

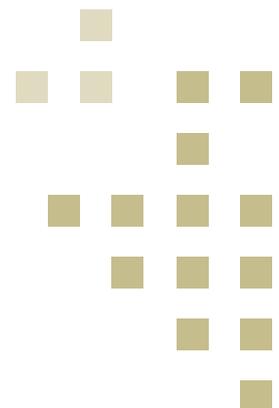


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Political Priorities and Economic Interests in Russian–Latvian Relations

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Political Priorities and Economic Interests in Russian–Latvian Relations

Andris Spruds

[Abstract] The paper focuses on interaction of political and economic aspects in Russian-Latvian relations. During the most of the 1990's, the relationship was dominated by the «conflict manifestation,» which could be witnessed during the protracted Russian troop withdrawal and mutually irreconcilable positioning over NATO expansion and status of Russian-speaking population. However, in the context of EU enlargement and «economisation» of Russian foreign policy, economic factors may play an increasingly important role in Russian-Latvian relations. It is possible to discover a complex web of links and economic interdependence between economic actors in both Russia and Latvia. This especially refers to transit as Latvian ports remain among the major routes of Russian exports, primarily oil, to Western Europe. Yet, certain interests of particular economic groups in Russia as well as economic and political priorities of Russian government generally, in the region and domestically will have influence, not necessarily favourable, on further development of this economic interdependence.

POLITICAL PRIORITIES AND ECONOMIC INTERESTS IN RUSSIAN–LATVIAN RELATIONS

Introduction

The interaction of political and economic aspects influences a state's domestic policies, its behaviour on the international stage and relations with other countries. Economic co-operation and conflict can strengthen and improve or, on the contrary, weaken and aggravate interstate relations established in the political domain. The economic factor especially may play an important role in relations that might be characterised as politically strained and unfriendly, such as those between Russia and Latvia during the last decade. After the break-up of the Soviet Union Russia sought to establish a patron–client relationship with its former territories, including the Baltic states. The success of this political project was substantially influenced by the degree of economic dependence of the new states on their former centre. Economic dependence, described by Keohane and Nye as “a state of being determined or significantly affected by external forces,” provides leverage for the stronger state to manipulate with and, if necessary, impose costs on the client state. Economic interdependence, which “refers to situations characterised by reciprocal effects among countries or among actors in different countries”, provides mutual reciprocity and might contribute to looking for means to ease political tensions between the parties. Thus, economic interdependence can be beneficial to respecting each other politically and aspiring to improve those relations. However, tense political relations may also promote aspiration to intentionally reduce economic interdependence.¹

Hence, analysing Russian–Latvian relations, it is necessary to reveal what are the Russian political priorities regarding Latvia, what is the degree of the latter's economic dependence on or independence from Russia, and what is the intensity and scope of mutual interest in economic co-operation and trade. It is also important to pose the question of how economic relations are influenced by, interact with, and, eventually, shape the political relations.

The first section of the paper outlines the dynamic and major problems in Russian–Latvian relations by 2001. The two subsequent parts highlight general tendencies in Russian–Latvian economic relations and reveal the role transit issues play in promoting the networks of mutual interdependence. The two following sections shed light on how political and economic interests interact in Russia, particularly with respect to the Baltic countries, including Latvia. The final part of the paper analyses the political and economic rationale behind and implications of the new Russian transit project with a prospective oil terminal in the Finnish Gulf.

Russian–Latvian relations: from geopolitics to geo-economics

Russia's support was essential for Latvia and other Baltic republics to obtain independence and international recognition in 1991. Yet, the tactical partnership came to an end immediately after the national leaders ensured dominant positions in their respective countries. Actually, after Russia assumed the status of the legal successor of

¹ Keohane, Robert O., Nye, Joseph, *Power and Independence: World Politics in Transition* (Boston: Little, Brown and Company, 1977), 8; Cichock, Mark A., “Interdependence and Manipulation in the Russian–Baltic Relationship: 1993–97” in *Journal of Baltic Studies*, No.2 (1999), 89–90.

the Soviet Union, Russia and the Baltic states, now as sovereign countries, had to resolve all those disagreements and problems that existed between the imperial centre and its periphery.

The Russian troop withdrawal from Latvia, Estonia and Lithuania stood as an immediate security problem, the solution of which was of an inordinate symbolic importance for Baltic independence. Although the Russian and Latvian governments in February 1992 agreed to address and settle the issue of Russian troop withdrawal, the process was soon intermingled with and complicated by other factors. The governments largely strove to establish a new identity, and to manifest and legitimise national aspirations and concerns internationally. Russia required of the Latvian as well as Estonian governments that citizenship be granted to all residents living in these Baltic countries. The Russian military sought to retain military bases on the territory of the Baltic countries and particularly the Skrunda early-warning radar site in Latvia. Concomitantly, Latvia repeatedly rejected to link troop withdrawal with other issues and appealed to the international community for assistance to end the “protracted occupation”. Eventually, after prolonged discussions and active involvement of international organisations and Western countries, Russia withdrew its armed forces from Lithuania by 31 August 1993 and from Latvia and Estonia by 31 August 1994. According to the agreements, which Latvia signed with Russia on 30 April 1994, Russia was entitled to use the Skrunda radar installation until 31 August 1998 with subsequent dismantling completed by 29 February 2000.²

To Neil Melvin the withdrawal of the troops was a sign that the Russian government once more recognised the independence of Latvia, Estonia and Lithuania.³ Yet, the period between 1991 and 1994 had revealed the disparity of power and problems left by the Soviet legacy as well as had a substantial formative influence on the future relations between Russia and Latvia. Russia strengthened perceptions in Latvia that it had retained imperialistic ambitions on various occasions, above all by its activities and official statements with respect to the so-called “near abroad”.⁴ The Russian Foreign Policy Concept, published in January 1993, strongly stressed the importance of geopolitical dictates. The Concept clearly located the post-Soviet space within Russia’s zone of interests by calling for more active promotion of integration and inadmissibility of foreign powers in the region.⁵ The Military Doctrine, adopted in November 1993, indicated that Russia would reserve the right to use military force if the rights of Russian citizens in other countries were violated, military facilities located abroad attacked or military blocs harmful to Russian security interests expanded.⁶ During discussions on the Russian Military Doctrine in May 1992, the Chief of the Russian Military Academy, General Igor Rodionov, announced that the Baltic countries must remain neutral or

² Bungs, Dzintra, “Russia Agrees to Withdraw Troops from Latvia” in *RFE/RL Research Report*, No.22, 3 June 1994.

³ Melvin, Neil, *Russians beyond Russia: The Politics of National Identity* (London: Books International Incorporated, 1995), 93.

⁴ Russian Foreign Minister Andrei Kozyrev in his official statement, which was published in *Izvestia* on 2 January 1992, used the term “near abroad” for the first time. He referred to the neighbouring countries of Russia as “something that could probably be called the “near abroad””.

⁵ *FBIS Report: Central Eurasia. Foreign Policy Concept of the Russian Federation*, 25 March 1993, 4–6.

⁶ *Rossiiskie Vesti*, 18 November 1993.

friendly to Russia, or otherwise anticipate use of military force by Russia.⁷ This was a revealing reminder, especially for the Baltic countries, of aspirations within the Russian political elite to establish patron–client relations with the former Soviet republics.

During the initial period of relationship Russia and Latvia alongside Estonia and Lithuania tended to avoid tackling the common problems in bilateral relations, instead appealing to international organisations and other states to achieve the respective foreign policy goals. Knudsen and Neumann have termed this policy “conflict manifestation”, the implicit strategic goal of which has been to attract the attention of and obtain support from other states by expressing explicitly security concerns and interests on the international level.⁸ This approach largely stemmed from and at the same time underlined and strengthened the Latvian aspirations to fully integrate with Western institutions, which had become one of the major priorities of the Latvia’s “return to Europe”.

In the mid-1990s Latvia submitted its applications for membership of the European Union and NATO. Particularly, the dynamics of NATO enlargement, complemented by the disputed status of the Russian-speaking population, now became a significant factor in Russian–Latvian relations. Russia’s assertive and vigorous objections to a potential NATO enlargement sharpened and contributed to the Latvian security and insecurity notions, with Russia being posited as a source of the latter. At the same time, Latvia could utilise the Russian rhetoric as a foreign policy instrument in order to attract international attention, promote the quest for security and justify domestic and external policies in general. However, the Latvian leadership eventually reduced the previously extensively invoked historical and moral symbolism and demonstrated willingness for a more co-operative approach with respect to Russia in order to press forward with the prospective EU and NATO membership. Following Estonia, Latvia in 1997 ceased to insist on Russian acknowledgement of the 1920 peace treaty and consequently withdrew its demands for return of the appropriated eastern Latvian territories. By 1997 the Russian leadership also became increasingly aware of the importance of avoiding actions that might be interpreted as threats to the Baltic states. The “conflict manifestation” was gradually supplemented by what can be labelled as a manifestation of dialogue.

In February 1997 the Russian President signed a document on the long-term strategy of Russia towards the Baltic countries, the objective of which was “the full realisation of the potential friendliness between Russia and the Baltic states [and]... the establishment of a constructive model of relations”.⁹ The adoption of the official “Baltic policy” indicated a certain shift from a reactive to a more active policy. The strategy, on the one hand, once more clearly expressed Russia’s objections to Baltic NATO membership. On the other hand, it also revealed Russia’s readiness to embark on a more subtle policy by combining economic levers and the issue of the Russian-speaking population to influence the relations with and the situation within the Baltic states. Russia proposed confidence-building measures and unilateral security guarantees to the Baltic states. Although the governments of the Baltic states flatly rejected the guarantees justifiably considered as a response to the prospective US-Baltic Charter and primarily

⁷ Brusstar, James H., “A Challenge for American Policies. Russian Vital Interests” in *Strategic Forum*, No.6 (1994).

⁸ Knudsen, Olav F., Neumann, Iver, *Subregional Security Cooperation in the Baltic Sea Area*, Research Report no. 189 (Oslo: NUPI, 1995), 13.

⁹ *ITAR-TASS*, 11 February 1997.

aimed at the international audiences, Russia continued to follow the recently adopted subtler foreign policy towards the Baltic states. This policy also became gradually “economised” as was revealed by the tensions in Russian–Latvian relations in 1998.

The 1998 default of the Russian economy further underlined and contributed to the importance of the economic factors.¹⁰ The new Russian Security and Foreign Policy Concepts, endorsed during the leadership of Vladimir Putin in 2000, have revealed an “economisation” of Russian foreign policy, thereby reflecting a shift from an explicit geopolitical thinking towards a more geo-economic approach.¹¹ Russia is increasingly interested in the European Union enlargement issues, especially such aspects as transit, the status of the Kaliningrad region, investments and access to the markets. As far as Latvia and other Baltic states are concerned, Russia seeks to ensure favourable conditions for Russian business, to support Russian companies’ positions in strategically important branches, such as the energy and transit sectors, and to promote the fulfilment of specific Russian economic interests.

Economic relations between Russia and Latvia: shifting and enduring patterns

In the former Soviet Union, the economies of the republics were closely connected with each other through links that were firmly controlled by Moscow. Having abandoned the centrally planned economy after the dissolution of the Soviet Union, the Baltic countries and Russia developed new modes of production and trade. Latvia alongside Estonia and Lithuania was re-orientating links of industrial and agricultural production and trade away from the post-Soviet space. Both political rationale and economic necessities initiated this reorientation of economy. Latvia was politically inclined to weaken any links with the former empire in order to strengthen newly obtained independence and consequently shape the new identity of the state, and develop a Western orientation. Economically, many industrial establishments previously closely connected with the Soviet production system and market became insolvent. The enterprises and growing number of private producers looked for more profitable Western markets. This situation determined that patterns of Latvia’s trade with Russia and other former Soviet republics shifted dramatically since the break-up of the USSR. In 1991, 96.8% and 87.2% of Latvia’s export and import, respectively, was related to the former Soviet Union with Russia making up the largest share.¹² In 1992, Russia’s share of the Latvian trade balance decreased to 26% and 28%, respectively, in Latvia’s export and import. The initial substantial decline was followed by a gradual decrease in the ensuing years. The 1998 economic crisis in Russia and tensions in Russian–Latvian relations had a further impact

¹⁰ Both official representatives and think tanks already expressed recognition of the strong significance of economics before. For example, Boris Berezovski, becoming a CIS executive secretary on 29 April 1998, stated that, “Private capital is the only force capable of strengthening the CIS”. See *ITAR-TASS*, 29 April 1998.

¹¹ Edward N. Luttwak, in his article “From Geopolitics to Geo-Economics: Logic of Conflict, Grammar of Commerce”, first published in *The National Interest* in 1990, described “geo-economics” as “the admixture of the logic of conflict with the methods of commerce”. The term also finds increasingly frequent expression and interpretation in Russian political science discipline. As Lapkin and Pantin have pointed out, geo-economics are about “economisation of politics” and “politicisation of economics”. See Lapkin, Vladimir, Vladimir Pantin, “Geoekonomicheskaya politika: predmet i ponatiya (K postanovke problemi)” in *Polis*, no.4 (1999), 48.

¹² *Latvijas Statistikas Gadagramata 1991* (Riga: Avots, 1992), 49.

on reducing trade between Latvia and Russia. In 1999, Latvia's exports to Russia and other CIS countries declined by 40% compared to 1998, with the most significant decrease in exports of machine building and food products.¹³ Although after stabilisation of Russian economy Latvian imports from Russia increased in 2000, the volume and share of Latvian export commodities to Russia decreased even further.

Table 1. Latvia's trade balance with Russia (thousand Lats* and share in external trade balance)

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Export	148,737	200,105	155,719	174,400	181,603	203,587	129,007	66,412	47,300
%	26	29.6	28	25	23	21	12	6.6	4.2
Import	150,825	181,941	164,178	208,300	258,416	246,946	221,290	180,971	224,50
%	28	28.5	24	22	20	16	12	10.5	11.6

* 1 Lats is approximately 1.7 USD

Sources: *Latvian Ministry of Economy, Central Statistical Bureau*

However, as this table to some extent already reveals, the focus on decrease of Russia's share in the Latvian external trade balance obscures certain specifics of the situation. The Western countries alone could not provide markets for all Latvian export products, especially agricultural products. Under these conditions, the markets of the former Soviet republics and, primarily, Russia still continue to be important for Baltic producers. After the recovery from the 1998 economic crisis Russia's share in Latvian export has increased both proportionately (from 10% in 1999 to 11.6% in 2000) and in value (by 24%). Whereas the Latvian share in Russian trade balance is rather small, accounting for 1–2%, Russia is still a second largest trading partner of Latvia after Germany with 9% of the total foreign trade turnover.¹⁴ Despite a deteriorating trade balance with Russia, Latvia largely depends on import of Russian energy resources. More than 50% of Russian export to Latvia consists of energy resources (natural gas, electricity, fuel) and Russian natural gas accounts for 25% of Latvia's energy supply.¹⁵

Thus, although on the whole Latvia has successfully adapted its economy to Western markets, Russia remains rather important for the Latvian economy in terms of access for some Latvian goods, especially food products and textiles, to Russian markets and, most importantly, by providing energy resources. A certain linkage between the Latvian and Russian economies was revealed by the 1998 economic crisis in Russia that had a rather damaging impact on the Latvian economy in terms of reduced production, decreasing trade profits and increasing unemployment. Additionally, financial damages to Latvian banks and a reduction of foreign investment contributed to a substantial slow-down in Latvian economy immediately after the crisis.¹⁶ Interest in economic and political developments in the neighbouring countries, however, exists mutually. This can be discerned by analysis of transit issues.

The Latvian transit corridor and interdependence

The Latvian ports have historically played a considerable role in Russian trade. Already in 1913, the Latvian ports Riga, Liepaja and Ventspils accounted for 24.5% of Russian

¹³ *Economic Development of Latvia. Report by Latvian Ministry of Economy* (Riga, December 2000), 30.

¹⁴ *Economic Development*, 32.

¹⁵ *Energy Overview of Latvia*, (2000), at www.eia.doe.gov

¹⁶ *Latvijas Vestnesis*, 19 January 1999.

foreign trade turnover. During the Soviet time, the infrastructure was developed further, strengthening links between the Russian central regions and Baltic seaports, among which the Ventspils port became an absolute leader in transshipment of freight. In the record-setting year 1983, the port shipped 38,196,000 tons of cargo, including 34,318,200 tons of crude oil and oil products. After the break-up of the Soviet Union, a reduction of the freight amount conveyed through the Baltic Sea occurred, caused by disruption in transmissions among former republics and a considerable drop in production in Russia.¹⁷ Nevertheless, the Baltic ports retained an extensive amount in Russian maritime trade transshipments, which proportionately even increased from 35% in 1990 to 45% in 1997.¹⁸ The Latvian ports Riga, Liepaja and especially Ventspils play an important role in Russia's export of minerals, chemicals, metals and especially oil products.

Table 2. The turnover of Eastern Baltic ports (million tons).

Seaports	1993	1994	1995	1996	1997	1998	1999	2000
Ventspils	22.4	27.7	29.6	35.7	36.2	36.0	34.1	34.7
Riga	4.7	5.9	7.4	7.4	11.5	13.3	12.0	13.3
Liepaja	0.5	1.1	1.4	1.6	2.3	2.3	2.3	2.9
Tallin	12.5	12.0	13.0	14.0	17.1	21.4	26.5	29.3
Klaipeda	15.9	14.5	12.7	14.8	16.1	15.0	15.7	19.3
St Petersburg	10.0	14.0	17.1	16.0	20.6	21.6	28.2	32.4
Kaliningrad	3.8	2.5	4.6	5.4	5.9	4.4	4.1	4.3
Helsinki	8.2	9.7	9.3	N/a	N/a	10.9		

Source: *Klaipeda port services*

Latvia is the leading Baltic state in transit of Russian oil, which accounts for around 60% of all transit through Latvia. Ventspils port, which is the twelfth largest port in Europe and the most modern oil export port in the Baltics, is a leader in transit of Russian crude oil and oil products. Annually 13–15% of all Russian oil and about 30 % of Russian oil exported to the West (mostly Finland, Germany, the Netherlands, Great Britain, Belgium) has been transported through Ventspils. Ventspils port has been only second after the Novorosiisk port in terms of transported volumes of Russian crude oil and oil products. In 1998, almost 500 barrels of crude oil and oil products were transported per day through Ventspils.

Other Latvian ports, such as Riga and Liepaja, have seen an increase of the amount of transported Russian oil as well as other Russian products. Latvia has profited substantially from the oil transit. In 1997, for example, transit of Russian oil products gave almost 160 million USD profit to the country.¹⁹ As an estimated one-fourth to one-fifth of Latvia's GDP has been linked directly to transit and the related branches of the economy, Latvia has a strong interest in retaining and expanding the transit through its territory.²⁰ It is also not surprising that Latvian ports and infrastructure attract the largest

¹⁷ For instance, oil production in Russia has decreased from 461 million tons in 1991 to 305 million tons in 1999.

¹⁸ Nyberg, Rene, "A Study in Interdependency. Russian transport needs and economic development in the Baltic Sea area" in *Kungl Krigsvetenskapsakademiens Handlingar och Tidskrift*, No.6 (1997), 142.

¹⁹ *Dienas Bizness*, 13 February 1998.

²⁰ For example, in the year 2000, approximately 80% of shipments by the state-owned Latvian railways company *Latvijas Dzelzceļš* were transit shipments; about 50% (17.69 million tons out of 36.41 million

part of state and private investments. Additionally, investment sources are sought for large development projects such as the Western Pipeline System that aims to increase the flow of oil to Ventspils port. The port has a capacity to operate 500,000 barrels of crude oil per day. The current pipeline system stretching from Polotsk to Ventspils provides 320,000 barrels per day. A substantial portion of oil products has been delivered to the Ventspils port by railway. With the ever-increasing quality and capacity of the Ventspils port facilities, the intention is to increase crude oil transit through Ventspils. For this purpose, in February 1998 several major Latvian oil transit companies, including the largest one, *Ventspils Nafta*, founded a joint stock company in order to implement the Western Pipeline System project. The main goal of this project is to construct an additional pipeline next to the already existing one, extending from Polotsk (Belarus) to Ventspils in order to increase the flows by 360,000 barrels per day by the year 2005. According to the Latvian assessments, implementation of the project would not reduce the oil flow to other existing and prospective ports on the Baltic eastern coast as by the year 2020 a considerably increased consumption of oil products in Europe is expected and extra Russian oil deliveries needed. The estimated costs of the project would be approximately \$500 million and Russian companies are envisaged to be among potential investors and expected to contribute around 40% of the total project financing.²¹ The investors would also be provided with an opportunity to become shareholders of *Ventspils Nafta*. However, soon after the announcement of the project, its execution and the whole Baltic transit problematique were complicated by political tension between Russia and Latvia, economic disagreements, increasing competition between the Baltic ports as well as the intention of the Russian government to develop own transit routes and facilities.

These emerging problems in further strengthening transit links, however, cannot conceal the fact that Russian and Baltic, particularly Latvian, transport and energy infrastructures are firmly interlocked and mutual interest in co-operation remains. The transit through Latvia has been beneficial for the Latvian economy and it has been important and reliable for Russia as export of crude oil and oil products is one of the most valuable sources of profit for the Russian state. Thus, it is possible to discern a rather ramified and complex web of interdependence between transit-related economic actors in both Latvia and Russia.

Russian economic interest groups and transit

Although recently the Russian President Vladimir Putin has aspired to centralise Russian foreign and domestic policy, an absolute consolidation, let alone consensus, would be difficult to obtain. The economic interests of various regions and interest groups have a substantial impact on domestic and foreign policies, especially concerning decisions on specific economic issues.²² The interests of the energy sector companies, which

tons) were oil and oil products mostly shipped to ports. The profits of the company have been estimated to around 2 million lats; *Dienas Bizness*, 9 January 2001. It should be noted that *Latvijas Dzelzceļš* is the largest employer in Latvia.

²¹ As other potential investors are envisaged Latvian companies with 20% of the project expenses, Western, Belorussian and Kazakh companies as well as the European Bank for Reconstruction and Development that would contribute 10% each; Western Pipeline System's website: www.rcs.lv.

²² McFaul, Michael, "A Precarious Peace. Domestic Politics in the Making of Russian Foreign Policy" in *International Security*; Vol. 22, No.3 (Winter 1997/98), 5–35.

contribute significantly to the state revenues, international standing and domestic social stability, are well expressed and supported among the Russian political leadership. The economic and political weight of the oil and gas companies can be assessed against the background that this sector generates 25% of the state's industrial production, 38% of the budget revenues and more than 50% of the overall value of exports.²³ As Alex Pravda has indicated, the immense foreign currency income provided energy sector companies with "an enormous stake in and considerable influence over external economic policy".²⁴ The energy companies in general are supportive of international co-operation with both Western countries, which guarantee the markets, and neighbouring states, which provide the transit routes to these markets.²⁵

Russian oil companies, such as *Lukoil*, *Yukos* and *Onako*, are interested in ensuring a stable transit corridor through the Baltic ports, particularly Latvia. *Lukoil*, which has ambitious plans for a considerable economic expansion outside of Russia, particularly in the East European countries, owns and operates gas service stations and other facilities in the Baltic states. The company, which has been contemplating further investments, has considered involvement in the Western Pipeline System project by investing \$125 million in return for obtaining 25% of the *Ventspils Nafta* shares and 40% of pipeline's company shares.²⁶ The two largest Russian oil companies, *Lukoil* and *Yukos*, have shown also a strong interest in investing in the other two Baltic countries, Estonia and Lithuania. *Transneft-Produkt*, the Russian state-owned oil transportation company, has invested \$61.8 million and possesses 34% of the capital shares of the Latvian-Russian joint venture *Latrostrans* that supervises a pipeline system in Latvia. The Russian gas giant *Gazprom* and *Itera*, allegedly associated to *Gazprom*, own 15% and 9% of *Latvijas Gaze* shares, respectively, and attempt to increase their share. *Gazprom* has invested more than \$15 million in *Latvijas Gaze*. Other Russian companies also reveal interest in investing in the prospective European Union country. It is estimated that approximately 100 Russian companies are participating in business activities in Latvia, by constituting 6.9% of the cumulative foreign direct investment.²⁷ Furthermore, a considerable number of the Russian regions have also established economic cooperation with Latvia.²⁸ Although this underlines the strong interest of Russian economic actors to develop economic relations with Latvia, and the Baltic countries in general, economic interests also exist that are willing to reduce further cooperation. Moreover, the state has its own foreign and domestic economic and political interests that might diverge from other economic interests. The 1998 crisis in Russian-Latvian relations has revealed

²³ Lane, David (ed.), *The Political Economy of Russian Oil* (Lanham: Rowman & Littlefield Publishers, 1999), 2.

²⁴ Malcolm, Neil, Alex Pravda, Roy Allison and Margot Light, *Internal Factors in Russian Foreign Policy* (Oxford: Oxford University Press, 1996), 183.

²⁵ *Business Elites and Russian Foreign Policy. Russia Beyond 2000*, The Finnish Institute of International Affairs, Report No. 5 (2000), 14–17.

²⁶ *Nezavisimaja Gazeta*, 17 February 1999.

²⁷ *Economic Report*, 50.

²⁸ The economic cooperation agreements have been signed between Latvia and the Republics of Sakha, Mari El, Chuvashiia, Karelia, Baskortostan, and the administrations of Omsk and Moscow regions. An intensive trade and interaction take place between Latvia and the bordering region of the Russian Federation, Pskov region.

controversy regarding interaction between political motivation and diverging economic and political interests.

The 1998 crisis in Russian–Latvian relations

Controversy regarding interaction between political motivation and diverging economic interests was revealed already before 1998 as Russia tried to use economic leverage several times to influence politics in the Baltic states, including Latvia. In 1992, in the midst of dispute over Russian troop withdrawal and protection of the Russian speaking population in Latvia, Russian officials were threatening to cut oil deliveries. Eventually, the Russian government abandoned energy deliveries at lower costs to the Baltic states and Ukraine, demanding payment in hard currency. Latvia, in its turn, implemented countermeasures by increasing the transit fee for the pipeline running to Ventspils port. Both countries suffered losses of several ten million dollars, thus proving existing interdependence and revealing the limits of Russian economic sanctions against Latvia.²⁹

The lack of alternative oil transportation routes diminished any intentions to cut off oil export through Latvia. In July 1996, the Russian Duma passed a resolution inviting the President to introduce economic sanctions against Latvia and Estonia for their violation of human rights with respect to the Russian speaking population. Notwithstanding harsh rhetoric, economic sanctions did not come to realisation. Rather quite the opposite, the years 1996 and 1997 demonstrated an increase in trade and transit volumes.

The most conspicuous and strict demands to impose economic sanctions against Latvia followed the Latvian police dispersal of the mostly Russian-speaking demonstrators in Riga in March 1998. A wide spectrum of Russian political parties and politicians called for economic sanctions against Latvia. Moscow Major Yuri Luzhkov, who fiercely castigated the Latvian government and compared the regime in Latvia to Pol Pot's Cambodia, promoted a boycott of Latvian goods in Moscow. To a certain extent, the Russian government followed suit. On 1 July 1998, Russia abandoned preferential tariffs on all railway shipments of goods from and to Latvia. The Russian government also canceled the envisaged meetings of the intergovernmental commission for trade and economic cooperation that was negotiating, among other issues, the agreement on the border demarcation between Russia and Latvia, which has been important for the latter in its EU and NATO membership quest. However, the Russian leadership did not support the law projects calling for wider economic sanctions that were proposed and supported by the Russian State Duma in May and November 1999.

Several factors contributed to the 1998 crisis. It underlined the continuous trend that economic sanctions might be used to distract popular attention from domestic problems and foreign policy drawbacks as well as to gain political assets. Notwithstanding official rhetoric, it also revealed a strong economic rationale in applying political and economic pressure. Alongside Luzhkov, the governors of other regions such as Primorie, Yaroslavl and Saratov regions, were among the most vigorous supporters of a boycott of Latvian goods and even cessation of diplomatic relations with Latvia. Behind politically and morally motivated declarations in support of the Russian-speaking population in Latvia, it was possible to discern the economic interests these regions have in altering economic relations with the Baltic country. Regional lobbying was implicit in

²⁹ Kramer, John H., “‘Energy Shock’ From Russia Jolts Baltic States” in *RFE/RL Research Report*, 23 April 1993, 41–49.

the aggressive stance against Latvia taken by Primorsk governor Yevgenii Nazdratenko, who had been advocating the use of Far East ports rather than Latvian ones for Russian export.³⁰

Although Russian gas and oil companies generally support cooperative relations, they can also temporarily resort to confrontational tools and economic pressure in order to achieve economic concessions. In 1998 Russian companies expressed their disappointment with allegedly high transshipment tariffs as well as a rejection by Latvians to let the Russian companies obtain a controlling share in the major transport company, *Ventspils Nafta*, which motivated the Russian oil companies to resort to a certain pressure on Latvia. However, the political crisis in Russian–Latvian relations in 1998, the support of the Russian companies in defending the rights of the Russian-speaking population in Latvia and recommendations to cut down oil export through Latvia did not cause major disruptions in the transit flow. At the end of 1998 and the beginning of 1999, in order to compensate for low oil prices, Russian companies had to utilise export routes at full capacity. Russia reduced considerably its oil export through Ventspils port only in the second half of 1999, when this became possible due to the growth in oil prices on the world and domestic markets, and also because of the appearance of alternative routes, such as the Butinge oil terminal in Lithuania. The temporary reduction of oil exports remained among a few concrete actions taken against Latvia.³¹ The importance of economic interests largely explained why Russia resorted to economic pressure as well as revealed the limits of this pressure and accounted for the Russian government's reluctance to support all-embracing economic sanctions proposed by the Duma. As a Russian newspaper observed, wide-ranging sanctions against Latvia would trigger a boomerang effect with negative consequences for Russian oil companies such as *Lukoil*, *Sidanko* and *Yukos*.³²

Thus, under certain political and economic circumstances, economic lobbies can invoke a certain political support of the state as revealed by the 1998 crisis in Russian–Latvian relations. The 1998 crisis underlined that several factors, including both political motivation and considerable economic interests, must coincide for the government to implement certain sanctions. Wide-range sanctions would not be beneficial to the political elite and even more so to the economic interests. The 1998 crisis underlined the existence of interdependence between both countries, which in a politically strained atmosphere, however, was increasingly perceived as an undesirable dependence and vulnerability. The 1998 events also revealed that notwithstanding a few exceptions there was no permanent harmony of interests and subsequently a joint strategy of co-ordinating Russian oil export and economic interests in general could only be set forth and implemented by the Russian president and the government.

Towards aggregation of interests: the Baltic Pipeline System

Although an absolute consensus would be difficult to establish, recently the Russian President Vladimir Putin has aspired to centralise Russian foreign and domestic policy. The Russian president and the government are increasingly playing a role in determining

³⁰ Kobrinskaya, Irina, "The Foreign Policy-Decision-Making Process in Russia" in Jakub Godzimirski (ed.), *New and Old Actors in Russian Foreign Policy* (Oslo: NUPI, 2000), 51.

³¹ Export of Russian oil through Latvia increased again in 2000 as compared to 1999.

³² *Segodna*, 5 April 2000.

the aggregation of interests and directing particular economic interests along the general domestic and foreign policy priorities. The Russian political leadership is interested in promoting and co-ordinating economic interests as their profits would add to the revenues of the state and eventually its international standing, which increasingly has been understood and defined in Russia in economic terms. The Russian government is in a strong position to apply leverage on Russian oil companies. It can regulate through the Ministry of Fuel and Energy and the state-controlled pipeline company *Transneft* oil export amounts and schedules. This can be used as powerful tools to keep the state's influence over the oil companies.

A certain aggregation of political and economic interests is being introduced during the interaction between the state and interest groups with respect to the Baltic states and transit issues. Economically, Russia is not interested to sever relations with Latvia. Blatant economic sanctions or freezing economic relations and transit flows have already proved to be counterproductive in economic and political terms, and would be economically unsustainable and unreasonable in the longer-term perspective, especially in the context of a prospective growth of trade between Russia and the European Union. Latvia along with other Baltic states are attractive to influential Russian economic interests. Moreover, the Russian state has invested in the pipelines running through Latvia. At the same time, Russia seeks to multiply the transit opportunities and, especially, develop its own transit routes.

Already in 1993, the government of the Russian Federation decided upon the construction of the Primorsk oil terminal in Leningrad region. The project also envisaged building an additional pipeline system that would extend to the prospective terminal. The Baltic Pipeline System project's feasibility study carried out in 1995 assessed that the overall costs of the project would reach \$2.2 billion.³³ Russian and international companies showed strong interest in the project in 1996. The Russian companies *Transneft*, *Rosneft*, *KomiTEK* and the foreign potential investors *Conono*, *Neste*, *Elf Neftegas*, *Total*, *British Gas* and *Williams International Company* initially came up with a declaration of intent to implement the project. The companies later signed an agreement to co-operate in implementing another feasibility study for construction of the Baltic Pipeline System that would envisage shipment volumes of seven to twelve million tons of oil a year. In 1997, the project received backing from the Russian President, who signed Decree 554 "On Ensuring Freight Transit across the Coastal Territory of the Gulf of Finland" that supported the construction of Primorsk port in the framework of the Baltic Pipeline System. The Presidential Decree was followed by governmental Ordinance 1325 "On Designing, Building and Operating the Single Baltic Pipeline System". Additional feasibility studies were carried out, including one financed by the World Bank and the European Union TACIS programme. The full implementation of the Baltic Pipeline System project is envisaged in three stages, concentrating on building the oil terminal in Primorsk, constructing a 270-km-long new pipeline from Kirishi to Primorsk and modernising the existing 495-km-long pipeline from Yaroslavl to Kirishi. Construction of the Kirishi-Primorsk pipeline was completed in August 2001. According to the plans, a first ship will depart from the terminal on 27 December 2001. The implementation of the project would allow Russia to reduce the estimated \$1.5 billion expenses every year for

³³ Estimated expenses of the whole project range from \$2.2 billion to \$3.5 billion.

exporting oil by transit routes through foreign countries, among which the Baltic route accounts for more than \$500 million annually.³⁴ The new transit routes and port facilities in Russia would also contribute to the development of Russian regions in terms of increased employment and advanced profits. Thus, it is not surprising that Yaroslavl and Leningrad regions, the city of St Petersburg and Karelia, alongside some oil companies, are strongly lobbying to promote the project.

Political factors also play a role in the position and strategy of the Russian government. Economic and political security are closely intertwined, and energy resources and their transit can become a national security priority, especially if the economic partners may be perceived to be contributing to the notion of threat. The issue of transit security influences the feeling of a certain dependency on the Baltic states, which are perceived as rather unfriendly with their national policies and pursuit of NATO membership. The 1998 tensions in Russian-Latvian relations provided the political impetus to start implementation of the project aimed at creating alternative transit routes bypassing the Baltics. On 30 April 1999, Primakov's government introduced an investment tariff of \$1.43 per ton of exported oil by any of the Russian companies in order to provide financial support for the project and start to implement it. *Lukoil* and other oil companies initially rather strongly objected to the transit charges for the Baltic Pipeline System but failed to succeed.

Realisation of alternative transit routes could not only reduce the degree of risks of potential unfavourable consequences of Latvian NATO membership, but also provide an opportunity to manoeuvre in relations with this and other Baltic countries both in economic and political terms. As Irina Busigina, an expert at the European Institute of Russia's Academy of Science has stated, the dependence of the Baltic states on Russia's energy resources and transit is a factor that keeps the former, to some extent, in the sphere of Russian interests.³⁵ Yet, there is also a growing awareness that by obtaining an opportunity to multiply transit routes, Russia would acquire an additional political leverage on the countries, the economies of which are largely influenced by income from the transit of Russian export. Russia increasingly may implement the policy of transit diversification and promote Baltic differentiation by shifting the flow of export across the range of Baltic ports, such as Ventspils, Riga, Liepaja, Klaipeda, Tallinn as well as Gdansk in Poland and Poorvo in Finland. These ports are competing with each other for export of Russian transit goods. Russia has the opportunity to use a stick and carrot policy in both political and economic matters. The Russian government will increasingly be in a position to resort to economic levers by offering rewards rather than coercing or punishing. Thus, the creation of its own transit routes would not only provide Russia with economic profits in the long term, but would arguably also allow to keep some influence on the economics and politics of Latvia in the short-term perspective. Without overestimating the decisive importance of such a Russian policy, however, a number of signs could be discerned to the effect that Russia's stick and carrot policy has already, to

³⁴ *Vnesneekonomicheskii Biulleten* (1998), 89.

³⁵ Busigina, Irina, "Krievija, Baltijas valstis un Eiropas Savieniba" in Talavs Jundzis (ed.), *Baltijas valstis liktengriezos* (Riga, 1998), 481.

a certain degree, been efficient in obtaining certain economic and political concessions and indirectly strengthening Russian influence in the region.³⁶

Conclusions

The dynamics of Russian–Latvian relations reveal a certain shift of emphasis from dominating symbolism related to ensuring security, identity building and protection of compatriots to more pragmatic calculations of economic and political interests, thereby underlining a turn from geopolitics to geo-economics.³⁷ Arguably, at the moment, the issue of the Baltic Pipeline System and alternative routes of Russian transit has become the central and integrating theme of the Russian–Latvian relationship. The project of the Baltic Pipeline System has largely stemmed from a combination of Russian self-asserted national interests, the state's economic interests as well as competing economic interests. Russia is increasingly interested in the European Union enlargement issue. The pending enlargement points to the growing importance of trade, access to markets, investment and particularly transit issues in Russian–Baltic relations. In fact, already now economic relations with the West influence Russia's relation with the Baltic states. One of the consequences of the prospective different timetables for EU enlargement has contributed to the Russian approach to differentiate between Estonia, Latvia and Lithuania, as well as the differences in the policy of the latter with respect to the former. Thus, it could be expected that Russia will further implement a differential policy towards them in the context of EU enlargement and taking into account Russia's willingness to promote competition between the Baltic states. This reveals that economics can involve aspects of co-operation, competition and occasionally even confrontation. Political motivation might have an influence on the particular kind of economic relations implemented.

Russia is willing to develop its own transit system, thereby weakening a perceived dependency on the Baltic ports, and creating a certain vulnerability. Thus, certain political estimations also have played a certain role in the decision-making. One may interpret the decision to embark on the construction of new ports in the Finnish Gulf has revealed implicit recognition that the Baltic states are slipping away from the Russian self-defined interest zone with potential membership in the European Union and NATO. However, a certain economic interdependency will remain because there are many actors interested in it.

This economic interdependency can be beneficial to respecting each other politically and aspiring to improve those relations. However, political relations may still

³⁶ At the beginning of 1999, Jamestown Foundation concluded that Latvian foreign policy decision-making experienced a certain crisis and a shift towards a more pro-Russian policy. The think tank interpreted the interview of a Russian newspaper with the then Latvian Prime Minister Vilis Kristopans as implying that Latvian relations should not be worse than those between Russia and Finland in the past and that Latvia would not become a member of NATO. Although denied by Latvian officials, the foundation made assessments that the economic interest groups in Latvia interested in good relations with Russia had a substantial influence on the position of the Prime Minister, the former Minister of Transportation (*Diena*, 20–22 January 1999). In the middle of 2001, the leftist coalition, which is in power in the capital city, Riga, was advancing the idea about a somewhat separate Riga's foreign policy, which would supposedly be much more accommodating and cooperative towards Russia than the official state foreign policy.

³⁷ In this respect, it was indicative that during the visit of Latvian parliamentarians to Moscow on 19 December 2000, the leader of the liberal democratic party, Vladimir Zhirinovski, supported constructive and pragmatic relations between the two countries (*Biznes & Baltia*, 21 December 2000).

influence as to whether the countries co-operate, aspire intentionally to reduce economic interdependence or resort to pressure. Barry Buzan has identified close interaction between political and economic aspects, “The international economy is just as thoroughly penetrated by state structures and the dynamics of power and security, as the state system is cut through by patterns of production, consumption and class, and by the dynamics of the market. Because of this, both systems can only dance partly to their own tune, the rest of their movement being prompted or constrained by ties to the partner system.”³⁸ In this context, one cannot overestimate the importance of attempts to establish good political relations between Latvia and Russia in order to utilise the economic interdependence in a cooperative way.

³⁸ Buzan, Barry, *People, States & Fear. An Agenda for International Security Studies in the Post-Cold War Era* (New York: Harvester Wheatsheaf, 1991), 232.