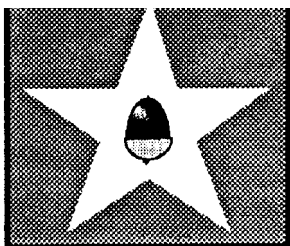


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**Electricity in the Air:
The Real Power Politics
in the Baltics**

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Electricity in the Air: The Real Power Politics in the Baltics

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The politics surrounding the power sector in the Baltics illustrate both the intricacy and complexity of contemporary Baltic politics, but also provide a microcosm of how this vital sector affects politics in general for European democracies.

Electricity occupies a vital place in modern society, necessary for economic production and individual survival alike.¹ Therefore, the capacity to provide that lifeblood for both the economy and for daily life has become one of the determining factors of a country's success. The ability to provide electricity is therefore key to a country's economic security.

The Baltic states of Estonia, Latvia and Lithuania have often been maligned as resource-poor states and net importers of energy. Though essentially true, this statement is certainly misleading in the vital area of electricity. Few analysts outside the Baltic area know that the three countries as a sub-regional grouping are completely self-reliant for their power generation, and are certainly capable of becoming regular power exporters. Despite such self-reliance, the politics behind the sector are among the most emotional and volatile as they directly impacts on the interests of everyone involved: business, pensioners, populist politicians, trade unions, multinational giants, corner shops, as well as export-hungry and import-hungry neighbours.

The politics of electricity are quite divergent in the three countries as each faces different challenges and opportunities to bring their power sectors to a quality able to function – and compete – in the integrating economy of Europe. Despite the differences in details, some of the key questions are similar: fuel and resource, import requirement and export capacity, interconnectivity, restructuring and privatisation, harmonising with the European Union's *acquis communautaire*, and so on. Only the most pressing of the political situations in each country will be addressed in this work.

Background

Fuel and Generation

With the collapse of the Soviet Union, the three Baltic countries regained the right to forge their own energy policy. Though highly dependent on Russia for much of their other energy sources – such as gas and oil – the three countries as a group

¹ I am heavily indebted to my former editors at Financial Times – Power in East Europe, Henry Edwardes-Evans and Martin Burdett, for pushing me to investigate into this sector while working as the publication's Baltics correspondent.

turned out to be self-sustaining in power generation. Latvia, the only country among the three to have regular power deficits, is easily sustained by imports from both Estonia and Lithuania. This self-sustainability is the key factor for consideration in examining the politics of this sector.

The foundation of Estonia's power sector lies in the relatively large deposit of oil shale in its north-east. Despite oil shale being of rather low caloric value, it is nevertheless plentiful and indigenous. Though first developed during the late interwar period, the rapid forced industrialisation of Estonia under Soviet rule really created the mass mining sector for oil shale, which was used not only for power generation but also for oil and chemical processing. The construction of the 1390 MW (Megawatt) Balti Power Plant in 1959 and the 1610 MW Eesti Power Plant in 1969 ensured Estonia's self-sufficiency in electricity; the two power plants, joined in 1999 under the company *Narva Elektriijaamad* (Narva Power Plants, NEJ), account for over 90 per cent of the 7.8 Terawatt-hour of generated power in the country.² Small gas-fired plants based in municipalities – albeit mostly used for heating – and also in some larger companies, as well as alternative energy sources account for the remainder. Though oil shale is of low caloric value compared to other fuel, thus raising the cost of generation, and dirtier than other fuels like natural gas, the overriding reason to continue with oil shale as the major fuel is due to its plentiful supply. Former Economics Minister Mihkel Pärnoja in 1999 estimated that the supply would last at least for 20-30 years (Huang 1999d). This issue of self-reliance played the major role in Estonia's power politics through the late 1990s in terms of cost, environmental impact, competitiveness, economic independence, and labour issues with the large mining sector.

Lithuania is also self-sufficient in electricity generation, albeit with an imported source – nuclear fuel from Russia. The 3000 MW Ignalina Nuclear Power Plant, which first went on-line in late 1983,³ was designed to generate enough electricity to power the entire corner of the former Soviet Union. Ignalina in 1999 generated 9.9 TWh (terawatt-hour) of electricity, though on very low capacity due to limited potential to export to countries that can pay in hard currency. Ignalina is of course a controversial issue with the EU due to its design, incorporating similar model RBMK reactors to those at the Chernobyl nuclear power plant, despite being refurbished by western experts. For many years Lithuania ranked highest as the world's most nuclear dependent country: 85% in 1995, 83% – 1996, 81% – 1997, and 77% – 1998 (PiEE 1999e: 9). The antiquated 1800 MW Lietuva Power Plant in Elektrėnai serves as the back-up for Ignalina when it goes off-line for service or technical reasons, and has received very little in way of renovation. The Elektrėnai plant has also used the cheaper but controversial fuel Orimulsion, a bitumen mixture from Venezuela that could cause serious environmental damage if leaked, since it sinks and disperses into water. However, the pressure by the EU to shut down Ignalina is impacting heavily on many fronts: export opportunities, sovereignty versus European integration, need to refurbish Elektrėnai or build a new nuclear reactor, and so forth.

Of the three countries Latvia is in the most precarious situation in relation to its power sector, being the only net importer of electricity among them. Most of

² All generation data (taken from 1999), for optimum comparative purposes, came from a single source – the US Department of Energy's Office of Fossil Energy (<http://www.fe.doe.gov/international/e-eur.shtml>).

³ The second reactor went on-line in 1987, following a delay after the Chernobyl disaster. Though construction of the third reactor began in 1983, it was halted after Chernobyl and abandoned in 1989.

Latvia's electricity is generated by a series of hydroelectric plants (totalling an estimated 1515 MW)⁴ along the River Daugava, generating 2.7 TWh in 1999 (accounting for almost 63 per cent of needs). Though supported by a few gas-fired plants,⁵ usually with primary responsibility for municipal heating, Latvia is, for a lack of a better term, dependent on an Act of God for its electricity; heavy precipitation minimises imports, a drought increases them. In 1999, with limited precipitation levels, Latvia imported 1 TWh of electricity, about 23 per cent of demand. Latvia has very little capacity for direct connections to the rest of Europe for any export possibilities in the future. Being in the most precarious situation in energy terms, Latvia's power policy has been protectionist: the issue of vital national interest has superseded those of cost and employment.

Connectivity & Interconnectivity

One of the most difficult tasks of the emerging power companies after the collapse of the Soviet Union was the gradual but necessary refurbishment of the transmission network. The old and decrepit transmission systems wasted significant amounts of power and frequently failed, leaving entire areas dark for hours or longer. The low reliability factor would have created serious speed humps on the road to economic recovery and development. Massive investments were needed to refurbish transformers and sub-stations throughout the countries, as well as large 330kV (kilovolt) lines and smaller 110kV cables. The investments were self-intuitive, since the less power was wasted in transmission, the higher profits companies would reap.

Interconnectivity also played on the efforts of the three utilities, especially Latvia's *Latvenergo*. The two 330kV lines connecting Latvia with Estonia and the four 330kV lines connecting it with Lithuania provide the source of the electricity import. Also, the three utilities work closely to synchronise maintenance and seasonal schedules, allowing for constant import/export of electricity among all three countries. The health of the interconnected points was vital in maintaining this relationship.

More importantly, the interconnectivity among the three Baltic countries, as well as with parts of Russia, is crucial in guaranteeing a stable current. Physical laws governing electricity maintain that the larger the electric network is, the easier it is to maintain a stable current. Thus, despite the closely-regulated trade on power in the region, the networks are linked with Russia to maintain maximum stability. During the preparations to tackle potential Year 2000 problems, Estonia's *Eesti Energia*, for example, suggested it could isolate its power network in a short time, but argued against that as a long-term possibility since the guaranteeing of a stable current for such a small country would be extremely expensive and still uncertain. The agreements signed by the Baltic power utilities, as well as Russia's YEES (United Energy Systems) in 1999 caused major controversy among some critics who saw it as linking the electrical systems of Lithuania with Russia; however, the laws of physics proved to be more important in this case.

The Russian interconnectivity issue remains large because there are no other connections to the rest of Europe from the Baltic states. The proposed Baltic Ring project to link the power grids of countries bordering the Baltic Sea has remained just talk years after its initial suggestion. The Estlink project forecasts the

⁴ The cascade series comprises the 855 MW Pļaviņas Hydroelectric, 260 MW Ķegums Hydroelectric; and 402 MW Riga Hydroelectric Power Plants.

⁵ The two CHP plants in Riga, 129.5 MWe Riga-1 and 390 MWe Riga-2, have larger capacities for heating (1853 MWt (megawatt-thermal) combined).

construction of a transmission line between Estonia and Finland, which would allow also Estonia to export a good part of its electricity surplus to Finland and the rest of Scandinavia. The PowerBridge project planned for the building of transmission capability between Lithuania and Poland would also allow for exporting the large surplus generation from Ignalina into Germany and the rest of the continent. However, both major projects have so far been stalled for various reasons, ranging from lack of immediate economic reason (Estonia-Finland) to external interests (Lithuania-Poland).⁶ The interconnectivity with Scandinavia and the rest of the continent could be a major step in giving the Baltic countries the choice of whether to disengage their system from Russia's, as well as the opportunity to broker power export deals from Russia to the rest of the continent.

Structure of the Companies

One of the key issues in examining the power sectors is the structure of the three utilities, as well as their restructuring process. All three companies are controlled by the state, though both Estonia and Lithuania have some minor parts in private hands. The lack of action by Latvia indicates again how the sense of preserving an item deemed as a vital national interest has superseded necessary restructuring.

Eesti Energia remained state-owned a decade following the restoration of independence. However, a restructuring decision in 1997 allowed for the creation of seven regional distribution companies and for the initial privatisation of two of them in 1998. A minority stake in *Narva Elektrivõrk* (Narva Power Network) and *Lääne Elektrivõrk* (Western Power Network) was sold to consortia led by US-based Cinergy and Finland's *Imatran Voima* (later merged into Fortum) respectively, and both consortia have since taken full ownership of the two distribution networks.⁷ However, the partial privatisation of large scale distribution did not continue further, though several small local distribution companies crept up over time.

The major part of the utility's generation arm, the Balti and Eesti power plants, were merged into the company *Narva Elektriijaamad* (Narva Power Plants, NEJ) in 1999 for partial privatisation. The state transferred the ownership of oil shale mining company *Eesti Põlevkivi* (Estonian Oil Shale) to NEJ (51 per cent) and *Eesti Energia* (49 per cent). This decision was made to ensure the fuel supply for the two oil-shale-fired plants as the company was facing sale to a US energy company. Though that partial privatisation process (discussed later) failed, the reorganisation of *Eesti Energia* by breaking off parts for future privatisation remained.

The Lithuanian energy sector was reorganised in 1995 with the creation of a fully state-owned independent company running the Ignalina Nuclear Power Plant. This resulted in normal business transactions being necessary for power utility *Lietuvos Energija* to purchase electricity from Ignalina for re-sale to the public and for export. *Lietuvos Energija* did not face much restructuring during the government of 1992-96 led by the Lithuanian Democratic Labour Party (LDDP), though just under 15 per cent of its shares went into the market. The shares floated on the Vilnius Stock Exchange until early 1999 when Sweden's public energy giant Vattenfall began purchasing all free-floating shares at an advantageous price (LTL 5) in order

⁶ Trying to build a power link between Poland and Lithuania, essentially to link the old Soviet power grid to the main European one, would impact on several external powers. For instance, it was hinted that Russia would undercut the Lithuanian sale price for electricity to Germany, if "eastern" interests gain hold of the vital infrastructure to export.

⁷ Perhaps as a symptom of the downfall of many US energy companies, Cinergy – among others – pulled out of the Baltic countries in 2002; Cinergy sold its holdings to its partner, a local investment company.

to gain a foothold for the eventual privatisation of the utility. It was not until the end of 2001 that the restructuring of *Lietuvos Energija* was finally completed, ironically under the government of Algirdas Brazauskas of the Lithuanian Social Democratic Party (LSDP) – which post-merger includes the LDDP. Two distribution areas – Vakarų (Western) and Rytų (Eastern) – were created with the aim of privatisation, alongside two generation companies – Lietuvos and Mažeikių.

Latvia's utility *Latvenergo* has failed to restructure seriously for any form of privatisation or strategic investment – due mostly to public pressure. Attempts at restructuring to create separate generation, transmission and distribution parts following European trends failed, most notably in a noisy public petition campaign in 2000 to stop the process.

The Politics of Electricity

The politics of electricity is indeed highly charged in the three Baltic countries. It is clear how important the future of the power utility is to the general development of the economy. As electricity is the sole universal (as opposed to sporadic usage of gas) and national-based (as opposed to water and heating, which are local utilities) utility in the three countries, the impact of changes in the sector reaches far beyond politics into the daily lives of everyone in society. This is what makes the sector so charged for politicians, especially as they use it for their own political gains.

This work will focus on one political issue relating to electricity in each of the three countries: for Lithuania, the issue of shutting down the controversial Ignalina nuclear power plant; for Latvia, the fight over the future status of power utility *Latvenergo*; and for Estonia the messy attempted sale of the country's main power plants. This is not meant to pass over other pressing issues, especially those relating to interconnectivity with the rest of the continent; however, it is more pertinent to deal with one issue in greater depth than to conduct a general survey of the various issues in this sector.

Lithuania: Ultimatum for Joining Europe

Energy politics remains at the forefront of Lithuania's political world, especially given the ongoing issues of privatising state-owned energy companies and the continual problems with both ownership and supply for the oil sector. Electricity is by no means playing second fiddle to oil and gas, with pressing issues such as the spiralling debts of power utility *Lietuvos Energija* and interconnectivity with Poland constantly creeping up at inopportune times for the government. However, the most pressing matter concerning Lithuania's power politics is what will happen to the controversial Ignalina nuclear power plant – the source of Lithuania's cheap electricity and the European Union's fears of an environmental calamity.

Though Ignalina is a source of controversy and the construction of a planned third reactor was shelved due to public protest following the Chernobyl disaster, it nevertheless remains a symbol of Lithuania's self-sufficiency in electricity. The public remembers the cut-offs of gas supplies by and from Russia in the early 1990s for both political concessions (pre-restoration) and payment arrears (post-restoration) and the burden of being dependent on an external – often antagonistic – source for such a vital resource, and any question of scrapping Ignalina would need to tackle this sentiment.

When the European Union chose to change the enlargement strategy at the 1999 Helsinki European Council meeting, from the echelon system of “front-runners” versus others to a “regatta” enlargement, Lithuania faced the demand for a commitment to shutting down the controversial facility. The Commission insisted that the first – and older – unit at Ignalina should be shut down in 2005, and the second unit in 2009, as a condition of EU membership. Other candidate countries with questionable nuclear projects, such as Bulgaria and the Czech Republic, also faced similar demands from the EU as a whole or from specific member states.

For Lithuanian politicians the issue of shutting Ignalina is multifaceted. Most basically, closing the power plant would result in astronomical costs. The government estimated the total shutdown cost for Ignalina to be as much as EUR 2.4 billion, a total that takes into consideration the physical shutdown, social spending for the plant’s 4,600 workers and their families, the cost of alternative energy sources and other major areas. The government’s own “decommissioning” fund has less than two per cent of that amount, and is clear Lithuania would not be able to fund the closure itself (Bradley 2002).

Secondly, the shutdown of Ignalina would turn the fabricated city of Visaginas, with a population of 32,600, into a “dead town” as a worried employee told Reuters (Frierson 2002). Nearly every household in Visaginas, a bleak residential city created from the wilderness (originally bearing the name Sniečkus to honour the long-time Soviet Lithuania leader) to house the workers of Ignalina, has employment ties to the power plant. To add to the problem, many inhabitants of Visaginas are not of Lithuanian origin and are Russian speaking. The social calamity of a shutdown, in which less than a third would remain for the decommissioning work, would be a major problem for future governments.

Thirdly, without Ignalina an alternate power source would need to be found. One possible solution would be to build a new Western-standard nuclear power plant, though the cost of such a project and the controversy about nuclear power in Europe seriously impact on such a solution. The more likely solution would be a refurbishment of the Lietuva Power Plant in Elektrėnai, which has been used in a minimal capacity since Ignalina went on-line, only as a back up when the nuclear plant was being serviced. The Elektrėnai plant burns hydrocarbons, which Lithuania would need to import – raising a debate about fuel dependency. By going for a cheaper import option such as the environmentally sensitive Orimulsion from Venezuela, Elektrėnai has already caused widespread anger among environmentalists. Elektrėnai would have enough capacity for Lithuania, but Lithuania would be at the mercy of either Russia or the unpredictable world gas market if it avoids oils.

Finally, closing Ignalina would also deprive Lithuania of a potential future source of revenue in power export. Ignalina, designed as a power source for an entire region of the former USSR, has a generation capacity far beyond Lithuania’s needs. The financial motivation for building a transmission link to Poland, the so-called “PowerBridge” project, was directly linked to the potential for Lithuania to export its surplus electricity – “stored” at the Kruonis Hydro Accumulator facility – to power-hungry Germany. A pre-construction report estimated annual revenues for exports to Germany and other European states at as high as USD 150 million (Huang 1999a).

Not directly of consequence to the country but to the politicians is that an easy agreement to shut down Ignalina would be seen as a *de facto* kowtow by Vilnius to

Brussels, which also sets a poor precedent in future disagreements. Importantly, Ignalina is exceedingly popular, with 80 per cent of respondents in a November 1998 Vilnius poll supporting the plant (Huang 1999b). With news coverage of the EU often negative, this perceived attempt by Brussels to “muscle” Lithuania into energy dependency seriously damages public support for EU entry. And with a referendum deemed necessary for accession, such a dramatic factor in public opinion would jeopardise Lithuania’s eventual membership – making the shutdown process rather futile. The effects of the demand are clear, as a poll taken after the covert EU threat indicated the popularity of the EU at an all-time low: a June 1999 poll following the most intense campaign by the European Commission for Lithuania to commit to decommissioning showed that only 27 per cent of Lithuanians would vote to join the EU compared to 50 per cent in previous polls (Huang 1999a). Both sovereigntists and Eurosceptics smirked at this perfect example of their concern that policy would be in the hands of Brussels and not Vilnius if Lithuania joined the EU.

Juxtaposed between political and economic policies, the Conservative government in 1999 was in a very difficult position. Though the Conservatives, with their Christian Democratic partners held a slim majority in the 138-seat *Seimas*,⁸ any move would be unpopular with the public and would become fodder for the left-wing opposition in upcoming election campaigns. Similarly, to the Conservatives the idea of being dependent on Russian gas to power the country is anathema, thus internal opposition within the coalition also existed; when Ignalina was shut down for maintenance in June 1999, gas suppliers used price-gauging tactics to increase natural gas costs, forcing *Lietuvos Energija* to pay a more than 50 per cent premium over their usual amount, intensifying the fears of becoming dependent on Russian gas (PiEE 1999g: 9). The only chance the Conservative-led government had was to work out a compromise – to commit to a partial, not full shutdown.

Under the plan drafted by the Rolandas Paksas government in September 1999, the first – and older – reactor would be decommissioned by 2005. With this reactor’s design life due to expire in 2010, the five-year gap did not seem controversial. Alongside this was the assertion that funding for the partial shutdown must be from international sources, a provision campaigned for by the angry ousted ex-Prime Minister, Gediminas Vagnorius. All of this was skilfully presented as a part of the government’s energy strategy for 1999-2004 – which creatively postponed the issue of the second reactor. Economics Minister Eugenijus Maldeikis rushed the plan to Brussels soon after its approval – even before parliamentary debate – in order to demonstrate Lithuania’s resolve to start membership talks, with the decision to be made in those coming months before the Helsinki European Council meeting (PiEE 1999i: 7-8).

The partial shutdown plan was a gamble for the increasingly unpopular Conservatives going into a final year in power. Unpopular as a shutdown was among both opposition and coalition MPs, a parliamentary failure to adopt the strategy would sink the government and Lithuania’s EU chances. Meanwhile, the vocal campaign against the shutdown increased. Scientists argued against it, with the Lithuanian Nuclear Energy Association leading the charge. The parliamentary opposition, including former co-operation partner the Centre Union (LCS), continued the attack, supported again by the vengeful Vagnorius and his venomous attack on his own party for ousting him. At the time Conservative MP Andrius

⁸ Though normally the *Seimas* boasts 141 seats, several were declared “vacant” by the Lithuanian Electoral Commission as “perpetual elections” continually failed due to low turnout.

Kubilius tabled a plan for a total shutdown of Ignalina if replaced by a new nuclear option – but the plan was then shelved during the heated debate;⁹ the Visaginas City Council also passed a resolution calling for the construction of a third unit to Western standards.

Lithuania was quickly rewarded with positive comments by European Commission President Romano Prodi in October, confirming that Lithuania would be included in the “regatta” enlargement process without reservation (PiEE 1999j: 8). A donors’ conference on funding the partial shutdown was eventually held in June 2000, in which various international sources pledged some EUR 200 million¹⁰ for the EBRD-managed fund. The EU, which pledged a large amount of the fund, also created programmes to deal with the effects of the shutdown; the plant estimates about 900 job cuts with the shutdown of the first unit (Frierson). Though public support for EU membership slowly returned to a positive balance, the government learned that the public would take another such confrontation with Brussels quite negatively.

However, as EU membership talks continued, the issue of the second reactor returned. The European Commission reinvigorated its demands for a commitment from the Lithuanian government for the closure of the second reactor by 2009. With its life designed to last until 2017 and beyond if rechannelled and refurbished, this eight year gap would be much more problematic. These negotiations have proven much more difficult as the funding requirements would be significantly higher; if around EUR 200 million has been pledged for the shutdown of the first unit and the total estimated cost is closer to EUR 2.4 billion, there remains a gap of over two billion euro for the full decommissioning that the Commission expects.

Now, with the political left governing Lithuania with a secure majority coalition of at least 81 of 141 seats, Prime Minister Algirdas Brazauskas could take a harder line on the matter, insisting that if the EU is demanding decommissioning, the EU should pay for it. “This is a European problem, not Lithuania’s problem,” said Brazauskas to Reuters, adding that the EU “should cover all the costs, from various sources, putting that into both its budget until 2006 and its budget after 2006” (Bradley). The ruling coalition faces little opposition from the ever-fragmented right-wing opposition, and taking a tough line with the EU on decommissioning would not be unpopular.

Even President Valdas Adamkus, at one time one of the highest-ranking officials at the US Environmental Protection Agency, took a hard line on the matter. Arguing that the best solution was to build a new, Western-model nuclear power plant to replace the current RBMK reactors, Adamkus cautioned that closing the second reactor by 2009 would be “signing and committing to the total bankruptcy of the country” (Frierson). At this point there is little sympathy from the European Commission, especially the Commissioner for Energy Loyola de Palacio, who insists that EU candidate countries must meet the same nuclear safety standards as member states, adding in her frustration with Brazauskas’ insistence that funding is for the EU: “if this is the kind of thing they say before they are in the EU, what will they say after they are in?” (Bradley).

The Lithuanian government and the European Commission did reach a deal in June for the shutdown of the second unit, with EU financial support. However, the

⁹ Of course Kubilius became prime minister just months later.

¹⁰ Denmark pledged EUR 16.2 million, Sweden EUR 13 million, Belgium EUR 1.65 million, and the US, Finland, Norway, Poland, Austria, Netherlands, Britain, France, Germany, Japan and others promised EUR 1.5 million each.

extent of the support and dealing with the various aspects of the shutdown will remain high on the public agenda for the near future, even after Lithuania's invitation to join the EU is finally issued, and will likely be revisited during the presidential election scheduled for the end of 2002. Everyone will remain edgy as long as the full detailed funding scheme for the total shutdown remains elusive; and even after that is reached, the concern will remain that it could be undone by an angry public.

Latvia: Preserve Our Precious Daugava!

As the only Baltic country not self-sufficient in electricity generation, Latvia is in the most precarious position. Although excess generation in Estonia and Lithuania more than make up for Latvia's deficit, power generated from an indigenous source benefits the power utility's balance sheets. The larger the deficit, the more the costs for imported electricity are passed onto consumers and impact the economy.

Technically Latvia's source of power generation is not indigenous; Latvia is dependent on precipitation for its chain of hydroelectric power plants over the River Daugava. The Daugava has symbolically acted as the nation's lifeline over the centuries, and it remains true today for it provides 63 per cent of Latvia's electricity needs (in 1999). Despite the damage to wildlife that hydroelectric dams create, the energy generated on the Daugava is much cleaner than burning the low-caloric oil shale found in Estonia and much safer than nuclear fission in Lithuania. In that respect Latvia does not have serious environmental issues with the EU, unlike Estonia (pollution) and Lithuania (nuclear safety). But as in nearly every political issue in Latvia, the politics of the power sector are linked to the national question – especially in the minds of the public.

The Latvian power sector required massive investments to refurbish equipment, replace outdated technology and to diminish the amount of electricity wasted by shoddy transmission systems. *Latvenergo*, as a fully state-owned company, established ambitious investment plans, such as one costing LVL 66 million in 1999, and managed to lower the percentage of transmission loss from 20 to nearly 11 per cent. However, the possibility for foreign investment to invigorate the refurbishment process has been zero, as the structure of the company did not allow a foreign entity to become a strategic investor in any of the company's arms. In addition, the VI *Saeima* (1995-98) had banned the privatisation of *Latvenergo* until the investigation into a scandalous loss of LVL 3 million was completed (PiEE 1999b: 7).

The newly elected government of Vilis Krištopans in late 1998 began looking into ways to privatise *Latvenergo*, though many believed his real interest was not in privatisation issues. A parliamentary commission ruled that the ban by the previous parliament was no longer valid as it has expired with their mandate (PiEE 1999c: 7). Various groups, from the Economics Ministry to the Latvian Privatisation Agency, drafted differing plans for the privatisation, and criticism of each others' plans increased in intensity.

At the same time, the Latvian Social Democratic Workers Party (LSDSP), a left-wing constructive opposition to the Krištopans government, voiced strong objection to the plan to privatise *Latvenergo* and threatened the government with a referendum campaign (PiEE 1999e: 8). Latvia, by restoring its 1922 Constitution, made binding referenda a major problem for governments. If a referendum overturns a government-proposed law, the government is forced to resign. A poll in early 1999

by SKDS indicated that 74.6 per cent of respondents opposed the privatisation of *Latvenergo* (PiEE 1999e), a disaster for the government if a referendum were called.

Economics Minister Ainārs Šlesers of the small centrist New Party (JP) openly quarrelled with Prime Minister Krištopans of the centrist liberal Latvia's Way (LC); both parties, ironically, are closely linked financially to the oil transshipment sector. Šlesers insisted on retaining *Latvenergo* as a single unit, with privatisation partially to involve privatisation vouchers and block share sell-offs at a later stage. Most significantly, Šlesers voiced the opinion that a strategic investor might not be necessary under his ministry's model (PiEE 1999e). However, this model would possibly turn control of *Latvenergo* over to an unsympathetic entity via a tertiary transaction after the shares floated on the market.

The plan from the Latvian Privatisation Agency, led by Jānis Naglis (member of LC), foresaw the breaking up of *Latvenergo* into components before setting up different schemes for each part. Though Krištopans urged Šlesers and Naglis to reach a compromise, Šlesers insisted that if his ministry's plan were rejected the Economics Ministry would support no privatisation at all. The cabinet in early May 1999 did indeed vote against the Šlesers plan. The confrontation led to the sacking of Šlesers, and a verbal tirade against the weak Krištopans under the thumb of Ventspils and its powerful oligarchic mayor, Aivars Lembergs (Huang 1999c).

Though unconfirmed, it is most probable that the Šlesers plan faced especially tough opposition from the ruling coalition's nationalist For Fatherland and Freedom party, which would have preferred the Naglis plan. For Fatherland and Freedom (TB) voiced its adamant opposition to any form of privatisation for the country's hydroelectric generators and the transmission network, naming both as vital national interests. On this matter and other national-related issues like citizenship and language, TB and LSDSP fielded similarly protectionist policies.

The privatisation scheme for *Latvenergo* dragged on as new Economics Minister Ingrida Ūdre, also from JP, remained committed to the one-company plan, and the inability to resolve the issue in the cabinet led to the only possible compromise – delay the process for further study (PiEE 1999f: 6). This was very much apparent when the *Saeima* extended the validity of privatisation vouchers to the end of 2000 (PiEE 1999g: 7).

However, the change of government in the summer of 1999 gave the privatisation of *Latvenergo* a more viable scenario. The rapprochement between oil-friendly LC and the popular and the anti-Ventspils People's Party (TP) forged the strongest government (with a 62-seat hold in the *Saeima*) since the restoration of independence. This helped the privatisation of *Latvenergo* in several ways. With such a majority, the government did not require the support of the opposition LSDSP as had the Krištopans government. The LSDSP had threatened to end all co-operation if the *Latvenergo* privatisation debate continued. Secondly, without JP, which maintained a stubborn insistence that *Latvenergo* must remain a single entity, the concerns of the nationalist TB on retaining state ownership of the hydroelectric power plants and the transmission network could be satisfied. Thirdly, by giving the Economics Ministry portfolio to Vladimirs Makarovs of TB, the cabinet would essentially bypass the internal argument as the one party with the most reservations over the process would be overseeing the drafting of the new privatisation plan. However, the success of the entire plan, as well as the new cabinet, was dependent on how well and long the rapprochement lasted.

The plan drafted indeed followed the earlier ideas by the Privatisation Agency to re-organise *Latvenergo* into four different entities – transmission, distribution, hydroelectricity, and hydrocarbons generation. To appease nationalists and anti-privatisation forces, safeguards were enclosed prohibiting any privatisation of the transmission network and, most importantly, the chain of hydroelectric power plants on the Daugava. The CHP (combined heat and power) plant in Riga would be subject to partial privatisation via a strategic investor, while the distribution would be structured to allow for privatisation. Though the nationalist TB was more satisfied with this plan, the anti-privatisation LSDSP still opposed this method and remained staunchly against selling off the utility.

The intra-cabinet disputes over *Latvenergo* quelled, the LSDSP raised the stakes as it failed to derail the plan within the *Saeima*. Alongside trade unions and other anti-privatisation campaigners, it began a petition campaign for a referendum to derail the *Latvenergo* restructuring plan in the summer of 2000. The opponents of privatisation were bolstered by a SKDS poll published during the summer that found 81.6 per cent of respondents opposing the power utility's privatisation (CER 2000c). Approximately 130,000 signatures, representing ten per cent of eligible voters, would be necessary for the measure to go to referendum. Campaigning on both social (tariffs rise scare) and national (argument that the privatisation would be a *de facto* sell-off of the Daugava) fronts, the campaign achieved about 300,000 signatures by the deadline (CER 2000d). Facing little other option, new Prime Minister Andris Bērziņš of LC backed down and took the restructuring plan off the agenda. This result also helped to quickly derail a planned merger of *Latvenergo* with its Estonian counterpart, *Eesti Energia* (see below).

The pressure to restructure *Latvenergo* continues from foreign sources, which will be required for Latvia's harmonisation with the EU's *acquis communautaire*. Even without the ever-present threat of referendum by anti-privatisation campaigners, it would be extremely difficult to put together such a plan within the current Latvian political environment.

The October 2002 general election radically shifted the political picture in the country, with two major parties of the previous *Saeima* failing to win seats – Latvia's Way and the Social Democrats; however, the large centre-right bias of elected seats, as well as the problems caused by personality disputes among this group, indicate the problems of the past remain, albeit in a different guise. The weakness of the two largest centre-right groups, the People's Party (21 seats) and the New Era (JL, 26 seats) of former central bank head Einars Repše, will keep anti-privatisation forces among the ruling forces for the medium term.

Even if such a coalition is managed and not based on this single issue, again the constitutional provisions for referendum could easily defeat the government. From recent examples, no government is willing to risk its survival on a populist referendum measure, especially if supported by opposition from both political flanks. If the issue of *Latvenergo* erupts again in the Latvian political world, the same tensions would again destabilise Latvian politics and cause the same type of chaos that plagued the governments of this past parliamentary cycle. The people will hold the veto on this matter, even if it damages Latvia's longer-term development.

Estonia: Running Out of eNeRGy

Among the Baltic countries Estonia boasts the reputation of being the most advanced with the privatisation programme, as the agenda focused also on the

largest state-owned companies and infrastructure. The government reorganised the power sector, which allowed for the privatisation of two of the country's seven distribution components in 1998 – the first partial privatisation of the power sector in the Baltics. However, the political and social controversy focused on the heart of the sector – the two oil-shale-fired power plants in the country's northeast.

These two plants sorely needed investment to bring them up to European standards. The antiquated equipment resulted in poor efficiency in the burning of the already low-caloric fuel, while its burning created major pollution problems both in the air and in post-firing sediments. Clearly on environmental grounds alone the power plants, without serious investment, would violate EU and Kyoto requirements, making Estonia's EU prospects significantly more difficult. However, the continued burning of oil shale would be necessary for Estonia to remain self-sufficient in power generation. With the level of investment needed to make burning oil shale possible in the longer term not available in the Estonia of the mid 1990s, the government of technocrat centrist Tiit Vähi chose to pursue the idea with overseas companies.

In 1995 talks began with Northern States Power, a US energy company based in Minnesota. Over protracted talks that lasted over six years, negotiations hit both peaks and nadirs, hindered by the rapid growth of opposition from various circles. The issue of a basic investment need to retain Estonia's self-sufficiency in electricity eventually faded away to increasingly ugly politics, while the influential business sector began to assert its influence in the chaotic situation. By the cancellation of talks at their near conclusion in late 2001, the political environment had soured to its most intense in years as the collapsed ruling coalition sought to save some of their political reputation by taking the populist step. Few other issues in recent Estonian politics have galvanised such opposition and controversy, nor has any other issue brought out the true colours of so many different interests.

In the investment-hungry Estonia of 1995, the news of the possible deal was greeted with interest as the significant US financial presence would also offer some level of security interest by Washington. The initial opponents of the deal were some EU member states, who cried foul at the selection process. The countries argued that the selection of Northern States Power did not conform to EU procedures, hinting it would damage Estonia's EU integration. What really drove these complaints was Finland and Sweden's own interests in privatising the Estonian energy sector. The complaints fell on deaf ears and over time were all but forgotten. Nevertheless, the government and NRG, an affiliate of Northern States Power, did little more than spar as the issue proceeded slowly over the early years.

An acceleration of talks occurred untimely, during the final months of the minority government led by Mart Siimann of the Coalition Party (*Koonderakond*). Transport Minister Raivo Vare, appointed in December 1998 to lead the government's team for the talks, began working out a framework agreement and timetable with NRG. However, as the talks hit the headlines, opposition to the idea of partially privatising the country's power plants started to grow within the *Riigikogu*, including elements of the ruling coalition, though most prominently with the centre-left populist Centre Party (*Keskerakond*). The parliament managed to push through legislation naming the two power plants as items of strategic national interests, forcing the government to seek parliamentary approval to complete the deal, which the government called an "unpleasant surprise" (PiEE 1999a: 8). This would become the first of many hurdles placed by the deal's opposition, led by the controversial but charismatic Centre Party leader Edgar Savisaar.

The official detailed negotiations began on 17 February 1999, despite the parties being in the thick of a heated election campaign. The Siimann government tried to establish the foundations for the deal, such as the principle agreement to link the power and mining sectors, before it left office a month later, knowing that the Coalition Party was about to be decimated at the March elections. The technocrat Coalition Party indeed fell from grace, winning just six seats along with two coalition partners,¹¹ and the centre-right three-party coalition of the conservative Pro Patria Union (*Isamaaliit*), the liberal Reform Party (*Reformierakond*) and the enigmatic centre-left *Mõõdukad*¹² took charge with Mart Laar once again taking the prime ministerial job. The coalition took a very positive view of the NRG deal, thus the negotiations proceeded. The Laar government and NRG continued with detailed negotiations over issues such as price and investments, while efforts were made to ready the institutions for the eventual deal. In April 1999 the two power plants were merged into one company, *Narva Elektriijaamad* (Narva Power Plants, NEJ).

The deal would also entail the complete restructuring of the mining sector. This is made the more difficult by social issues, as many of the miners have few other skills, especially in the economically-depressed northeast. A majority of miners are also Russian-speaking, creating additional social tension between the region and prosperous Tallinn. Fears for job losses prompted 6,000-8,000 energy workers and miners to protest in Narva in May 1999, while in June 2000 a human chain was formed by 5,000 protestors between Narva and Jõhvi to protest declining job prospects and their social consequences. Unless the fate of the mining sector could be secured alongside NEJ, there would be little future for NEJ as an oil-shale-firing facility.

The mining sector was in crisis, as it was in most former Soviet-controlled states, not coping in a market economy. The mining technology was antiquated and unsafe, and the high number of miners was artificially retained. Some of the mines were already nearly depleted and not economically viable, only useful to keep miners at work. The closure of various mines commenced at the start of 1999, though at first miners were simply transferred to other facilities in order not to upset the social situation.

Economics Minister Mihkel Pärnoja, responsible for the deal, voiced his interest in merging fuel and generation (PiEE 1999d: 6). Following on, the government ruled in June to transfer the ownership of *Eesti Põlevkivi* (Estonian Oil Shale, EP) to NEJ (51 per cent) and *Eesti Energia* (49 per cent), giving the eventual operators of the power plants responsibility for the source of the fuel. This also solidified the government's commitment to oil shale as the primary fuel source for Estonia; Pärnoja confirmed in an interview in May 1999 that "the current government has decided that it will be so for about 20-30 years," adding that the role of other fuels would gradually increase during that time (Huang 1999d).

However, the amount of public dissent increased – especially among populist politicians and business circles. Rumours floated about how NRG was pressuring changes in environmental conditions and other matters, all denied by NRG (PiEE 1999k: 8). Instead, a landmark deal was worked out by both sides in November

¹¹ Later, accounting for defections and mergers of other coalition parties to the Estonian People's Party, the Coalition Party was left with one seat – that of ex-Prime Minister Siimann; the party was dissolved in 2001 as Siimann founded yet another party.

¹² The word "mõõdukad" translates approximately to "moderates" but the party insists that the translation not be used; instead the Estonian term should be used in English-language texts.

1999, with NRG promising an investment of USD 376 million in 15 years (PiEE 1999l: 4). The more damaging rumours of a dramatic rise in power tariffs hit a nerve with the public, so why did *Eesti Energia* announce a tariffs rise just at the same time? (CER 2000a).

Opposition among the business community changed the debate drastically. Prominent businessmen such as Toomas Luman (chairman, Estonian Chamber of Commerce and Industry) and Aadu Luukas (chairman, Estonian Business Association), queued up to argue that a tariffs rise from any guaranteed purchase agreement demanded by NRG would hinder economic growth. The focal point of business opposition rested in Jüri Kõo, chairman of Norma Investments and the Estonian Association of Industry and Employers, as well as of the supervisory board of power utility *Eesti Energia*, and in the utility's own Chief Executive, Gunnar Okk. The businessmen also argued that the investments needed to refurbish NEJ to European standards could be found from domestic sources, venting a long standing grief that the government always preferred foreign entities in large privatisation processes. Some in the business community also hinted that cheaper electricity could be obtained by transforming one of the power plants to gas-firing – thus damaging Estonia's self-sufficiency in electricity (Huang 2000a). The self-sufficiency issue was not covered as much as the tariffs prediction, indicating where public sentiment remained.

For the governing coalition the issue became a major problem, as they rose to power with healthy funding and support from business circles. This was especially of concern to the Pro Patria Union of Prime Minister Laar, as a slight shift towards business interests and liberalism during the campaign, partially reflected in the recruiting of controversial banking magnate Jüri Mõis to the party's list, was especially in the spotlight. Aadu Luukas, also chairman of the board of oil transshipment company *Pakterminal*, donated EEK 100,000 to both Pro Patria and the Reform Party in 1999-2001 among many others (Lõhmus 2001).

Another interest in derailing the deal came with the quickly developing talks between *Eesti Energia* and Latvia's *Latvenergo* in the spring and summer of 2000. What started as co-operation talks soon bloomed into possible merger talks, and Estonian business figures began looking at a grander company to control. Latvia, lacking self-sufficiency in generation, would dearly want NEJ as a part of a merged company to take care of that generation need. Therefore if the NRG deal proceeded, the entire merger idea would likely be scrapped by the Latvian side. Though the Latvian public derailed the plan by stopping *Latvenergo* from being restructured (see above), it nevertheless demonstrated the ambitions of Estonia's business elites as they start to assert themselves with increasing economic power.

Populist politicians also attacked the deal on tariffs grounds, using scare tactics with the public suggesting that their electricity bills would rocket after the NRG take-over. Not surprisingly the split between supporters and detractors of the deal fell on opposite sides of the governing-opposition line; the three-party governing coalition supported the deal, while most of the opposition – primarily the populist Centre Party and the rural-centric Estonian People's Party (ERE) – vocally opposed the deal. This motivation looked more like politics than content, as ERE was a part of the Coalition Party-led coalition that began the NRG talks years earlier. Another former prominent Coalition Party member, Ülo Nugis, attacked the efforts made by then-US Secretary of State Madeleine Albright in supporting the deal, calling her efforts an “unheard of and incomprehensible” interference into Estonian affairs (BSR 2000a). The biggest surprise came with the unexpected opposition of then-

President Lennart Meri, who during his independence day speech on 24 February 2000 slammed the deal and later even suggested the deal would cause Estonia to remain connected to Russia's grid (Huang 2000a).

Nevertheless the three-party coalition proceeded with the plan. The opposition attempted to call several special sessions of the *Riigikogu* to debate the deal, but with the governing coalition boycotting, there was never a quorum at the many attempts. The opposition also attempted to quantify public disenchantment by sponsoring a petition drive. The resulting petition – though non-binding unlike in Latvia – was signed by over 100,000 people – representing the largest social protest since the restoration of independence (BSR 2000b). This was little surprise for opponents of the deal as a poll by EMOR in summer 2000 indicated that 67 per cent of the public opposed the deal, compared to only eight per cent in support (BSR 2000c). No-confidence motions were launched against Economics Minister Pärnoja for his role in furthering the deal, and internal squabbles in *Möödukad* called for his resignation – all from politicians looking to score political points against the unpopular deal. The Centre Party even tried to stop the deal via the courts (BSR 2000b). As the government proceeded further with the talks the opposition continued to grow. Seemingly only the mining union rallied to support the deal, knowing that the deal would be the best guarantor of jobs and welfare for workers in the mining sector (Huang 2000a).

A preliminary agreement was signed in August 2000, with its conclusion based upon sealing several other issues such as a loan agreement for the purchase. Mart Laar said that the cabinet's decision to proceed was "the most difficult" adding that it was "popular" to have a different decision than the government's (Huang 2000a). NRG would pay USD 54.5 million for the 49 per cent stake in NEJ, as well as the earlier agreed-to investment schedule. The management of *Eesti Energia* threatened to not sign the deal, to which the government responded by threatening their immediate sacking (CER 2000c). The management relented as NRG agreed to all the conditions established by the state, but the talks dragged on through 2001 on specific issues.

However, a year later as the three-party coalition began to crumble over the 2001 presidential election,¹³ the NRG issue became an external agitator. It did not help that newly-elected President Arnold Rüütel of EME did not support the deal. The September 11 terrorist attacks in the US also exacerbated the situation as loan guarantees for such projects became increasingly stringent. Opposition remained firm during the talks, already in their last stages, as Kõo and Luman insisted that NRG must find additional guarantees backed by international banks as the burden of the risk could not be unequally heavy on the Estonian side (ETA 2001).

Prime Minister Mart Laar in December 2001 announced his January 2002 resignation and the collapse of the coalition. Laar also said that if NRG could not meet the conditions set out by the government, the deal would be cancelled. NRG failed to sign the EUR 285 million loan agreement by the government's deadline, and indeed the deal was cancelled on 7 January 2002 at the outgoing cabinet's final meeting (ETA 2002a). Outgoing Foreign Minister Toomas Hendrik Ilves said that NRG was "unable to fulfil its commitments" (ETA 2002c), though NRG continued to disagree. NRG had presented documentation that stressed that its financiers would

¹³ For more on the politics of the election, see the forthcoming article: Mel Huang, "Estonia's Knight Returns", *Demokratizatsiya*, Vol 10, No 4, Fall 2002.

not require extra conditions to back the deal, but the government had already acted and decided to use this populist trick before leaving office (ETA 2002b).

As the government changed and business circles continued to debate the future of the power sector, the biggest deal in the history of the country indeed became history.¹⁴ The politics behind the NRG deal, especially in its final years, demonstrated the political intrigues possible in modern Estonia. The business circles continued to assert their role in debating the economic future of Estonia, having won the NRG debate by near default and winning a major privatisation deal for the country's railways.¹⁵ The opposition showed that scare tactics with the public, even without the powerful tool of a binding referendum, could place significant pressure on an otherwise strong ruling coalition during a non-election period – even if the motivation was simply political and not truly based on content. The NRG saga demonstrated the full scope and spectrum of Estonian politics, and many of the hidden sources of power in the country. And the dormant public is again awake.

Electricity in the Air

Among the sea of challenges to reform, the power sector posed some of the most difficult and intricate dilemmas for politicians to tackle. The universal connection of every entity in society, ranging from the simple resident to the largest enterprises, makes the politics of electricity a serious concern for every possible interest in the countries. Specific issues galvanised unusual coalitions and reactivated dormant forces, while the impact of public opinion – revealed by polls – fortified the political opposition and cautioned those in power. The difficult aspect of the politics of electricity in the Baltics and beyond is that it extends beyond the floor of the parliaments and halls of governments, far into the economic world and society in general.

To the politicians in power, dealing with vital issues in restructuring their power sectors proved to be immensely difficult with this extended interest. More problematic is the focus on near-term effects by such extended interested parties – businesses and private consumers – as opposed to a longer-term problems with other considerations like self-sufficiency and EU integration that governments in power are required to tackle. Thus governments have been especially susceptible to populist campaigns in opposition to the restructuring efforts, whether it be for partial privatisation and liberalisation or partial shutdown or refocusing.

In the three major examples above, the public weighed in heavily in all three cases and the opposition tapped into the public discontent to score political points. In the Estonian case, the public petition campaign warned the increasingly unpopular Laar government of the level of public disenchantment of which the opposition Centre Party took advantage. The simple act of cancelling the NRG deal at its final sitting in January 2002 is a clear indication of how important public opinion in this

¹⁴ The meltdown of US energy companies in 2002 did not spare NRG or its parent company Xcel Energy (formerly Northern States Power), as NRG itself came close to bankruptcy. In a controversial move, NRG filed suit against Estonia in London for £100 million for failure to privatise NEJ. Most analysts viewed this as a desperate attempt, and it has continued to harm those earlier supporters of the deal in Estonia among the public.

¹⁵ Though the more prominent and larger group of local business tycoons did fail to win the bid for *Eesti Raudtee* (Estonian Railways), the new owners of the company include local business interests.

case became, especially for the coalition to win back some of the political points lost over the debate. The case is even more visible in Latvia, as the binding petition campaign overwhelmingly succeeded in derailing the restructuring process of *Latvenergo*, which took a collapse in the Krištopans government to reach even basic compromise. The Lithuanian example provided some food for thought for politicians as the heavy swing in public opinion over Lithuania's prospective EU membership due to Brussels pressuring for the closure of Ignalina remained on their minds – especially as a referendum would be necessary for the eventual joining of the EU.

The impact of the public, and how opposition forces tapped this energy source, is the most revealing aspect of the politics of power in the Baltics. The intrigues within the traditional political circles increased to a dramatic level, evidenced by the stand-off in Latvia between Krištopans and JP. The involvement of business interests in attempting to exercise their influence, especially the obstructionist tactics by some of the most powerful Estonian businessmen to the NRG deal, also revealed an increasingly assertive business community in the political world. The case of the oft-failed project to build a power link between Lithuania and Poland, not covered in this work, is an excellent example of this mix of business and political interests. However, in these the three most dramatic cases of power politics in the Baltics, the involvement of the public is the most significant.

The politics of power will continue to energise the public in a way that many other issues would not, due simply to the universality of electricity in modern society. As the process of restructuring the power sector continues, the same debates about reorganisation, privatisation, self-sufficiency, tariffs, and sovereignty – the real power politics – will continue to plague governments in the future. Electricity in the Baltic air indeed.

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