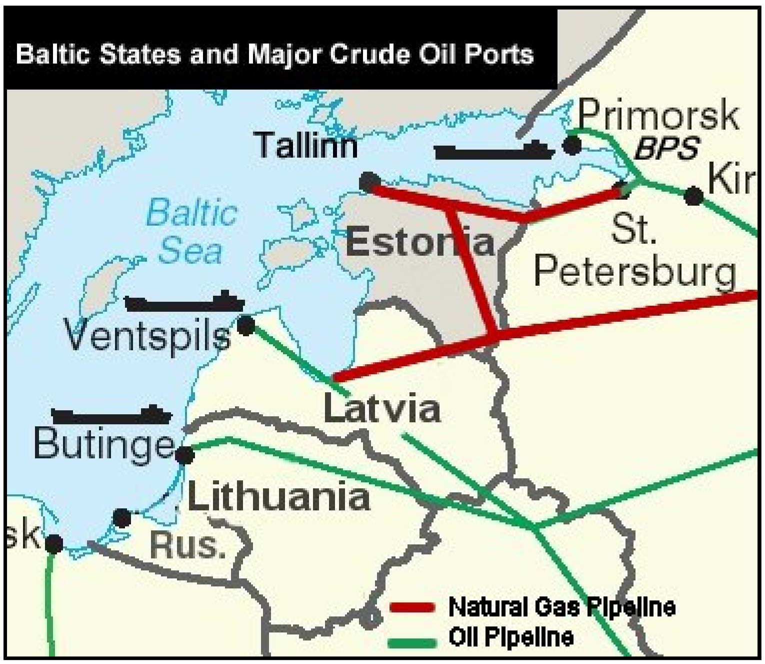
March 2005

Baltic Sea Region

Although only minor energy producers and consumers, the Baltic states--including Estonia, Latvia, and Lithuania--occupy a strategic location as transit centers for Russia's northern oil exports.

Note: Information contained in this report is the best available as of March 2005.



GENERAL BACKGROUND

Alone among the former Soviet republics, the Baltic Sea region states of Estonia, Latvia, and Lithuania were quick to adopt market economies and to implement democratic reforms. As a result, they have mostly avoided the economic and political crises that have beset other regions in transition from a centrally planned economy, including the Balkan region and southeastern Europe. Privatization in the Baltics is nearly complete, and in 2004, despite the slowdown in the global economy, the three countries posted an average 6.6% increase in their real gross domestic product (GDP).

With a combined population of only 7.1 million people, Estonia, Latvia, and Lithuania have achieved greater presence in the international community by joining forces in a number of political and economic arenas. In 2004, after years of preparations, Estonia, Latvia, and Lithuania joined the North Atlantic Treaty Organization (NATO) as well as the European Union (EU). Membership in NATO and the EU has been a stated foreign policy goal in each of the three countries since they became independent.

REGIONAL ENERGY ISSUES

Although the Baltic states are not significant energy consumers or producers, together they occupy a key transit location for Russian oil exports. The Russian crude oil pipeline system is connected to three ports on the Baltic Sea: Latvia's port of Ventspils (completed in 1961); Lithuania's port of Butinge (completed in 1999); and the Russian port of Primorsk (completed in 2002). These three ports transited roughly 1.1 million barrels per day (bbl/d) of crude oil in 2004, or roughly 16% of Russia's net crude oil exports. Smaller quantities of crude oil, as well as significant quantities of petroleum products, are also distributed via rail to other Baltic ports, such as Tallinn or Kaliningrad.

With the completion and upgrades at Butinge and Primorsk, export capacity in the Baltic region has nearly doubled since 1999 (detailed below). Because virtually all of the oil exported through these ports comes from the Russian pipeline system, competition among the regional players has been fierce, and the distribution of market share has changed dramatically in recent years. As a result, Latvia and Lithuania have been compelled to compete with Russia's own Transneft-operated export route at Primorsk. Crude oil shipments from Ventspils and Butinge have fallen drastically as a result.

Baltic Sea Region: Major Crude Oil Ports

Ventspils (Latvia)

TABLE 1: Major Baltic Sea Port Oil Shipments

Terminal	Country	2004 Capacity (bbl/d)	2004 Flows (bbl/d)	Type	Ice-Free Days	Expansion
TALLINN	Estonia	350,000	328,000	Fuel Oil	365 (about 350 during 2003)	During 2004 added extra rail links, jetties
VENTSPILS	Latvia	400,000	146,000	Crude/Products	365	New Rail terminal in 2004 allowed it to expand from 300,000 bbl/d
BUTINGE	Lithuania	160,000	145,000 (2005F: 105,000)	Crude/Products (at Klaipeda)	365	Planned expansion to 280,000 bbl/d, Klaipeda expansions for crude oil export planned
PRIMORSK	Russia	1,000,000	880,000*	Crude (considering light petroleum products)	210	Transneft lobbying for 1.25m bbl/d, Expanded from 2001 level of 240,000

*Sources: Reuters, WMRC, EIA, NEFTE Compass, Transneft.ru -- *Primorsk flows are for Jan-Nov 2004*

Before the recent expansion of export capacity in the Baltic region --led by the construction of Russia's Primorsk facility (see below)-- Ventspils was the largest port in the Baltics and the second largest oil export terminal for Russian crude after the Black Sea port of Novorossiysk. In late 2002, the Russian pipeline monopoly, Transneft, stopped deliveries of crude oil to Ventspils following the completion of its own port of Primorsk. Having been left without a source of oil, authorities at Ventspils undertook an effort to increase shipments of crude oil and petroleum products delivered by rail. During 2003 and 2004, this effort has reportedly served to mitigate some of the losses owing to the absence of Russian crude oil, and in 2004, the port exported roughly 215,000 bbl/d of oil (total), roughly one-third less than pre-embargo averages. Ventspils has, however, lost significant market share, and has exposed its balance sheet to greater risk as petroleum products and rail-borne crude oil are more expensive than crude delivered via pipeline and carry slimmer profit margins.

The future of Ventspils remains uncertain. The two primary owners are the Latvian government (38.6%) and a private concern, Latvijas Naftas Tranzits. Press reports in early 2005 indicated that the Latvian government planned on divesting its share of the port. Several firms from around the world have expressed interest in acquiring a stake in the port's management, including Russia's Transneft and Rosneft, the Russian-UK joint venture TNK-BP, Kazakhstan's Kaztransoil, and the U.S. investment company BroadStreet Group. Most recently, the Russian company Surgutneftegaz expressed interest in the port. The ability of Ventspils shareholders to secure a reasonable selling price and to award a tender will be largely determined by the future of Russian pipeline deliveries to the port. They hope to conclude talks by mid-2005.

Butinge (Lithuania)
Although considerably smaller in terms of capacity, Lithuania's port of Butinge exported slightly more oil in 2003 than the port of Ventspils. This is because Butinge has enjoyed considerably better relations with its Russian suppliers than has Ventspils since 2002 when Russian oil major Yukos became the port's largest shareholder. In 2003, Butinge underwent significant expansion and exported roughly 230,000 bbl/d of crude oil. Port authorities plan to increase throughput to 260,000 bbl/d next year while also increasing storage capacity, thereby ensuring a stable supply of crude oil during inclement weather. However, Butinge did not handle any oil shipments in January 2005 after a hurricane hit the country. In 2004, Butinge recorded a 32 percent drop in the volume of operations to 7.2 million tons.

Lithuanian petroleum concern Mazeikiu Nafta, which is controlled by Russia's Yukos, revised its 2004 forecast for crude oil exports via its Butinge terminal down 23% from an original 13.01 million tonnes (200,000 bbl/d) It shipped 10.72 million tonnes in 2003, 76% more than in 2002. Yukos supplies around 45% of the crude handled by the terminal.

The port of Butinge is one part of a larger Lithuanian oil and gas complex including the Mazeikiu Nafta refinery and a pipeline system connecting the complex to Russia and to Latvia. The refinery owner's two main shareholders are the Russian oil major Yukos (53.7%) and the Lithuanian government (40.66%). Butinge was designed with both import and export capabilities, giving the Latvians the option to import oil should Russian supplies be disrupted. The smaller Klaipeda port can handle tankers that are approximately 90,000 tons and handles mostly petroleum products

Tallinn (Estonia)
The Estonian port of Tallinn depends on rail routes for all of its crude oil and products receipts. Of all the Baltic Sea ports, Tallinn had the largest year-on-year increases in fuel oil export levels, boosting exports by 4.168 million tons, to 16.338 million tons, in 2004. The Baltic Sea port's main export terminals, Estonian Oil Services (EOS), Pakterminal and Eurodek, all added extra rail links and jetties, providing a greater outlet for Russian fuel oil exports. The Tallinn port complex incorporates four large ports: Muuga, Old City Harbor, Palyasaare and Paldiski. During early 2003, the port encountered some icing problems and traffic became congested. Economic shipment of products depends on the availability of large tankers, yet most of those tankers do not have ice-breaking capabilities. Tallinn also exports coal from Russia, and during 2004 it exported 2.276 million tonnes, an increase from 1.825 million tonnes in 2003.

Primorsk (Russia)
The port of Primorsk came online in December 2001 along with Russia's Baltic Pipeline System (BPS), which carries oil from Russia's West Siberian and Timan-Pechora oil provinces westward to the Russian Gulf of Finland. Significant expansion took place over the course of 2003, and by the end of the year throughput had reached approximately 600,000 bbl/d, making Primorsk the Baltic region's busiest port. In 2004, crude oil flows reached an average of 880,000 bbl/d (see Table 1). Transneft, the state-owned Russian crude oil pipeline operator, is planning to add a product export terminal designed to handle between 100,000 bbl/d and 120,000 bbl/d of petroleum products. Primorsk's operators also have plans to expand its crude oil export capacity from 1 million bbl/d to 1.2 million bbl/d by the end of 2005.

Since Primorsk is wholly owned and operated by Transneft, the state monopoly, Russian crude oil that traditionally moved through the Baltic states has been re-routed to Primorsk. Russian authorities have stated publicly that when allocating the country's exports, precedence will be given to sea ports in which Russia has a stake over foreign ones; in other words, Primorsk over other Baltic ports. (For more information on Russian oil exports see EIA's Russia Country Analysis Brief)

Oil: Market Dynamics
The countries of the Baltic region are net oil importers, depending on Russia for approximately 90% of their supply. In 2004, regional domestic production totaled roughly 20,000 bbl/d, with Lithuania producing roughly 14,000 bbl/d and Estonia producing around 6,000 bbl/d. Most of Estonia's oil production comes from oil shale. Latvia produces no oil domestically and is entirely dependent on imports.

Lithuania's 263,000-bbl/d Mazeikiai refinery is the only refinery in the Baltics region, and it is the country's largest revenue generator. The Mazeikiai refinery sells its products in Lithuania and Estonia and is jointly owned by the Lithuanian government and Russia's Yukos oil company. Since the start of the Yukos 'affair', the Lithuanian government has considered buying out Yukos' remaining stake in the refinery. The refinery underwent modernization in September 2003 enabling it to produce higher-grade gasoline compliant with EU standards. The Baltics region also imports petroleum products from Russia that are marketed at filling stations branded by Russian oil major LUKoil.

Natural Gas: **Market Dynamics**
The countries of the Baltic region are entirely dependent on natural gas imports to meet their domestic consumption needs. The Baltic countries produced no natural gas in 2001, while consuming a total of 202 billion cubic feet (bcf). Natural gas imports come mostly from Russia and are handled by Russia's natural gas monopoly, Gazprom, and its subsidiaries. Gazprom holds long-term supply agreements with each of the Baltic states and maintains a favorable relationship with them due to their importance as transit states. Gazprom plans to raise natural gas tariffs from the current price of around $80-$85 per thousand cubic meters to be more in line with European prices (around $120-135 per thousand cubic meters). Gazprom plans to gradually increase the tariffs depending on the pace of the Baltic region's economic development.

Gazprom is also increasingly becoming an owner of natural gas utilities in the Baltic region. Gazprom holds a 34% stake in Latvia's Latvijas Gaze and a 37% stake in Estonia's Eesti Gaas (along with other major foreign shareholders, Germany's Ruhrgas and Finland's Fortum). Most recently, in January 2004, Gazprom finalized its acquisition of a 34% stake in Lithuania's natural gas company, Lietuvos Dujos. After the three Baltic states' entrance into the European Union in May 2004, Gazprom's growing influence in the Baltics will likely serve as a staging ground for greater exports to the countries of the European Union. Also, the development of the North Trans-Gas pipeline, a natural gas pipeline running from Russia to Europe via the Baltic Sea, would give Gazprom an even larger role as the EU's dominant supplier.

Some of the Baltic states have plans for or have already undergone natural gas market liberalisation. Lithuania began a two-stage privatization program for its state-owned natural gas company that resulted in the partial divestiture of the utility in January 2004. A German consortium (E.ON - Ruhrgas) and Gazprom own each own 40% stakes in the utility. Natural Gas prices in Lithuania have been partially deregulated, although most transmission and distribution tariffs are set by the state and prices set for regulated consumers are based on their planned consumption values.

Currently, Latvijas Gaze has a virtual monopoly on the import, transmission, and distribution of gas in Latvia; this situation should not change until market liberalization is slated to begin in 2007. Gazprom supplies a large portion of the country's gas, accounting for more than 80% of Latvia's natural gas imports. Gazprom will remain the country's primary gas supplier because of a long-term supply deal between Latvian Gaze and Gazprom.

Electricity: Market Dynamics

Estonia and Lithuania are net electricity exporters, sending their surplus to neighboring Latvia and parts of northwest Russia. In 2004, Estonia generated 8.9 billion kilowatts (bkwh) of electricity, the majority of which came from the country's Narva oil shale-fired power plants. During March 2005, the Estonian government proposed the initial public offering of its state electricity company, Eesti Energia. Although the company is valued at around $441 million, investment banks in Estonia doubt the government will follow through with its plan because the company is highly profitable.

Lithuania generated 19.8 bkwh in 2004, of which a majority came from the country's Soviet-era Ignalina nuclear power plant. The Lithuanian government plans to close the Ignalina plant in two stages beginning in 2005 and ending in 2009. Although Lithuania has agreed to the shutdown of its nuclear facilities under strong safety concerns from the EU and over $1.5 billion in foreign aid, the country has indicated its interest in developing a new nuclear facility. The proposal has received support from Estonia, which will see its environmentally hazardous oil shale-fired electricity generation decline over time under EU environmental policies. Importation of nuclear electricity from Lithuania would then serve as an alternative to imports of natural gas from Russia.

Latvia is the region's only net electricity importer, buying from other Baltic states as well as from Russia. The country has some hydroelectric facilities, but in a dry year is estimated to be only 60% self-sufficient. Latvia is working with Estonia and Finland to develop the "Estlink" project, a 43-mile underwater cable linking the Baltic states to the Scandinavian and Nordic power grids. Estlink will be a direct current cable between the Harku 330 kV substation (in Estonia) and the Espoo 400 kV substation (in Finland). "Estlink" is designed to reduce regional dependency on Russia, and is expected to be completed by late 2006. ABB was selected in February 2005 to design, build, and lay, the high-voltage and undersea cable.

Table 2: Baltic Region- Energy Statistics (2004)				
OIL				
Country	Reserves (million barrels)	Production (th. bbl/d)	Imports (th. bbl/d)	Consumption (th. bbl/d)
Estonia*	0	6	54	60
Latvia	0	0	47	47
Lithuania*	12	14	93	107
*Estonia's production is in the form of oil shale, Lithuanian crdue oil production = 7.8 th. bbl/d				
NATURAL GAS				
Country	Reserves (Tcf)	Production (bcf)	Imports (bcf)	Consumption (bcf)
Estonia	0	0	50	50
Latvia	0	0	62	62
Lithuania	0	0	110	110
COAL *(mmst)*				
	Recoverable Reserves	Production	Imports (Prod'n = 0)	Consumption
Estonia	0	0	1	1
Latvia	2	0	0	0
Lithuania	4	0	0	0
ELECTRICITY				
Country	Capacity (GW)	Generation (Bill. kwh)	Consumption (Bill. kwh)	
Estonia	3.3	8.9	6.4	
Latvia	2.2	4.4	5.5	
Lithuania	5.8	19.6	11.6	
Source: WMRC, Oil and Gas Journal				

Sources for this report include: Agence France Presse, Baltic News Service, The Baltic Times, BBC Former Soviet Union Monitoring Unit, CIA World Factbook, US Department of Commerce's Central and Eastern Europe Business Information Center, Deutsche Presse-Agentur, Dow Jones, US Department of Energy, US Energy Information Administration, Environment News Service, Estonian News Agency, The Financial Times, FSU Oil and Gas Monitor, Global Insight, Interfax News Agency, ITAR-TASS, Nefte Compass, PAP Polish Press Agency, PR Newswire, Radio Free Europe/Radio Liberty, Reuters, RosBusinessConsulting Database, Russian Business Monitor, Russian Economic News, Russian Oil and Gas Report, Stratfor, US Department of State, The St. Petersburg Times, and World Markets Research Center.

LINKS

For more information from EIA on the Baltic Sea Region, please see:

EIA: Country Information on Estonia
EIA: Country Information on Latvia
EIA: Country Information on Lithuania

Links to other U.S. government sites:
U.S. Agency for International Development
CIA World Factbook
U.S. Department of Commerce, Central and Eastern Europe Business Information Center (CEEBIC)
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Interfax News Agency
Oil Shale: A Scientific-Technical Journal (Estonia)
Port of Kaliningrad
Regional Environmental Center for Central and Eastern Europe
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United Nations Framework Convention on Climate Change and the Kyoto Protocol

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