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Economic Ties between Lithuania and Russia: National and Group Interests on the Global Background as Viewed in the Light of Positive Economics

This article aims to review the economic cooperation between two countries, with more attention devoted to the energy sector as seen in the light of positive economics that describes the world as it is – through statistical indicators, calculations, statements and examples (as opposite to normative economics). The intentions are to analyze the economic trends, events and facts in Russia and Lithuania between the years 2004-2005, focusing on the significance of the national energy system, explaining reasons of certain solutions, unveiling the strategists and executors as well as possible consequences affecting the economic development and the economic security of the population.

Introduction

The standing statement to be heard nowadays both in the academic and the political circles is that the Lithuanian national economy is part of the global economy, while its strengths and weaknesses depend on the extent of its ability to develop in line with the common economic trends. At the beginning of 2005, a renowned Lithuanian economist and author was sharing his cheerful expectations: "Our neighbours outside the EU seem to have grasped that Lithuania is a EU member, and investment as well as other economic ties with its business mean ties with EU business", whereas the main achievement of the independence years is "demolition of command economy" as well as the "fall of the behemoths that had been providing it"[1]. The researcher had no doubts about economic growth and noted that "within 14 years, Lithuania is likely to resemble present-day Luxembourg or some other similar small European country"[2]. This conclusion was intriguing, since the impressions of the Luxembourg study visit, and a look into, its economic policy and views on economic security were fresh

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[1] *„Prof. J.Čičinskas apie 14 metų kuriamą mūsų valstybę"* [Prof. J.Čičinskas interviewed by *Integration News on 14 years of state-building*], IŽ interviu, „Integracijos žinios", 2004 m. Nr.7-8.

[2] *Ibidem*.

enough. That's where principles of positive economics come in handy. As put by Milton Friedman, every such system of conclusions may be meaningful if it aims to "predict the consequences of any change of circumstances while creating theories and hypotheses about phenomena that have not yet been observed"[3]. The author of this article believes that a sole aspect in the whole structure of the economic ties between Russian and Lithuania, and specifically trade in energy resources, globally applied for political causes and on the background of economic security concept becomes a threat for the welfare of a small state. As author, I conclude with this maxim: "New harvest comes fed by old roots".

The Lithuanian national security system lists these factors of economic security: competitive economy, energy supply and transport infrastructure[4]. Now, being proud members of the EU, we remember that the resources for the national economy originate in the East, and Russia holds 25 percent of global mineral resources. This makes the national economy to a certain extent dependent on the interests of Russia.

Regrettably, political speculation in Lithuania is often confused with economic reality. To give an example, let's look back at early 2005, on a discussion related to whether the President should attend the Moscow celebrations of 60th anniversary of the victory against Nazism. This was said by President of the Lithuanian Confederation of Industrialists that "we should not worry about demonstration of any *tail*, we should rather think of what we shall eat and put on the table, how the economy will work, because economic issues are more important"[5]. The opposition labelled the wording as an attempt by the Kremlin to intimidate us, where monetary interest overweighs national pride[6]. Meanwhile, the Russian Ministry of Foreign Affairs made a statement that Russia and the EU agreed on Road Maps to create the Common Spaces (for Economic Co-operation, External Security, Internal Security, Freedom and Justice, and Culture), and prepared the guidelines for the agreements[7]. In Lithuania, the statement received no comment, whether economic or political. In Russia it was discussed as a new opportunity, where as in Europe it was painted in search of the *roads* for 3-4 years. Russia was then open to take advantage and formulate the real common future instead of the *road maps* designed to obscure the airy relations and foster small trade, "since we, as before, may win from rising energy demand and rising prices, because globally we weigh more than some think we do"[8].

Lithuania is boiling in discussion on the lesser, Russian energy-related problems. The Government Report to the Seimas (Parliament) 2005 notes that due to the tense relations between *Mažeikių nafta* and the Government of Russia,

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[3] Friedman M.., *The Methodology of Positive Economics,* in: Essays in Positive Economics (1953), University of Chicago Press, http://www.marxists.org/reference/subject/philosophy/works/us/friedman.htm , 2004 10 03.

[4] Lietuvos Respublikos Seimas, 2002 metų nacionalinio saugumo sistemos būklės ir plėtros ataskaita, Vilnius, 2003, http://www3.lrs.lt/pls/inter/w3, 2005 05 16.

[5] Kuzmickaitė J., *"B.Lubys: Inžinierių kartos verslininkas"*, "Atgimimas", 2005 03 22.

[6] *"V.Landsbergis: pramonininkai spaudžia prezidentą"*, DELFI informacija, 2005 m. kovo 3 d., http://www.delfi.lt/archive/index.php?d=6167388.

[7] DELFI informacija, http://www.delfi.lt/archive/index.php?id=6646370.

[8] Караганов С., "Резкое падение влияния России в странах бывшего СССР", *Российская газета*, 21.07.2005, http://www.rambler.ru/db/news/print.html.

Russia may attempt to, through government-loyal *Lukoil* and *Gazprom* take over direct control of *Mažeikių nafta* and thus become dominant in the national oil sector. The National Security Committee responded much later – in July it requested a "stricter governmental position, based more on national security, rather than on purely economic criteria"[9].

This discourse provokes certain popular views on the ties between Russia and Lithuania[10]. Management of the Lithuanian Free Market Institute expressed the opinion that "holding an oil pipe in not enough to exercise political influence, unless we ourselves are willing to empower it (…). Taking the oil story seriously, Lithuania would magnify the political risk, and would lessen the economic one"[11].

Anyway, contemporary economic thought invites us to view economic cooperation between the two states and its influence on national economies in the light of positive economics combining two elements – assumptions and a set of hypotheses.

1. Normative Statements Suggest Evaluation, Positive Economics Explains the World as it is

On the academic level, the search for rational answers to "what is economics?" goes on for years. So does the search of common ground for fundamentalism and realism. The 19th century scientist Alfred Marshall defined economics as a "science of human behaviour in business". Oscar Morgenstern, in search of a place for modern economic theory within economic policy was critical about statistical indicators and tended to separate economic analysis from ideology.

Contemporary views are based on the assumption that normative economics is comparable to prescription writing as requested by political demand. Indeed, a lot of standard normative economics statements are uttered during election campaigns, coming from a variety of speakers declaring intentions to conduct economic reforms, collect larger budget at the expense of the rich, etc.

Positive, or descriptive, economics is based on the fact of disclosing how the economy works in reality. It looks into causality, standard indicators and faces difficulties while interpreting them - for economic experiments are not possible, since people get experience and change the usual behaviour. The theory of positive economics relies on statistics and seeks to disclose "what is

[9] BNS informacija, 2005 m. liepos 26 d., http://www.delfi.lt/archive/index.php?id=7162893.
[10] "Lietuvos verslininkai neigiamai vertina "Gazprom" ir "Lukoil", *DELFI*, 2005 m. liepos 26 d., http://www.delfi.lt/archive/index.php?id=716153). [From 2004 August-September *Baltijos tyrimai* Report : 14 per cent of the population believe that Russia is willing to develop mutually beneficial relations; a year later, 75 per cent of entrepreneurs believe that Lithuania is in need of an ‚independent supply of oil", 47 per cent are unfavourably disposed towards *Gazprom,* 31 per cent – towards *Lukoil*].
[11] Steponavičienė G., "*Dalybos briedžių girioje*", "Laisvoji rinka", 2005 Nr.1, sausis-kovas.

happening now, what has happened and what is probable", while the society is in the process of search and realization of rational solutions through elected political leaders[12]. The difference between normative and positive economics may be well illustrated by different comment 'on a hungry man'. A normativist would say: "This man is hungry, and we must feed him". The positivist would consider: "This man is hungry, but what are the feeding costs? How would society benefit if we feed him? What would we lose if he remains hungry?". The positivist's answers would vary with analysis of costs and benefits per solution, hypotheses would be tested and new ones created. According to F. Friedman, there is no such formal methodology on how to act. The process must be discussed and promoted by maxim and example, not syllogism or theorem.

2. About Tangible Lithuanian Capital, Economic Vision and Weak Links in the Chain

From the strategic point of view, the global economy is seen as an environment for trends in which to act upon opportunities or threats affecting long-term national development strategies. Five decades of Lithuanian history were shared in the economy of the collapsed USSR. Historically, we were an agricultural country. The tangible capital was constructed in process of Soviet industrialization, transplanted by Moscow institutions and at its will as "internal co-operation of branches of economy". Even now we complain about the obstructions due to the inherited, old tangible capital. Yes, we continue to bicker, we have become independent as an economy that had been built on Soviet principles of regional development (as part of North West region together with Belarus and Leningrad, or the Baltic Region – with Kaliningrad region). Independent, we were still a "perverse" structure of economy. We should remember that such sectors as electronics, machine-building, chemical industry and military complex came into existence in the days of the Soviet era, together with the traditional ones – food, textiles, building materials, etc.[13]. None of these were related to local resources or raw materials.

The transitional years, 1990 to 2000, were dedicated to specific problems, because correlation between the structure of the economy and its advantages was poor and is still hard to integrate with the global economic trends. While the global economic trends at that period were characterized as dynamic and predictable[14], Lithuania resembled a country of low and medium income. The struc-

[12] Sampson H., *"Welcome to are 012"*, http://www.cals.nesu.edu/course/are012/lecture.htm, 2004 04 18.

[13] Vilkas E., Vasiliauskas A., Kuodis R., *Ekonomikos augimo ir jos struktūros plėtotės strategija*, psl.13, http://www.ukmin.lt/files/Docs/Ilgalaikė.doc., 2005 05 19.

[14] Accepted by majority of researchers, „primary sectors" (agriculture and mining) are replaced by „secondary sectors" (processing and construction), and by „third-tier" (services). By the end of the 20th century, this general trend resulted in 60-70 per cent of GDP of developed countries generated by services. In industrial countries, share of processing in GDP grows to a certain level, and stays or even recedes, while agriculture, industry and trade integrator into an agroindustrial complex that reflects a new type of industrial relations.

ture of economy is directly related to the quantities of the physical capital supported by adequately qualified labour, a proportion slow to change. On the other hand, the slice of IT and telecommunications in the GDP, as well as higher value of services like management, education and healthcare are slow in growth, as the resources to finance them[15] are slim.

The 2001-2002 analysis of the Lithuanian economic situation resulted in a document "Long-term Economic Development Strategy of Lithuania until 2015". The vision for Lithuania 2015 depicted it as a "member of the EU with modernized economic strategies, national economic policy and employing financial and technical support of the EU, as well as EU economic model of a welfare state with low unemployment rate, high labour costs, strong social guarantees and close social cohesion"[16] . The document contains statements directly relating to this article. For example, if accepted that world trade is largely, to the extent of one third, is trade between transnational corporations, the document recommends the government to "apply measures for the elimination of animosity arising from the general public and local business towards the big corporations." Meanwhile, among the strategic goals is the "policy of continuous and active exports of electricity and oil products, promotion of transit of electricity and gas" and "improving the research of Russian, NIS and Asian markets regarding their high growth potential".

The World Bank study of the investment climate in Lithuania concludes that on the international scale the country lacks specialization and works in the low added value sectors. Merely 5 to 6 percent of its total exports are high-tech, low and only comparable to Latvia, and they share the lowest place among EU members[17] . Statistics too, reflect that the workforce is not prepared for the market, although well-educated[18] .

The employment rate of population aged 15-64 in smaller European countries is high. E.g. this indicator is as high as 61.2 percent in Switzerland, 87.6 percent in Iceland and 78.3 percent in Denmark[19] . While in Lithuania it is as low as 60.9 percent, with college or high school graduates comprising more than 13 percent of the unemployed.

A study "Higher Education System: Problems and Solutions" (September 2005) by the Lithuanian Confederation of Industrialists lists 44 drawbacks that hinder measuring contemporary education in terms of added value growth, development of spiritual values, effectiveness of financial activity and common levels of the quality of life.

The income of the population is adequate to the low added value generating activities. Statistics shows that in 2002 the average monthly net income was

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[15] Vilkas, (note 13), p.27.

[16] Respublikos ūkio ministerija, Lietuvos mokslų akademija, *Lietuvos ūkio (ekonomikos) plėtros iki 2015 metų ilgalaikė strategija*, V.: AB Vilspa, 2003, p. 20.

[17] The World Bank, *Lithuania, Investment Climate Assessment, Draft Report,* ECSPF, December 2004,
http://www.lrv.lt/pasaul_bankas/FINAL%20DRAFT%201CA%REPORT.pdf., 2005 02 18.

[18] Statistikos departamentas, Lietuvos statistikos metraštis 2004, Vilnius.

[19] "*Ranked only seventh*", http://www.rovo.ch/swissinfo.org./sen/swissinfo.html, 2005 09 16.

795.6 Litas and has been growing by 50-60 Litas annually[20]. Meanwhile, the "take home money" or the salary that we should expect the country to resemble within 14 years should serve as an argument to drop our illusionary expectations. To compare, in Switzerland 2002, average monthly net income was SFR 75000 (LTL 13900), in Norway and Denmark – about USD 40000 annually (LTL 9500 monthly), Austria - USD 30000 annually (LTL 7100 monthly)[21]. Thus, from a purely theoretical point of view "if viewed objectively, security is lack of threat to existing values", but viewed subjectively, "lack of fear that these values shall not be attacked"[22], it is evident that purchasing power, and consumption (both its quality and quantity) of the Lithuanian population is most fragile.

3. Foundations of Lithuanian and Russian Economic Diplomacy

Several years ago Lithuania was declaring that its mineral resources are meagre, technologies are old and its economic structure does not correspond to the real advantages and goals of economic integrity, while its foreign policy lacks adequate defence of national interest. Having become a member of the European Union (EU), Lithuania lost its rights to implement an independent foreign trade policy as the common trade policy is an exclusive competence of the European Community. The country has to support international economic relations often at the expense of national interests and obey the rulings of external institutions.

The foreign trade regime and policy since the independence date, and for a decade, had been based on a number of unilateral decisions or agreement-based decisions that were in force until the accession date. The country was undergoing systematic change, as it was leaving the centralized planning system that had barred non-tariff trade, and transiting into the open economy. Thus, Lithuania was curbing foreign trade with the former USSR and facing Western countries, thereby relating re-orientation to the political goals and security[23], often worded as "EU and NATO membership". In the process, foreign trade has been changing. All pre-EU free trade agreements were denounced. In accordance with the EU regulations, the Ministry of Economy started issue of licenses and supervision documents for the import of textiles and steel products from third countries, where quotas and double control were applicable; advance documents for provisional exports of textile with re-import as compensational pro-

[20] Metraštis, (note 18), p. 141.
[21] *Ranked*, (note 19).
[22] Buzan B., *Žmonės, valstybės ir baimė: tarptautinio saugumo studijos po šaltojo karo,* Vilnius: Eugrimas, 1997, p. 50.
[23] Čičinskas J., Cornelius P.K., Treigienė D.,"*Trade policies and Lithuania's reintegration into the global economy*", in: Lithuanian Economic Reforms: Practice and Perspectives. Vilnius: Margi raštai, 1997, p. 347-365.
[24] Volovik N., "*Foreign trade*", in: Russian Economy: Trends and Perspectives, December 2004, Institute for the Economy in Transition, Moscow, 2004, p. 45.

ducts were issued, too. On May 1st, 2004, the Law on Export Control of Strategic Goods, aligned with the EU regulations, as well as the Law on Export, Import and Transit of Strategic Goods, Intermediation and Licensing was enforced.

The Russian Federation opened 2005 with major changes in foreign trade legislation too such as: new Customs Code followed by about 20 Government Resolutions and more than 80 federal customs acts. More than 900 legal acts on foreign trade regulations became null and void during 2004; by the end of 2005, electronic declarations system has to be installed in 56 customs posts[24].

Formally, the EU accession and joining the EU Partnership and Co-operation Agreement with Russia, the Russia-related initiatives on Russia did not change the foundations of economic ties with Russia. Trading with Russia *was based on preference*, and Common Customs had hardly any effect on imports from Russia (general increase of costs was 3.1 per cent[25]) but non-tariff measures related to quality of goods and certification then came into more active use. In 2004, the Economy and Trade Ministry of the Russian Federation, declaring further economic interests in Lithuania, favoured the opportunity to use Lithuania as a "base" for the movement of its capital aiming at bigger influence on the EU economy as well as make use of the EU funds in the Kaliningrad region where Lithuania is the third most important partner in terms of trade and investments (after Germany and Poland). Statistics gives the following figures of Lithuanian-origin capital in Russia (2004): in 2004 it was USD 76.3 million compared to USD 12.4 mill in 2001. A larger part of investments are located in the Kaliningrad region, where the market entrants are a confectionary (AB *Naujoji Rūta*), meat processor (*AB Klaipėdos maistas*), fish processor (*UAB Vičiūnai*), refrigerator producer (*AB Snaigė*), fertilizer producer (*Arvi*). These are private initiatives and represent private interest in search of better supply of raw materials and higher sales as well as inexpensive labour for traditional production. Based on private influence on local public sector and businessmen, these investors are far from implementing the strategic goals as they are laid in "Long-term economic development strategy of Lithuania until 2015".

Statistics show that the presence of Russian capital in the Lithuanian economy in most significant in the high-profit sectors: USD 23.1 million in 2001, it rose to USD 466.3 million by the end of 2004, after *Jukos* acquired 53.7 percent (USD 160 million) of an oil refinery *Mažeikių nafta, Lukoil-Baltija* became owner of the biggest petrol stations network for USD 120 million, and 2 acquisitions by *Gazprom* – 34 percent of *Lietuvos dujos* (Lithuanian Gas) for USD 81 million and a bulk of Kaunas heat supply network Kauno *šilumos tinklai* shares for another USD 36 million[26].

[25] *"Состояние торгово-экономических связей РФ и Литовской Республикой"*, Министерство экономического развития и торговли РФ, http://exportsupport.ru/law.tv?n$docid=193899, 2005 09 06.
[26] *Ibidem*.

Related to these investments came the significant Lithuanian economy the end to energy policy issues as they are outlined in the global context: globally the environmental requirements are becoming more rigid, the EU is stimulating Lithuania to use the clean fuel - gas, while modern technologies and the quest for higher quality of life raise the demand of oil products. It is quite natural that Russian analysts have spotted the pending "oil power" pressure on Lithuania, which is only by 10 percent lower than the financial power of any country; for Lithuanians must eat, procreate and behave just like any other nation, and while big money flows where there's security and stability, The same methods apply whether it is America, Eastern or Western Europe but the code of conduct applied may differ.

Analysts widely agree that a Common Trade Policy is fully integrated in Lithuania and is in working condition[27] . On the other hand, group interests and markets protection instruments provided by EU and its members intertwine with trade protection measures and foreign trade policy measures as well as personal business interests of politicians. The trend may help augment the powers of the interest groups. A prominent trade policy expert[28] notes that no other economic sector is influenced by interest groups to the extent that trade is influenced. There, as illustrated by Lithuanian realities, interest groups prevail over consumers and large corporate producers and together they join forces with the political elite. Otherwise, both Lithuanian and Russian institutional structures benefit from the *status quo.*

As for "modernized" market strategy, Lithuania is no different from any other state with its unstable financial markets due to globalization of financial resources and wider liberalization. The latter paves the way to "hot money" mostly flowing from Russia. While the is in process, complemented by interest of various groups and nurtured by lack of responsible modern management, the Lithuanian economy is affected on a growing scale and itself becomes the obstacle to building the economic structure based on the real economy rather than financial capital.

Contemporary transnational corporations employ innovative marketing methods and principles, hardly ever known to the politically biased top management tolerated by the national political leadership. For example, it is widely known in the academic circles, that many large corporations have employed the POISE idea in strategy-building. In POISE, P stands for *PROFITABLE,* O - *OFFENSIVE*, I - *INTEGRATED*, S – *STRATEGIC*, E – *EFFECTIVELY EXECUTED*[29] . POISE proponents have observed that in 100 international mergers that only 49 result in higher share value and have a positive effect on the host country economy, 39 cases qualify as losers and 12 show somewhat in-between results. In Lithuania, privatization and sales of strategic companies is not really a matter of calculation and logic, it is rather the instrument of political games. More comment follows in chapters 4.5 and 6.

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[27] Meunier S., Nicolaidis K., "Who speaks for Europe? The delegation of trade authority in the EU", *Journal of Common Market Studies*, Vol.37, No.3, p.5.

[28] Pelkmans J., *European Integration, Methods and Economic Analysis*, NewYork: Longman,1997, p.207.

The classical view on the national foreign and internal policy gives the upper most hand to the political decisions rather than decisions by economic players. The choice for the state between "butter (welfare) and cannon (security or military powers)"[30] , is too simplistic for the modern world where global trends rule and to a larger extent in the post-soviet economies. If one so by declared that both are sought after, a special factor pops up – the quest of political leaders for economic security and growth for the sake of ones own stability and financial support guarantees.

The principles of primary privatization, deliberate and the accidental legislative mess-up, indicate that economic or, if put more accurately, the ownership interests of the owners, conduct the national position and decisions on so many issues, including foreign trade. For instance, Russian Ministry of Foreign Affairs, in response to the WTO requirements to introduce uniform prices for both internal and external markets on energy resources (as a precondition of Russian membership in WTO) they have worded their position as follows: the growing economic and especially energetic and infrastructural, interdependence of countries within the common European space makes Russia as significant as the EU. Thus, Russia may disregard the WTO requirement, which is a fair recognition of the natural competitive advantage[31] . The link between national economic policy and the business of gas was demonstrated in 2003, when upon assignment of the president, the Ministry of Foreign Affairs and *Gazprom* prepared a program of incentive measures for the promotion of international activities of local energy and fuel companies and a medium-term strategy of reinforcement for *Gazprom* on the international gas market.

4. *Gazprom* as a *Grand Prix* of National Games

At the end of 2004, the first signs of stagnation appeared in Russian economy, after years of rapid growth. Government institutions and some analysts looked into statistics and tried to elucidate the reform as a positive factor affecting growth of GDP; independent analysts were relentless on slowdown diagnosis[32] . The economic change had to be modelled by foreign capital investment and foreign interest to participate in the events, and hold influence on own

[29] Hugh Davidson, *Offensive Marketing or How To Make Your Competitors Followers*, Penguin Books, 1987, p. 19.
[30] Kirshner J, *"Political Economy in Security Studies After the Cold War"*, in: *Review of International Political Economy*, Vol.5, No 1, 1998, pp.64-91.
[31] *"Экономическая дипломатия России в 2003 году"*, МИД России, http://www.ln.mid.ru/ns-dipecon.nsf, 2004 12 16.
[32] E.g. Evgenij Gavrilenkov, chief economist of *Troika Diaqlog*, an investmen company, "Troika Dialog", or Michail Dmitriev, head of *Strategic Development Research Centre*, are pessimistic; both seem to agree that economic growth will be hindered by lack of fundamental decisions in non-economic sectors, since the state is not mature for change. It is actively involved in the private sector activities, while drastic tax measures tour the economy backwards. (See: Fomichev O., *"Of the Course of Reforms in December 2004"*, in.: Russian Economy: Trends and Perspectives, December 2004, Institute for the Economy in Transition, Moscow 2004, p.6).

markets. 2002 *McKinsey* research reports interest of big asset managers in investing in Russia. In countries like UK, France, Germany, the acceptable premium on shares for good governance ranges from 10 to 12, in Russia they would readily pay 38 percent premium for good governance[33] . The research *Good governance* reflects a set of 16 indicators related to the capital structure, shareholder structure, profitability, publicity and transparency, loyalty of staff and shareholders in respect of corporate policy, and accounting standards. Fuel and energy sector was singled out as the most attractive.

Results of 2004 led to the conclusion that *Gazprom* growth has stopped. Gas production fell to the level of 1999. But the developments in the global energy sector had restructured the flow of capital: 2004 foreign investment in Russia increased by 2.9 percent compared to 2002, and foreign capital targeted fuel. By the end of 2004 the sector had attracted USD 8 billion, and that was 2.5 more than at the end of 2003[34] . Luxembourg-based companies were considered to be the most powerful source of capital with 4-fold growth of total assets during 2004 and 52 percent of the total in the fuel industry. The Government of Russia cut a slice off this fat lump by overtaking the management of *Yukos,* one of the oil giants, and approached the portal to take control of *Gazprom*[35] .

Russian reviewers noted wittily[36] that while Western politicians were busy with exports of democracy, the gates were widely open for the Russian government and *Gazprom* to enter the European market, which has been good for "exports of gas with a long-term guarantee and significant geopolitical outcome". It is not about the monopoly of gas production and supplies. It is all about a Russian-German energy alliance, where the interest is expressed both by business leaders and political figures in these countries.

The principal agreement was delivered in the familiar milieu – the Hanover trade fair that was attended by 150 Russian corporations, the President himself and, of course, Chancellor Gerhardt Schroeder. There, among the 8 memoranda signed, 3 were on energy issues. The contents of the agreements were not public, but on the eve of public announcement, referring to its sources in the government, *Handelsblatt* informed that *Wintershall AG,* via its subsidiary, shall sign an agreement with *Gazprom* on a joint venture on exploiting a West Siberian gas field and construction of a pipeline on the Baltic Sea. Actually, the Septembers 8th, 2005 agreement on the Baltic Sea oil pipeline between Russia and Germany was the result of that earlier memorandum.

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33 Newell R., Wilson G., *"A Premium for Good Governance",* in: The McKinsey Quarterly, No3, 2002.

34 Ilyuchina E., *"Foreign Investment"*// Russian Economy: Trends and Perspectives, December 2004, Institute for the Economy in Transition, Moscow 2004, p. 29.

35 Jun 16th, 2005 is the date of the first deal. *Gazprom* agreed to sell 10,7 per cent of stock to the Government for 7,2 bill USD. As holder of 50 per cent, the Government would offer it all to foreign investors. As long as shares were not listed on the stock exchange, they were only available as ADRs on the US market. As soon as they appear on the Russian stock exchange, the Government would be prepared to deliver a energy giant similar to the Saudi Arab *Aramko* (See in *Mixing oil, gas and politics,* The Economist, Jun 20th 2005).

36 Мосякин А., *Здесь русский газ, здесь Русью пахнет,* http://www.w-europe.org/rel-RU/260505-2.php, 2005 09 18.

So when did the Lithuanian expectations fail? The answer is as simple as that: after the failure of a 'long-play' on the idea of the future pipeline across the Baltic States and Poland. Economists and politologists named authorities as the culprits, while the authorities put the blame on the overall political situation[37]. Meanwhile, *Gazprom* was gaining weight. Just a fortnight after the grand agreement, 6 of the largest global banks concluded their readiness to extend a USD 12 billion 5-year loan to *Gazprom*, to be repaid in instalments. The forecast of Russian analysts was now coming into reality: for the largest-ever per-legal-entity loan *Gazprom* acquired "Sibneft"[38], an acquisition from a private person and *oligarch* Roman Abramovich and his partners. Representatives of the Russian authorities at *Gazprom* voted in favor of the USD 13 billion deal and control over 75 percent of *Sibneft* shares, although the registered capital of the company was as mean as 7.6 million rubles. On the other hand, its profitability in 2004 was by 10 percent lower than a year before, and according to GAAP amounted to USD 2.04 billion[39].

That was the deal of the century, a wording fit both to Russian and global financial markets. Although Russian analysts had preferred "having Europe on the Russian energy needle"[40], the talk now is on Europe becoming financially dependent on Russia. The European institutions will have to release pressure on the Russian monopolist for very sound reasons: *Gazprom's* profit from activity in 2005 may reach USD 3 billion, while its loans are a meager 10 percent of its capital[41], while five-year expectations are similar; Europe will not press the on the spot deals, it would rather sign long-term contracts at acceptable prices.

As soon as *Gazprom* acquired *Sibneft*, it became co-owner of a share in TNK-BP[42] assets, or, indeed, became the first Russian transnational corporation. Upon acquisition of a company that extracts three times more oil than *Gazprom*, the corporation is an oil and gas producer capable of supplying both

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37 President V.Adamkus was quoting to the media his discussion with President Horst Koehler: "I told him it was regrettable that Lithuania, EU member, will not be able to participate in the project (…) which is a violation of Baltic and Polish interests; the German president answered that the situation could hardly be changed (…) and the EU Energy commissioner had mentioned that "these are negotiations between two countries and they could not be reverted" (see: BNS information, 2005 09 15, http://www.delfi.lt/archive.php?id=7492905).

38 An investment company Millhouse Capital, incorporated by R.Abramovich and partners owns 72,663 per cent of stock. The obligation of *Gazprom* is to purchase them for USD 13,091 billion; *Gazprom* has already acquired 3,016 per cent of stock, while another 20 per cent of *Jukos*-owned shares are under arrest, and, as soon as the dispute is settled in court, would hardly be bought by anyone else but *Gazprom*.

39 Щеглов А., *Сделка века близка к завершению*, http://www.rambler.ru/db/news/html?mid=6692461. 2005 10 18.

40 *Gazprom* holds 20 per cent of global gas resources, produces 16 per cent of the total extraction and has a 25 European market share. Largest supplier to Germany. When Nordic gas resources consumed, and the demand tripling by 2020, Russia is to grow into the largest supplier (see: Mosiakin, note 36).

41 Плетнев С., *В РФ создается первая ТНК*, http://www.rambler.ru/db/news.html, 2005 10 13.

42 The company owns 6 oil refineries in Russia and Ukraine, half the shares are owned by *British Petroleum*, the rest is held by Russian *AlfaGroup*, *Access Industries and Renova*. In 2002, till *Slaveneft, a purchase by* TNK-BP, was not divided between partners (*Sibneft* and *TNK-BP*), *Gazprom* will overtake it by becoming co-owner of TNK-*BP* assets.

raw materials and a wide range of products for refineries and final consumers. This type of diversification is typical of transnational corporations, and aims at levelling of profits by becoming less dependent on the fluctuations of price on raw materials.

Lithuanian consumers never bothered themselves with gas as long as the Lithuanian gas supplying company raised heating prices. In 2004 gas consumption totalled 2.881 billion cbm at a price of USD 85 per 1000-cbm, compared to USD 150 per 1000 cbm paid by other EU members. Currently, when West European consumers are complaining about rocketing prices of gas, we know that the agreement between Lithuania and *Gazprom* envisages review of prices in 2006, and the plans are to raise gas prices by 10 USD annually till it equals European price levels[43] . We know that the current price was put into primary agreement, when the gas supplier *Gazprom* acquired 1/3 of the Lithuanian gas supplier *Lietuvos dujos*. What was there in this acquisition? Was it a nice discount to a neighbour? And how much of POISE was in the agreement? The answer is straightforward: the situation on both sides was very favourable for the POISE principles to prevail in favour of the *Gazprom* scheme, when all gas was provided from a single source – oil fields of *Gazprom* – and supplied to consumers by a chain of intermediaries. The scheme seems to be favoured by the new project partners, e.g. by the German political and business moguls.

The first intermediary company in Lithuania was *Lietuvos dujos (Lithuanian Gas)* that was conceived as a natural monopoly but soon entered the scheme invented by *Gazprom, but* implemented by the staff and related persons. The scheme embraces registration and management of intermediary companies in neighbouring countries, and finally, sharing the profit received from gas supplied at advantageous prices. The number of those willing to share the sunny side of the wall, and owning the cash to buy the ticket, were available at first call. The National Audit Office calculated that the two (*Dujotekana* and *Lietuvos dujos)* could help consumers save about 100 million Litas[44] if the price structure had been based on cost of imports. As a matter of fact, *Dujotekana* alone applied a margin that in some months was as high as 27 percent, and managed to generate annual turnovers as high as LTL 514.6 million and pre-tax profit LTL 55.8 mill (2003).

Alongside, Russian politicians adopted resolutions on intentions to raise the price of gas supplied to Lithuania, thus affecting inflation and preventing the Euro. On the other side of the border the comment is about "Russia intimidating Lithuania and changing its tone from irritation to foot-stamping and fist-shaking"[45] . *Gazprom* management makes statements on its neutral position on 'Lithuanian internal matters'. Meanwhile, the representative of *Gazprom,* in negotiations with Lithuania, is Chairman of the Board of *Lietuvos dujos* who is also representing *E.On Ruhrgas,* co-owner of *Gazprom*. As seen from this perspective,

[43] „Maskva dėl kainų gąsdina, o Vilnius ramina ", *Lietuvos rytas,* 2005 m. liepos 12 d.
[44] Makaraitytė I., „Kiek kainuoja dujos arba kodėl V.Uspaskichui „Dujotekanos" dujos pigesnės [What is the price of gas, or Why is the gas from Uspaskich's Dujotekana cheaper?]", „Atgimimas", 2005 m. liepos 15 d.
[45] Editorial of national daily *Lietuvos rytas*, 2005 07 12.

the representatives are 'in the position' to blame the Lithuanian Government for failing to meet certain requirements of the privatization agreement as regards regulation of gas market and pricing methodology. Thus, they are 'in the position' to determine the pricing, terms and conditions that would meet their own financial interests.

5. On the Reliability of the Lithuanian Energy Sector and the Dictatorship of the Black Gold

The economic, social or environmental progress of the modern state runs on energy. Lithuanian national energy strategy declares such priorities as reliability and safety of energy supply at lowest costs important. Thus supporting the competitiveness of the energy sector within the EU energy market as well as increasing its productivity, and cutting emission of waste upon closure of the Ignalina Nuclear Plant.

Strategies, realities, and facts could be measured by the ISED (Indicators for Sustainable Energy Development) system. Three criteria help measuring the reliability of energy: the indicator of energy supply dependence on net imports, the level of utilization of local resources and the share of renewable energy in the total balance of the primary energy and electricity[46] . Recently, numerous information sources indicate the falling dependence on net imports in Lithuania; figures show that 90 percent of the national energy sector depends on net imports.

The energy consumption per unit of GDP is widely used to measure the relationship between energy consumption and economic development of a nation. In the old members of the EU, for years, this ratio has not been changing significantly, while in Lithuania it has been rising. In 2000, final energy output consumption was 50 per cent, and electricity - 60 per cent of 1990 levels. The primary energy per GDP unit in Lithuania is twice EU average[47] . Globally, the output of energy from primary to useful is about 30 to 35 percent, while Lithuania stands among the ones listed low on the list in terms of output consumption. The National Energy Consumption Program 2000 indicates the availability of about 20 to 50 percent energy saving capacity both in households and principal sectors of economy. The national program offers long-term measures for more effective use of energy, but finances are not available.

Discussions on the limited global energy resources have been in the air since the past century. The oil price has become the main fluctuator of the welfare of industrial nations due to a long list of factors including the: growing demand of oil, political instability in oil-rich countries, overcapacity in OPEC countries, market speculations related to instability of the oil market, unreliable sup-

[46] International Atomic Energy Agency, International Energy Agency, Indicators for Sustainable Energy Development. Overview, 2002.

[47] IAEA Coordinated Research Project. Indicators for Sustainable Energy Development. Lithuanian case study // First progress report, 2002.

ply, new environmental requirements, the US dollar exchange rate, and quite numerous accidentals such as hurricane *Katrina.*

In 2004 the International Energy Economics Conference participants forecasted further rises of the 13-year highest oil price up to USD 30 per barrel. And that was a wrong guess: in August 2005, after a quarter of US oil fields devastated by *Katrina,* global commodity markets were in turmoil[48] , for a barrel was at the level of USD 70.85, with October futures at USD 64.4 per barrel. New attempts to forecast events a week later were controversial. Claude Mandil, head of International Energy Agency, promised a global energy crisis; Stephen Forbes, billionaire, saw the break of price to USD 35 per barrel and an unpleasant threat to Russia, "much worse than crisis of 1998"[49] .

6. Lithuanian "Oil Games" – Mix of Politics, Economic Pragmatism and "Tragic Global Milieu"

The Lithuanian national "grand oil games", although not so bright, are quite discernible in the milieu of global battlegrounds. The Government is in discussions on the alternatives of the new owners for the 40.6 percent of *Mažeikių nafta* and options for incomes from privatization of the company. They are also discussing the options opened by the Russian *Jukos,* owner, via its subsidiaries, of 53.7 percent. The single oil refinery in Lithuania, constructed in 1980 as a Union-level company, with guaranteed supplies and sales, *Mažeikių nafta* has an marine oil terminal in Būtingė with a 91.5 km crude oil pipeline, pumps, onshore terminal equipment and tanks, offshore pipeline, and a single point mooring buoy. Mažeikiu Nafta owns and operates a system of pipelines that includes two pump stations near Birzai and another near Joniškis, crude oil pipelines to the Mazeikiai Refinery and Būtinge Terminal, a crude oil pipeline leading to Ventspils, and a products pipeline supplying diesel fuel to Ventspils. In 2004, the total flow of oil was 9.0 tons, whereas the annual capacity is 16.2 tons[50] . The gap must have caused wide discussions in spring 2005, with numerous opinions and interests intertwining on the privatization agreement article demanding to sell 11.5 percent of shares at a fixed price, of course much lower than the current market rate. V. Uspaskich, Minister of Economy at that time in history, demanded control and sales of 36 percent to "supplier of raw oil in Russia, with supply guarantees", plus sales of 15 percent to financial investor. Meanwhile, *Baltic Holding,* representing bank *Gazprom* (owned by *Gazprom* itself), and Jurimex, a company registered in Austria, was offering to buy *Mažeikių nafta* shares from *Jukos. Mažeikių nafta* proposed to start the production of polypropylene, an investment offered by *Baltic Holding*, a "serious investment group (…) able to extend the technological process of *Mažeikių nafta* (…) to make it more

[48] CNN, News on Financial markets, 2005 08 29 and 2005 09 04.
[49] *Опившиеся нефтью* [Oiloholics], http://www.rambler.ru/db/news/mid=6503145, 2005 10 06.
[50] *Состояние* (note 25).

potent", as seen by Prime Minister Brazauskas[51] . Advisor to PM Saulius Spėčius was open to comment that "without Russian capital *Mažeikių nafta* will not be able to operate, (…) because we do not hold any gas, oil or line connections to the West", while the national security issues related to the company are overestimated. Authorities were pragmatic, since the measure of economic security within national security system is worded as supplies of energy and resources, but not the price paid by the society for the decisions made by the authorities. In September 2005, upon public discontent with *Mažeikių nafta*[52] piracy, Prime Minister Brazauskas's reaction was simplistic:"(…) the global background is tragic. It is a natural disaster (…). One cannot take away the profit of a good company; it would look strange in Europe. Profits are high, but the oil business is always profitable, if well-run". According to the PM, the excise duty of 382 EUR per ton is the lowest possible "allowed by the EU", while "large imports of cheap petrol from Russia or Belarus is restricted by the EU regulations"[53] . The Prime Minister did not find any possibilities to have an influence on the company.

This pragmatic approach of the authorities could be explained by the economic indicators. Taxpayer, *Mažeikių nafta* paid semiannual LTL 1.3 billion, and that is 1.53 times more than the semiannual in 2004. Exports to Western Europe, the USA, Canada and other countries via Klaipėda rose by 16 percent. Good count of this was related to the GDP and less worry was on rising prices or inflation[54] .

The prehistory of the current national oil production starts back in 1999, when the Government signed an agreement that, as was later concluded by the Constitutional Court, contained anticonstitutional articles. Having declared integrational NATO-driven guidelines, the government passed *Mažeikių nafta* on to the American "Williams International". The Russian Ministry of Energy threatened to "turn the refinery into a heap of junk"[55] , and *Lukolian* plans to be masters of both production and consumption had to be abandoned, at least for some time. Nevertheless, the oil giant was feeding the political and academic circles on the idea that fully operative refinery is the guarantee of Russian success on the international oil markets should the oil prices rocket.

The present day *Lukoil* is a company established in 1991, after merger of oil and gas companies operating in Western Siberia (Langepas, Uraine, Kogalym – wherefrom comes the corporate name) and an oil processing companies in

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[51] *„Gazprom" keičia strategiją dėl „Mažeikių naftos* [Gazprom is changing strategy on Mažeikių nafta] „Lietuvos žinios", 2005 m. rugpjūčio mėn. 29 d.

[52] In 2002, Mažeikių nafta signed a 10-year agreement on supplies oil with Jukos, whereas the latter - with the following Russian companies: *LUKoil, Rosneft, TNK-BP, Sibneft, Salveft, Surgutneftegaz, and Tatneft.* Total amounts or prices are not disclosed, but it seems to be known that they are lower than market price.

[53] A.Brazauskas to *ELTA,* 2005 09 08, http://www.delfi.lt./archive/php?id=7441041.

[54] Presuming that the producer price for both local and overseas consumers is the same, ironically, we are in the advantageous position in this *tragic global milieu*. Within half a year, we have consumed about 19 per cent of total *Mažeikių nafta* production and let it earn, domestically, a profit of 7,28 cent per litter, but we seem to have profited well from sales overseas.

[55] *"Диктатура черного золота",* Политэкономия, http://www.baltkurs.com.russian.htm, 2005 10 16.

Perm, Volograd and Novoufimsk. It operates on the vertical integration principle (i.e. "from oil well to the petrol station") and expresses its priority interest to "expand production and sales both domestically and on international markets" in Azerbaijan, Kazakhstan, Iran, Iraq, Egypt, Algeria, Cyprus, Serbia, Romania, Bulgaria, Columbia, USA the Baltic countries too[56]. 11.3 percent of *Lukoil* is owned by US energy giant *ConocoPhillips*, intending to augment its share.

In 1992, when shrewd businessmen were transporting oil and oil products to *Mažeikių nafta* by rail, *Lukoil Baltija* was established to take care of its flows of oil, refining business, exports and settlements[57]. Presently, the company buys, refines and sells products, with a turnover of a billion Litas, and also with an expanding network of petrol stations (more than 110 now and to operate up to 120 by the end of 2005). It declares on the website that the present-day network owner is "market leader and reliable partner, which applies the principles of justice and legitimacy". And is also the retail price dictator to boot.

No surprise was the news on September 13, 2005, when President Brazauskas was quoted saying that his "*old acquaintance since the days in Ufimsk*" Vagit Alekperov, President of *Lukoil*, was planning a visit to Lithuania. Was it a hint that *Lukoil* was a company meeting the criteria as buyer of the refinery? The tandem bicycle could have turned into a simplistic bicycle, for *Lukoil*, operating oil fields in Western Siberia and the Urals, would have overtaken all the agreements on supplies (including diesel produced in Russia) by the pipeline, while *Mažeikių Nafta*, under the EU banners would have remained supplier of lowest acceptable quality products at wholesale price, that, as worded by its representatives, are "set by Rotterdam"; meanwhile, its subsidiary *Lukoil Baltija* would have controlled supply and consumption in Lithuania and other Baltic countries in the interest of its profit margin. President of the Russian *Lukoil* seemed to have left clear guidelines for the Lithuanian authorities, i.e. with no space for negotiations between *Lukoil* and *Jukos* on *Mažeikių Nafta* shares, for it is the business of the Lithuanian Government. The national political opposition was urging the government to look for oil-solutions and were addressing another candidate – *TNK-BP*, which was introduced as a "British" company. A. Brazauskas, interviewed on the radio after accusations of 'private interests' was pleased to change his mind: "It seems that *TNK-BP* may be a priority (…) No objections, if the Parliament approves the deal we have prepared. That would be quite satisfactory, and many would be calmed"[58].

Lithuania seems to be a small bump on the road of *Gazprom-the-Giant*, who has already girdled a portion of *TNK-BP*. It is hardly possible for Lithuania to open negotiations with the investor who seems to be more interested in overtaking the position of *Lukoil* in the Baltic markets than the production of *Mažei-*

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[56] *About the group*, http://www.lukoil.lt, 2005 09 11.

[57] After five years of *Lukoil* on the Lithuanian market, Ivan Paleichik, head of *Lukoil Baltija*, Ltd, evolved as a charismatic personality (...) Five years ago he was a successful investor into the election campaign of the Brazauskas party. Smoothly, as soon as Paksas became Prime Minister, he concluded successful "negotiations" on Russian oil supplies to Lithuania (see: *Диктатура*, note 55).

[58] ELTA information, 2005 10 11, http://www.delfi.lt/archive/php?id=7680490 .

kių nafta. Modern political thought is intrigued: these games are separate and independent, but plying these games is about making moves where purpose is set in the rules[59]. As seen in the light of the modern game theory, there is no political or economic puzzle on the Lithuanian-Russian "Grand Oil Game", for the players are merely striving to raise the probability of victory and are proceeding in the direction best fitting their goal. Should the observer feel misled by the misbehaving player, there is only one thing that helps – convincing the observer that the (mis) behaviour has a proper purpose.

Well, what about the final consumer, who, according to G. Soros, has the right to change the rules of economics and social systems just by merely expressing their views on the rules?[60] It is not just the demand of oil products that makes Lithuania dependent on oil. Oil products are being bought at the best terms, while the problem lies in the lack of oil supply or poor governance of *Mažeikų nafta*, and loss of competitive edge. Author of this article, as the smallest entity, had found an individual solution when petrol prices reached the peak, a solution to serve extra proof of the hypothesis that the quality of locally produced petrol is poor[61]. Unfortunately, this is an endangered solution, for the supplier of the Scandinavian product and competitor of *Lukoilian* applies certain rules of the game, and "the rules are created in accordance with collective solutions, or politics"[62], that may as well be dictated by *Lukoil*, should it succeed in merging its own and *Mažeikių nafta*-owned *Ventus* network of petrol stations. Alternatively, *Gazprom* may dictate, if it divides the assets with *TNK-BP* and overtake *Mažeikių nafta* shares for a premium (a matter of time and availability of monetary resources) – either from *TNK-BP*, or from *Lukoil* or any more.

Conclusions

Facts and figures serve proof that current trends may have a negative effect on the integrity of national economy and the security of the population. They may also ruin both the strategic and the weaker sectors of economy. Just like in other countries with limited resources and big ambitions, the gospel of economic liberalism is spread by the most competitive sectors with ties to transnational corporations and with direct interest in internationalization as a possibility to cut costs and raise profits as well as exert influence on regulations. It would be wise to agree that after 16 years of independence Lithuania has solved quite a number of economic problems, but has hardly acquired enough skills of national strategic planning. Political geography is favourable and is exploited

[59] Political Economy, Englewood Cliffs, New York.: Prentice-Hall, 1978.
[60] Soros G., Pasaulinio kapitalizmo krizė: Atviroji visuomenė pavojuje, Vilnius:Tyto alba, 1999, p.23.
[61] Replacing *Lukoilian* A-95 petrol by the same type from Scandinavia; bought at a higher price per litter (by 2 per cent compared to *Lukoilian* equivalent), the driving distance, provided similar driving conditions, was longer by 20 per cent.
[62] Soros (Note 60).

for transit between East and West; EU membership is a guarantee of economic stability. Nevertheless, Lithuania must take into account economic integrity, national competitiveness and national security, and create an efficiently structured economy based on production, where energy plays key role. Now that we are still discussing the restructuring of the economy, only the traditional sectors and products guarantee growth due to the volume and this helps producers to enter new markets or to maybe recover the lost ones. Still, after 16 years of independence production remains on too small of a scale and primitive. The share of more sophisticated sectors (electronics, machine tools) have shrunk, while the simpler ones (food processing, textiles) have expanded. Compared to services, the proportion of processing has also shrunk by far too much, while products of some sectors of economy are of lower technical levels than in the Soviet days. This context requires an ironical view on our illusion that we have any advantage as compared to the new EU member states just because we are close neighbours of Russia. President Adamkus had once noted: "Lithuania is interested in Russia as participant of European life. We are dedicated to cooperation with neighbouring Russian regions (…) Together, we can turn the Baltic region into one of the richest in the world"[63]. Regrettably, the reality seems to be the opposite. It is Russia, or indeed its energy (oil and gas) giants, which decide what projects Lithuania is to participate in, best serving the Russian interest.

[63] LR Prezidento V.Adamkaus kalba, pasakyta Karališkajame tarptautinių santykių institute: "Lietuva integruotame pasaulyje", Londonas, 2002 m. kovo 27 d [Speech by President Adamkus at the Royal Institute of International Relations *Lithuania in the Integral World*], in: Lietuvos užsienio politika 2002, Vilniaus universiteto leidykla, 2004, p.63.