report

The Baltic ghost.
Selling out or keeping the Russians out?

A specter is haunting the Baltic States. It appears in different forms and with different names: Air Baltic, Mažeikių Nafta, Lattelecom, Ventspils Nafta, Latvenergo, Estonian Air.

One may wonder whether an evil spell has been cast on the nationalized and public-owned big enterprises, this cumbersome heritage of the Soviet era.

And when a formerly successful private business suddenly goes broke and is saved by the state, its nationalization threatens to pull a whole country and its neighbors down the financial drain, as happened with Parex Bank in Latvia two years ago.

One keyword here is corruption. Another is Russia.

Mažeikių Nafta is perhaps the saddest story of all. Or maybe Latvenergo is. Or Air Baltic. They are all a combination of farce and tragedy.

With their independence in 1991, the Baltic nations inherited enormous state enterprises, built to serve large parts of the Soviet Union, and thus too big for small republics like Lithuania, Latvia, and Estonia. Running the huge industries was often overwhelming for inexperienced governments, while privatization proved to be a financial and judicial quagmire. No wonder it became one of the most sensitive political issues in the Baltics.

As in Russia, the sale of state-owned businesses produced criminally rich oligarchs. In Latvia, Andris Skele was probably the most cunning of the lot. By means of offshore companies, he built up an enormous personal fortune. He became an advisor to the Latvian Privatisation Agency and then rose to Prime Minister, creating the country's most influential business and social network. Together with rival oligarch Aivars Lembergs, Skele was able to control much of the privatization process in Latvia.

And if the problem was not corruption, it was fear of Russian influence.

Mažeikių Nafta was one of the most modern refineries in the oil-rich Soviet Union. After 1991 it became the largest company of any kind in the Baltic states, producing a tenth of Lithuania's GDP. The well-managed Mažeikių might have made Lithuania richer than Latvia and Estonia, but instead it became a millstone around the neck of the government in Vilnius.

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Russian Lukoil would have been the natural choice to buy Mažeikių. It was the heir of the Soviet oil industry, which built both Mažeikių and its crude feeder, the Druzhba pipeline. But politicians in Vilnius turned their backs on Russia, made a bad deal with an American company, and ended up with a dry pipeline and huge losses.

The Americans escaped through the backdoor, selling their stakes in Mažeikių to Yukos in secret, not long before Yukos' CEO Mikhail Khodorkovsky was arrested, charged with fraud, and saw his financial empire and the most enormous wealth in Russia eliminated.

Lukoil was then left out a third time, when Polish PKN Orlen became the new owner of Mažeikių. The Poles paid almost two billion euros for an 84 percent stake in an oil refinery where the pipeline has now been dry for four years due to "technical" problems east of the border. PKN Orlen is searching for a buyer.

The nuclear power plant Ignalina, the other energy giant that Lithuania inherited from the Soviet Union, was shut down by the European Union for safety reasons. More than seven years after the decision to close Ignalina, the state's policy for the alternative generation of energy has made little progress, despite Lithuania's urgent wish to become independent of Russian energy.

The one achievement was the Leo LT company, created by the government in Vilnius to raise funds for new reactors and oversee the establishment of electricity grid lines to Sweden and Poland. After allegations of corruption, however, Leo LT was liquidated.

According to a recent analysis, Lithuania's state-owned assets in energy, transport, and land are worth over five billion euros, but provide only 13 million in dividends. This is reason enough to keep the most coveted investors at a distance. Mismanagement is particularly obvious in the forestry industry, where average yield is a quarter of that in Sweden, according to a report in The Economist.

Latvian State Forest might be more attractive to investors, though it is not a popular political move to sell out national forests in a country where the population has a deep attachment to rural areas, where many families have lived for generations, and where the woods have an almost religious significance in folklore — as it is for ethnic Latvians; and the Russian minority, for ideological reasons, votes for a party that opposes privatization in general.

Political fighting over the privatization of lucrative Latvijas Kugnieciba (Latvian Shipping Company) has divided a number of consecutive governments in Riga. The state still has a stake in Latvijas Kugnieciba, but the majority shareholder is Ventspils Nafta, one of the most questionable businesses in the Baltics. Ventspils Nafta is controlled by Latvia's richest man, the oligarch and mayor of Ventspils, Aivars Lembergs, who is on trial for corruption, suspected of having bribed a huge number of Latvian political parties, ministers, and parliamentarians.

State-owned Latvenergo has also gone through years of political wrangling. Despite the fear of having the Latvian energy monopoly swallowed by Russian Gazprom, Latvenergo might have been an example of a well-managed, financially sound state business. That was until this last summer, when the Corruption Prevention and Combating Bureau arrested five executives at Latvenergo, including the CEO, on suspicion of bribery, embezzlement, and money laundering.

The government had hoped for privatization of Latvenergo. There has also been talk of selling Parex Bank, Lattelecom, and Latvijas Mobilais Telefons (LMT), partially or fully owned by the Latvian state.

The government had to buy Parex Bank, when it became insolvent in the autumn of 2008, a deal that almost caused the state to go bankrupt, and forced Latvia into a controversial 7.5 billion euro loan deal with the IMF, the EU, Sweden, and others. Now Parex Bank has split, and the part remaining with the Latvian Privatisation Agency will soon be sold.

The IMF is asking the Latvian government to acquire capital by selling more state assets. But an insolvent bank is an easy case compared to the profitable Lattelecom and LMT. Oligarchs and politicians have fought endlessly over how to privatize the lucrative telecom business and get the most out of it. The main bidder, Swedish—Finnish Telia Sonera, has showed admirable Nordic patience, still willing to negotiate after numerous setbacks.

Air Baltic is a story of its own, with loose canon CEO Bertolt Flick in partnership with oligarch Ainars Slesers — referred to, even by himself, as a "bulldozer" — making headlines ranging from business success to corrupt deals that seem to escape both the hand of the law and the hand of the government.

Estonian Air, like Air Baltic, is still partly state-owned, and the government in Tallinn plans to renationalize most of the remaining shares. Scandinavian SAS has long tried to get rid of its financially bleeding daughter company, but the Estonian government has not been clear on how privatization or renationalization will take place.

Eesti Raudtee (Estonian Railways) was partly privatized in 2001 and became Baltic Rail Services, owned by Estonian and foreign shareholders, among them American investors. The deal was politically controversial and the operation and management fell under much criticism. After heavy political and financial infighting, Eesti Raudtee was renationalized in 2007, and is now fully owned by the state. That deal was criticized as favoring the Russian transport sector, since it permitted discounts for shipments to the east.

The story of Estonian Railways is symbolic of state-run businesses in the Baltics. Political controversy surrounds them constantly, influence peddling or allegations of such are always present, and shadows of suspicious foreign interests lurk in the background, mostly Russian interests, but also American, European, and not least Swedish.

The shadows here are seldom illusions, but rather signs of real and strong financial — and sometimes political — powers, often able to profit from conflicting political and private interests in these young and vulnerable democracies. ≈

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The state qua cleaning woman was revived in the post-Soviet reality. Now the threat is a Russian capitalism.