government decided that the best solution would be to supplement domestic production covering almost half of the demand – 4 TWh (Elektrenai – 2,5 TWh, Lithuanian thermal power plants – 1,15 TWh, production from renewable sources – 0,35) with imported supplies. Imports are possible thanks to the existing cross-border electrical power links with Latvia, Estonia, Russia and Ukraine (transit through Belarus). All these countries have surpluses of energy.<sup>17</sup> Building additional electricity interconnections to Sweden and Poland will diversify import choices in the future.

In this difficult situation, the new Nuclear Power Plant (NPP) in Visaginas – on the same site as the closed Ignalina NPP – is the biggest hope for energy security not only for Lithuania, but also for Latvia and Estonia. Yet, talks between the three Baltic states and Poland regarding the construction of a new NPP began only in 2006 and have been difficult. Political discussions and controversy among the various stakeholders have hampered the project. It was also delayed several times by the Lithuanian government. False hopes about the extension of operation of Ignalina raised by some Lithuanian politicians did not help to keep the focus on the new NPP project. Until the latest government change in Lithuania in 2008, there were doubts about the project's transparency. Only recently have preparatory works for the new NPP started to proceed more smoothly.

Yet, some problems still remain. For example, the estimated costs of the necessary investment given by the Lithuanian authorities refer only to one block of the power plant. According to the Lithuanian Energy Minister Arvydas Sekmokas, one block of the new NPP will cost up to EUR 5 billion and its power, depending on invested resources, will reach 500-1700 MW. This is too small to meet the needs of all partners – Poland has a requirement for 1000-1200 MW, Latvia and Estonia each demand 500 MW. The construction of another block has not been mentioned

<sup>15</sup> Tomas Janeliunas (2009), "Lithuanian energy strategy and its implications on regional cooperation" in Spruds, Rostoks (ed.-s), p. 192.

<sup>16</sup> Joanna Hyndle (2010), "Lithuania after the decommission of Ignalina" 06.01.2010, Centre for Eastern Studies, Poland. <http://www.osw.waw.pl/en/publikacje/ceweekly/2010-01-06/lithuania-after-decommission-ignalina>

<sup>17</sup> Hyndle, (2010).

so far. Polish claims vis-à-vis Visaginas NPP are further diluted by more recently announced plans about national nuclear power plant development plans.<sup>18</sup>

In May 2008, the AB LEO LT energy holding company, was formed by the Lithuanian state as the majority shareholder (61,7%) with a private investor UAB NDX Energija as a minority shareholder (38,3%). The process of forming the national champion evoked much discussion and controversy in Lithuania. Currently, LEO LT is in the process of being nationalised and dissolved. In September 2009, the Lithuanian Parliament and cabinet decided that the state should take over 100% of LEO LT's shares and pay compensation to NDX Energija.<sup>19</sup> UAB *Visagino Atomine Elektrine* (VAE), a company established in 2008 as part of LEO LT to manage the new NPP project, continues to remain in charge of all technical preparations for the new NPP.

In order to have a comprehensive expert assessment of the new NPP building project, the Lithuanian government ordered an analysis from an international consortium, headed by the investment bank N M Rothschild & Sons. This was aimed to dispel doubts regarding the economic feasibility of the Visaginas power plant, its possible capacity and the selection of foreign investors and partners, as well as the impact of alternative projects in the region.<sup>20</sup> The Rothschild business model and financing plan for the Visaginas NPP was presented in September 2009. It concluded that the new NPP was an economically attractive and feasible project. It also advised that a financially strong strategic investor with experience in nuclear energy should be recruited to the project. Lithuania, even in conjunction with its regional partners Estonia, Latvia and Poland lacks experience and financial resources and would not, therefore, be able to implement the new NPP project on its own.<sup>21</sup>

An open international tender was announced in December 2009 to look for a strategic investor. The Lithuanian authorities offered a prospective investor 51% or more of the shares in the future power plant. By February 2010, the Lithuanian government selected five companies out of the initial 25 which had expressed their interest as potential partners in the construction of the power plant. The final two potential nuclear plant strategic investors will be selected by mid-summer 2010.<sup>22</sup> Hopefully, the NPP can be completed by 2017-2020.

The Visaginas NPP project has demonstrated that for Lithuania, the most serious challenge in the energy sector is the careful coordination of all interest groups. This is the biggest project in the Baltic states, and it will be a good test case of whether real energy policy coordination and cooperation between the three Baltic countries and Poland is actually possible.

#### **1.4. EU and Interconnections**

The EU has a significant role to play in the Baltic regional energy cooperation. The EU has financial motivators to facilitate agreements and energy projects between the Baltic states. Also,

<sup>18</sup> "It is still not known what power plant will be built in Lithuania", 10.07.2009,

<http://www.osw.waw.pl/en/publikacje/ceweekly/2009-10-07/it-still-not-known-what-power-plant-will-be-built-lithuania>

<sup>19</sup> "The liquidation of LEO LT has been decided", 09.09.2009, <http://www.osw.waw.pl/en/publikacje/ceweekly/2009-09-09/liquidation-leo-lt-has-been-decided>

<sup>20</sup> „Future planned Iganlina 2 project uncertain“, 12.08.2009, <http://www.osw.waw.pl/en/publikacje/ceweekly/2009-08-12/future-planned-ignalina-2-project-uncertain>

<sup>21</sup> *Newsletter*, Issue 5, August/September 2009, [www.vae.lt](http://www.vae.lt)

<sup>22</sup> "Five bidders for new nuclear plant", 02.02.2002, [http://www.alfa.lt/straipsnis/10312813/?Five.bidders.for.new.nuclear.plant=2010-02-02\\_09-33](http://www.alfa.lt/straipsnis/10312813/?Five.bidders.for.new.nuclear.plant=2010-02-02_09-33)

the EU provides a multilateral forum for the neutral discussions of various energy issues. This way, the EU can be effective in preventing energy unilateralism.

So far the Baltic Energy Market Interconnection Plan (BEMIP) is the EU's most significant achievement to be generally recognised by all Baltic energy policy stakeholders. BEMIP is one of six EU priority infrastructure projects under the EU Energy Security and Solidarity Action Plan. The logic driving this plan is that an interconnected internal EU energy market and a proper working system of energy solidarity would increase the energy supply security of all Member States. The goal of BEMIP is to connect the Baltic energy islands with the EU internal market, and to provide the necessary financial assistance framework. In terms of priorities, BEMIP focuses on the electricity sector first, then gas.

Estonia's, Latvia's and Lithuania's electricity grids are currently linked only to the post-Soviet eastern system IPS/UPS of Russia and Belarus. The Baltic states are connected neither to the Western electricity grid system (UCTE), nor to the Scandinavian one (Nordel). Three main BEMIP projects aim to address that deficiency and are directed at interconnecting the Baltic electricity systems with those of Scandinavia and Poland. Firstly, an electricity cable between Estonia and Finland called Estlink2 is to be established by 2013. Together with the currently functioning Estlink1 (350 MW), they should be able to carry 1000 MW. Secondly, 1000 MW connection between Lithuania and Sweden called NordBalt will be built and power links in Western Latvia will be improved. Thirdly, a 1000 MW connection between Lithuania and Poland called LitPol will be created.

Of these three projects, the interconnection between Poland and Lithuania has proceeded with most difficulties caused by various political, economic and technical reasons, lack of competence and problems in buying land. According to a Lithuanian government official, the bottom line seems to be that Poland does not have the same amount of political will to build this electricity bridge as Lithuania does. Poland links LitPol with its share in the Visaginas NPP project and is not eager to rush into an agreement on this until the final agreement on the new NPP is not reached.

Alongside power networks, the gas systems of the Baltic states also need new connections. The matter of establishing a gas interconnection between Lithuania and Poland is still waiting for a solution. As several interviews indicated, work on the BalticConnector, which will link Finland with Estonia and Latvia, thereby enabling the use of Latvian gas reservoirs for a potential LNG terminal created either in Finland or Estonia, proceeds very slowly. Also, the domination of one natural gas supplier in the region does not support the liberalisation or diversification of the market. It is difficult to believe that Estonian or Finnish gas companies that are controlled by Gazprom would promote a project of political interest that does not comply with Russia's business logic.

### **1.5. Nord Stream**

Nord Stream, a gas pipeline planned between Russia and Germany on the bottom of the Baltic Sea with a total capacity of 55 billion cubic metres, satisfying at once one tenth of the EU's gas needs and being twice as big as Nabucco, is naturally also relevant from the point of view of the

energy security of the Baltic states. The Baltics are mainly concerned over the impact of the lack of exploitation of new deposits on the capacity of future gas production in Russia and Russia's capability of supplying gas to all interested buyers after 2010. The Baltic states are concerned that when the Nord Stream is built, Russia will have additional possibilities to manoeuvre its gas supplies directly to "priority partners" in Western Europe by cutting off gas supply to the Baltic states if necessary.

## **2. Russia's Presence on the Baltic Energy Policy Scene**

The British Conservative politician Harrold Elletson has underlined that, "the Baltic states need to bear in mind that it is not Russian energy per se that is the problem, but the fact that an over-dependence on it has potentially uncomfortable political implications. Equally, it is not the fact that Russian companies are keen to invest in the energy infrastructure of the Baltic states that is a problem but rather that they do so without operating to the same standards as Western European companies."<sup>23</sup>

Over the last ten years, Russia has transformed from a relatively weak and partially democratic country to an authoritarian one strengthened by a wealth of natural resources. Russian attempts to gain influence over political and business-related decision-making in the Baltic states have gradually become more intensive. The economic sphere, and especially the energy, provides Russia with nuanced and differentiated opportunities to approach its Baltic neighbours. Russia seeks to influence local energy politics by extending its soft power - by establishing lobby groups, encouraging and sustaining a non-transparent and informal political culture in the Baltic states, and encouraging a post-Soviet way of interaction between local business circles and the political elite.<sup>24</sup>

Russia's leverage has borne most fruit in Latvia, which has emerged as the weakest link in the Baltic chain. This is partly because of the sizable Russian community in Latvia – 29,2% of the total population – which provides Russia with a significant foreign policy lever to legitimise its coercive action. In addition, certain internal policy trends in Latvia during the ongoing economic crisis have complicated the situation. In order to cope with the crisis, the Latvian government has had to adopt painful economic reforms. This has brought about public criticism and decreased the popularity of the current government and parliament. Some populist politicians blame international organisations like the IMF and the EU for Latvia's hard times and, as a result, the EU's popularity in Latvia has greatly diminished. This can become a source of insecurity.

Latvia is heavily dependent on Russia's gas and oil which, by definition, increases its political vulnerability. Until very recently, the Latvian government had hardly any energy policy as it had been privatised by *Latvenergo* and *Latvijas Gāze* (which is controlled by Gazprom). *Latvijas Gāze* head Adrians Davis, who has been in the position since Soviet times, is becoming a living example of the Soviet legacy in the Latvian energy sector.

<sup>23</sup> Elletson, Harold, (2006) *Baltic Independence and Russian Foreign Energy Policy*, Report of Global Market Briefings Series on Russian foreign energy policy, pp.25-26; cit in Spruds, Rostoks, (ed.-s) (2009), p.235.

<sup>24</sup> Riina Kaljurand, Maria Mälksoo (2008), „The Russian influence on Latvian politics during the Putin era (2000-2008)“, International Centre for Defence Studies, [www.icds.ee](http://www.icds.ee)

A number of independent thinkers interviewed in Riga were concerned that the direct and indirect Russian presence in the Latvian energy sector could lead to a so-called “Gazpromisation” of the Latvian political elite, as exemplified by the willingness of some Latvian politicians to increase Gazprom’s power over the Latvian energy sector even further. Latvia’s Gazpromisation is illustrated by the discussions about the new gas storage station being built in Dobele. Head of the Latvian People’s Party and a business oligarch Andris Šķēle, who has served two terms as Prime Minister of Latvia (1995-1997 and 1999-2000), strongly supports this project. As the to next general elections in Latvia will be held in 2010, the danger of the Gazpromisation of Latvian politics is clear and present.

The problem of Russian leverage is not only present in the Latvia, but also in Lithuania. Until recently, Russia’s influence in Lithuania’s energy sector was quite heavy. A major Lithuanian energy corruption case has evolved around the transactions of *Mazeikiu Nafta*, the biggest oil refinery complex in the whole Baltic region and the biggest taxpayer company in Lithuania. In 1999, then-Prime Minister Rolandas Paksas had to resign five months after assuming power because of a disagreement over the sale of *Mazeikiu Nafta*. During Paksas’ term as President of Lithuania (2003-2004), concerns arose that he had ties to Russian organised crime and he became the first European head of state to be impeached.

The Lithuanian government’s decision to sell the majority of shares in *Mazeikiu Nafta*, to a Polish oil company, PKN Orlen, in 2006 again upset Russia. The refinery was purchased in May 2006 and in July 2006 the transport of Russian oil to Mazeikiu via the *Druzhba* pipeline was stopped because the Russians claimed that the pipeline needed urgent repairs. It is likely that the transport of Russian oil to Mazeikiu will not be resumed.<sup>25</sup>

Additionally, the major Lithuanian gas supplier, *Dujotekana UAB*, is considered to have a significant influence on the political stage in Lithuania. The company contributed financial support to political parties and politicians, especially before the parliamentary elections in 2004. The Lithuanian media believes that the president of *Dujotekana UAB* has very close ties with high-level officials and politicians.

### **3. Lack of Domestic Energy Expertise and Deficiencies in Strategic Planning**

The Baltic states’ internal energy security problems evolve around the lack of strategic competence and deficiencies in strategic planning. Unfortunately, the growing dominance of the energy topic among national security issues is not accompanied by a growth in the number of domestic energy experts. Estonia, Latvia and Lithuania are short of professionals who have a combination of technical knowledge and a broad political-strategic outlook in energy policy. The few existing specialists often focus on their narrow job-related concerns and are reluctant to see the problems and issues in a broader national energy security context.

Part of the problem is that, for a long time, energy policy in the Baltic states was perceived and deliberately presented as the domain of energy practitioners, who supposedly had to make

<sup>25</sup> “Energy Security”, Institute of Analysis of Global Security, 29.02.2008, <http://www.iags.org/n022908.htm>

informed and rational policy and business choices in a technologically and financially complex environment.<sup>26</sup> As a result, the energy sector has remained outside public interest and scrutiny.

Latvia seems to spend all its efforts handling the ongoing economic crisis. Little thought is invested in plans to provide Latvian energy security after the crisis. In Lithuania, the lack of preparedness for the closure of Ignalina was the most obvious confirmation of a lack of strategic energy thinking. Ignalina's closure became obvious as early as 2002 when negotiations on EU membership concluded that its second reactor had to be decommissioned. However, even after the closure of the first reactor in 2004, no real steps were taken to prepare alternative ways of producing electricity after 2009.<sup>27</sup>

Foreign energy expertise is very rarely used in the Baltic states. Somewhat paradoxically, the Baltic countries were not shy in accepting Allied advice on military reforms and defence policy when their defence forces were started from a scratch after 1991. In energy and economy, the former recipients of Western knowhow suddenly become the "Baltic tigers" regarding themselves as leading experts in economic reforms and energy development without any need for foreign expertise. During the interviews, an often cited reason for not using foreign knowhow was that "it is not customary". The latest Lithuanian National Energy Strategy (2007) was written entirely by local experts - a comfortable choice for the ministerial officials, who thus avoid criticism as the domestic 'energy specialists' are closely linked with ministerial circles and often dependent on state financing.

It is useful to bear in mind that that today's strategic energy policy decisions - or lack thereof will bear fruit in about eight years. Current energy policy discussions will be reflected in the Baltic energy security situation in 2018. Just as today, by default, we have to implement solutions proposed about a decade ago when there was much less experience about the EU, and the political dimensions of energy security and a generally more naïve outlook about energy dependence on Russia. For example, back in the late 1990s, the idea of building gas powered stations to replace the Ignalina NPP resonated in Lithuania, leaving few other immediately available options today.

In Estonia, the long-standing Estonian Energy Research Agency was closed in 2004 and established Estonian energy expertise was lost. The Agency had an extended history originating in Soviet times. It had developed a close cooperation partnership with the Lithuanian Energy Institute in Kaunas. In the 1990s, the Agency was transferred to the Tallinn Technical University, where it eventually started losing people, knowledge, competences and influence. For a while, in the early 2000s, an Energy Council was set up at the Estonian Ministry of Economic Affairs. However, the work of the council was not very constructive as it lacked a professional secretariat.

In order to improve its long term strategic planning capacity in the energy sector, Estonia has been considering the establishment of a new Energy and Climate Agency under the Ministry of Economic Affairs and Communications. According to existing plans, the Energy Agency would work with data collection and analysis, develop energy technology programmes and calculate

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<sup>26</sup> Spruds, Rostoks (ed.-s) (2009), p.237.

<sup>27</sup> Spruds, Rostoks (ed.-s) (2009), p.207.

the best options for emission trading schemes, as well as provide advice to policymakers. This is exactly what Estonia needs. However, exact functions of the Energy Agency will only be clear after the next parliamentary elections in Estonia in spring 2011. Due to the distinctive features of Estonian party politics, the ambitious list of responsibilities can only seek financing from the next government coalition, which will be formed after the 2011 elections.

Another nuance of the problem of the lack of expertise in the Baltic states stems from the small size of the Baltic government sector. For example, in Estonia and in Latvia, the energy sector is the responsibility of the Ministry of Economic Affairs. Inside the Estonian ministry, there is only one department dedicated to energy matters, led by the ministry's deputy secretary general of energy. Essentially, there are only about ten people in Estonia thinking about energy.

In this regard, Lithuania's decision to create a separate Ministry of Energy in January 2009, sets a good example. Energy has been declared as the first priority of the current Lithuanian government. The establishment of the new ministry can be seen as an attempt by the centre right parties in Lithuania to create an institution responsible for the state supervision of top-priority energy projects and the companies in charge of their implementation. The Energy Ministry's responsibilities include the implementation of projects vital for state energy security, namely the construction of the new nuclear power plant, electric energy bridges to Poland and Sweden, a gas pipeline to Poland and an LNG terminal.<sup>28</sup> In addition to the recently-established ministry, the Lithuanian Prime Minister has a separate Energy Advisory Committee available for consultations and advice; another forum for providing external advice to the Lithuanian government is an Energy Security Council under the Minister of Energy.

Contrary to Lithuania, high-level inter-agency coordination and management in energy issues in Estonia is missing. In spite of the increasing importance of the energy topic, there is no standing government commission or parliamentary committee in Estonia focusing on energy or energy security issues. Nor is the Minister for Economy a member of the Government Security Commission – the most important and highest executive-level inter-ministerial body for coordinating and discussing national security affairs.<sup>29</sup> As a result, by default, the Government Security Commission cannot discuss energy security issues.

The three Baltic states are small, and very often, most of the decision-makers in one field know each other informally and exchange information easily. However, the downside of these small homogenous professional groups is that the procedures for coordination and information exchange are sometimes too informal without any fixed sustainable procedure or institutional framework. For example, it appeared from the research that all energy-security related issues in Estonia are managed by an email list on energy security. Email lists and other web-based solutions are used to coordinate all EU-related urgent energy issues between relevant ministries and agencies. But email, although quick and convenient, cannot be the most effective or sustainable method of including decision-makers, or for discussing and coordinating vital matters for state security.

<sup>28</sup> „Prime Minister Kubilius wants increase control over LEO LT“, 14.01.2009, <http://www.osw.waw.pl/en/publikacje/ceweekly/2009-01-14/lithuania-prime-minister-kubilius-wants-increase-control-over-leo-lt>

<sup>29</sup> Estonia's Government Security Commission is comprised of the Prime Minister (chairman), Minister of Defence, Minister of Foreign Affairs, Minister of Interior, Minister of Justice and Minister of Finance. ([www.riik.ee](http://www.riik.ee))

A number of positively innovative initiatives in energy policy consensus building in Estonia have failed to be institutionalised and rather, remain one-time efforts. The main principles and long term development plans in Estonia's energy policy are reflected in two strategic documents that were approved by both the Government and the Parliament in 2009 – “National Energy Sector Development Plan Until 2020” and “Estonia's Electricity Development Plan Until 2018”. In preparing the “National Energy Sector Development Plan Until 2020” for the first time, the Estonian Ministry of Economy and Communications went through an elaborate yet transparent process of bringing together and engaging both political-strategic, operational technical, and public and private actors. Ministerial officials prepared a “green paper” on energy challenges and organised a series of roundtables for discussing national strategic energy policy. As a result, a broad consensus on the national energy development plan was reached. However, ministerial officials admitted during the interviews that while the process of drafting the strategic plan was comprehensive and useful for all sides, there are no plans to institutionalise this decision-making process for the future. So most probably, when a new Development Plan will be drafted in about five years, and some of the key officials have rotated to other positions, the whole process will start from a zero again.

### **Conclusion**

Energy security issues in the Baltic region are multidimensional and deserve attention. There are a specific set of challenges that Estonia, Latvia and Lithuania have to address in their energy policy choices, especially in the fields of oil shale, gas and nuclear. Whereas about 60% of Estonia's current domestic energy production comes from oil shale, this has to be cut by half in 15 years, because burning oil shale creates pollution that does not comply with the EU Climate and Energy Package. For Estonia, the EU directives on emissions standards together with new CO<sub>2</sub> trading schemes create a challenge. Estonia has to figure out a new economically viable energy mix, while not surrendering national energy security interests by increasing dependence on Russia.

The proportion of natural gas in Latvia's energy mix is the highest of the three Baltic states. Latvia has the third largest natural gas storage facilities in Europe and *Latvijas Gāze* is actively planning even to double this. However, questions rise about the motivations for the expensive investments required for the gas storage enlargement project, especially in a situation where all of Latvia's gas is supplied by Russia and Gazprom also owns blocking share packages in the Latvian gas-distribution company *Latvijas Gāze*.

In Lithuania, the second and last 1500 MW unit in Ignalina, which supplied almost 70% of Lithuania's total electricity production, was closed in December 2009 to comply with EU accession treaty requirements, leaving the Lithuanian government facing serious challenges in finding a new balance and diversifying the sources of imports of electricity. In this difficult situation, constructing a new Nuclear Power Plant (NPP) in Visaginas – on the same site as the closed Ignalina NPP – is the biggest hope for energy security not only for Lithuania, but also for Latvia and Estonia which have become regional partners in the new NPP project. An open international tender was announced in December 2009 to look for a strategic investor for the

NPP. The final two potential nuclear plant strategic investors will be decided by mid-summer 2010 and, hopefully, the NPP can be completed by 2017-2020.

In addition, the Baltic states face two broader challenges in energy security. Over-dependence on Russian energy supplies has uncomfortable political and business implications. Even if it is unlikely that Russia would attempt a direct political takeover of the Baltic states, the signs of its attempts to disturb the effective functioning of state apparatuses by destabilising the Baltic business and political elites have nevertheless been clearly visible from the 1990s till today. Russia seeks to influence local energy politics by extending its soft power - by establishing lobby groups, encouraging and sustaining a non-transparent and informal political culture in the Baltic states, and encouraging a post-Soviet way of interaction between local business circles and the political elite.

The direct and indirect Russian presence in the Latvian energy sector could lead to a so-called "Gazpromisation" of the Latvian political elite, as exemplified by the willingness of some Latvian politicians to increase Gazprom's power over the Latvian energy sector even further. The problem of Russian leverage is also present in Lithuania. A major energy corruption case has revolved around the transactions of *Mazeikiu Nafta*, the biggest oil refinery complex in the Baltic region and the biggest company and taxpayer in Lithuania. The bottom line is that Latvia and Lithuania have to search for counterbalancing measures against Russian dependence.

Last but not least, while looking for solutions to energy concerns, the Baltic states have to address the expertise problem. Estonia, Latvia and Lithuania are seriously short of professionals who have a combination of technical knowledge and a broad political-strategic outlook at energy policy. The Baltics must improve domestic energy competence in order to avoid dangerous changes of direction in energy policy formulation. Energy education, research and development should receive adequate funding without delay.

## INTERVIEWS

### Estonia

**Kisel, Einari** Deputy Undersecretary on Energy, Ministry of Economic Affairs and Communications, 17/12/2009

**Liive, Sandor** *Eesti Energia* CEO, Chairman of the Management Board, 23/12/2009

**Murd, Mati** Ministry of Foreign Affairs of Estonia, Director of Energy and Environment Division, 15/12/2009

**Mälk, Raul** Estonian Ambassador to EU, 21/12/2009

**Vare, Raivo** former Minister of Economic Affairs, Chairman of the Board of the Estonian Development Fund, Entrepreneur, 15/12/2009

**Vares, Villu** Associate Professor, Tallinn University of Technology, 15/12/2009

**Tropp, Andres** *Eesti Energia*, Head of Nuclear Energy Department, 14/12/2009

### Latvia

**Balins, Andris** Director of Corporate Strategy of *Latvenergo*, 22/10/2009

**Manika, Maija** Ambassador, Head of Directorate, Economic and Bilateral Relations, Ministry of Foreign Affairs of Latvia, 23/10/09

**Ozolins, Zaneta** Head of Department of Political Science, Director of Advanced Institute of Social and Political Research, University of Latvia, 21/10/09

**Rinkevics, Edgars** Head of the Office to the President of Latvia, 22/10/09

**Rostoks, Toms** Assistant professor at the Department of Political Science, University of Latvia, 22/10/09

**Spruds, Andris** Director of the Latvian Institute of International Affairs, 01/10/09

### Lithuania

**Aleksa, Karolis** Acting Deputy Head of Strategic Analysis Division, Ministry of Defence of Lithuania, 25/11/2009

**Janeliūnas, Tomas** Professor, Institute of International Relations and Political Science, Vilnius University, 26/11/2009

**Naudužas, Vytautas** Ambassador-at-Large, Ministry of Foreign Affairs of Lithuania, 26/11/2009

**Šešelgytė, Margarita** Studies Director, Institute of International Relations and Political Science, Vilnius University, 25/11/2009

**Vaičiūnas, Žygimantas** Head of Strategic Planning Division, Ministry of Energy of Lithuania, 27/11/2009

**Vasiliauskas, Šarūnas** General Director of the Visaginas Nuclear Power Plant Project, 25/11/2009