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RUSSIA'S ROLE IN THE BALTIC STATES' INVESTMENT

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Abstract

The aim of this article is to determine the modern role of Russia in the investment space of the Baltic states and to assess the current stage of integration of Russian and the Baltic states' economies. The basis of the work is the analysis of the dynamics and structure of Russian investment in Estonia, Latvia and Lithuania. This article shows the decreasing role of Russia in the Baltic states' investment, but Russia is still an important economic partner for these states. Absolute amounts of investment are growing, while the share of Russia in different countries varies in different ways and, depending on the implementation of any project. Structure of Russian investments is different in all countries.

Key words

Russia, Estonia, Latvia, Lithuania, investment, business.

1. Introduction

The research of the economic impact of one country to other is the key method in modern economic geography. The influence of one economic system on other may increase or decrease depending on the historical, geographical, institutional and other features of countries' cooperation.

The border and historical links with such a large state as the Russian Federation, of course, affects the economy of the Baltic states. However, the existing different political views and rather "cool" relations at the international level between Russia and the Baltic states disrupt economic links to a certain degree. After the dissolution of the Soviet Union Estonia, Latvia and Lithuania became independent and the vector of their economies was sent to the European

Union, in particular – to the states of Fennoscandia. Currently Sweden, Finland, Germany and the Netherlands are the main trade and economic partners of the Baltic states. However, certain Russian interests in the Baltic states and current economic and transport links make Russia as one of the most important partners of Estonia, Latvia and Lithuania.

The initial hypothesis is that Russia lost during last 23 years its status as the main economic partner of the Baltic states, but saved important role in some parts of economy (transport, industry) and that modern Russian interests are not only in industry, but also in financial sector.

2. Russian role in trade and investment

After the dissolution of the Soviet Union Estonia, Latvia and Lithuania have started pro-western policies, trying to focus mostly on European Union, not on Russia. During the Soviet period, about 95% of economic and trade balance were in communication

with the other republics of the Union. Nowadays Russia's share in the trade balance of the Baltic states rarely exceeds 25%, but is not the same for Estonia, Latvia and Lithuania (fig. 1).

Russia's share in the trade balance of Lithuania is much higher than other Baltic states. More than 90% of Russian import to Lithuania are oil and oil

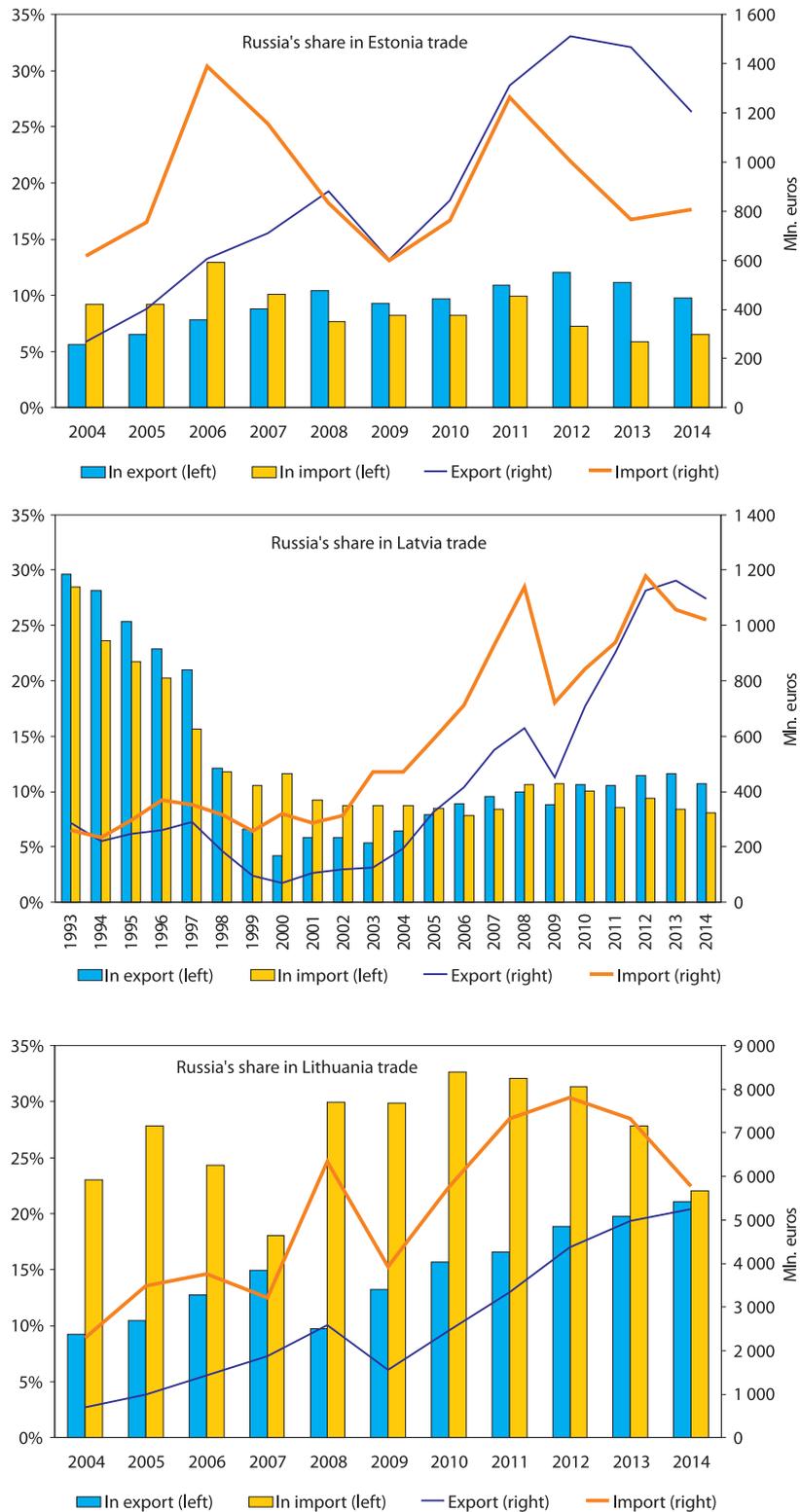


Fig. 1. Russia's share in the trade balance of the Baltic states

Source: statistics departments of Estonia, Latvia, and Lithuania.

products, because the only oil refinery in the Baltic states is in Mazeikiiai, Lithuania. At the same time, in Estonia and Latvia Russian share is lower than 10–12% during last 10 years. The share of Russia changed wavy: recessions are connected with crisis in 1998 and 2008. It is remarkable that only Lithuania still has trade deficit with Russia: Estonia got trade surplus in 2008, Latvia – in 2013. The delay of Russian economic growth in 2013-2014 and developing

of Russian ports in Leningrad oblast had negative impact on trade between the Baltic states and Russia: Exports from Estonia began to decline, and from Lithuania – slowed; imports stagnated in Estonia and in Lithuania – decreased significantly.

Russia was not the major investor in the Baltic states in 2014 (tab. 1).

Share and place of Russia in the incoming flow of foreign direct investment (hereinafter – FDI)

Tab. 1. Main investors in the Baltic states in 2014

№	Estonia		Latvia		Lithuania	
	Country	Share	Country	Share	Country	Share
1	Sweden	26.4%	Sweden	21.1%	Sweden	23.0%
2	Finland	21.8%	Netherlands	8.2%	Germany	10.1%
3	Netherlands	10.4%	Cyprus	7.3%	Poland	9.8%
4	Norway	5.5%	Russia	6.9%	Netherlands	9.1%
5	Russia	5.5%	Germany	5.6%	Norway	6.0%
6	Cyprus	3.4%	Norway	5.5%	Estonia	5.6%
7	Denmark	3.2%	Estonia	4.7%	Denmark	5.4%
8	Lithuania	2.7%	Denmark	4.0%	Finland	4.5%
9	Latvia	2.7%	Lithuania	3.0%	Russia	4.1%
10	USA	2.2%	The United Kingdom	2.7%	Cyprus	3.5%

Source: statistics departments of Estonia, Latvia and Lithuania.

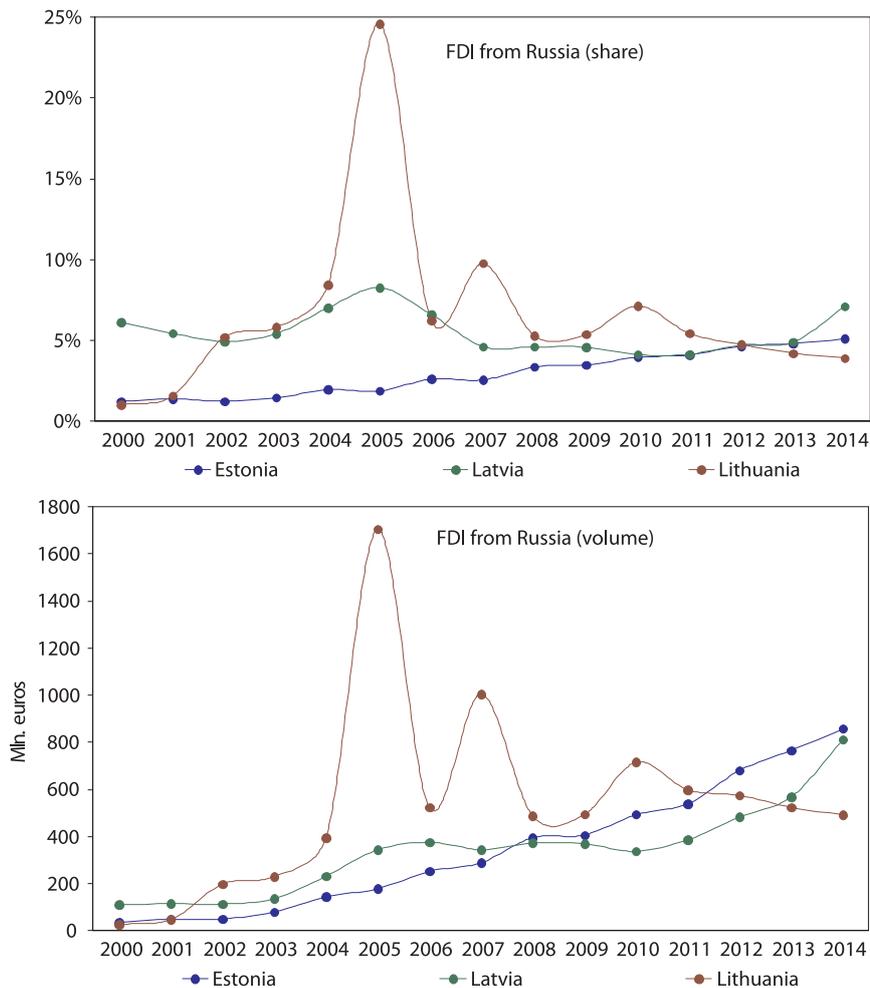


Fig. 2. Dynamics of the Russian volume of FDI in the economy of the Baltic countries and Russia’s share in total FDI

Source: statistics departments of Estonia, Latvia and Lithuania.

in the countries differ slightly. However, consider the volume and share of FDI in one year is not quite correct, so consider the dynamics of the volume of FDI in the economy of the Baltic countries and Russia's share in total FDI (fig. 2.).

Absolute figures of Russian investments grow in all the Baltic states (except Lithuania), and the

proportion varies in different ways: in Latvia - decreases with the increase in 2014, in Estonia – is growing, in Lithuania – changes in waves. To understand the causes of this dynamics, it is necessary to analyze the structure of Russian investments in the economy of these countries (fig. 3).

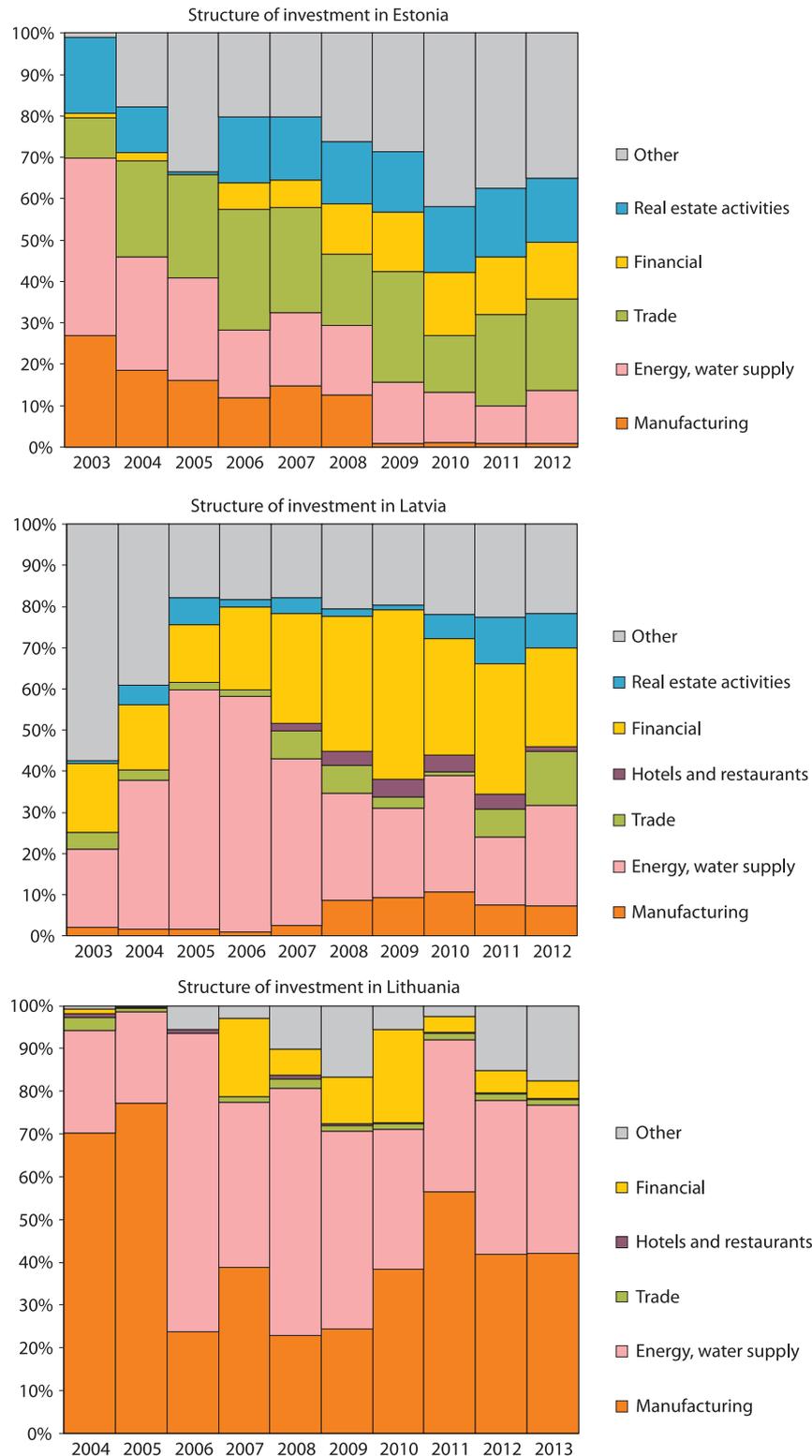


Fig. 3. The structure of Russian investments in the economy of the Baltic states
Source: statistics departments of Estonia, Latvia and Lithuania, Eurostat.

Analysis of the data shows that all three countries have different structure of Russian investments. It shows different directions of Russian interests in the Baltic states. Dynamics of investment in Latvia shows that the most interesting for Russian investors are the financial sector and the production and distribution of electricity, gas and water. This is explained by increased activity of Russian banks in the Latvian financial sector and the fact that 50% of the shares of the largest gas company in Latvia «Latvijas Gāze», controlling pipelines Latvia, belong to Russian companies (“Gazprom” – 34%, “Itera”¹ – 16%). The share of investment in real estate is growing since 2008. Russian bought real estate in Latvia to receive permanent residency, but since 2014, it is forbidden to the Russian citizens. This can decrease Russian investment in Latvian real estate in future.

From the rest of the Baltic states Lithuania is allocated with the least level of diversification of Russian investments. In 2004–2005 manufacturing attracted more than 60% of all Russian investments. In 2005 also was the largest volume of Russian investment in Lithuania, and in 2006 was a sharp recession. In the same year, the share of manufacturing in the structure of Russian investment felt sharply and sharply increased the share of energy production and distribution, gas and water. The reason is that Mazeikių oil refinery was bought in 2003 by the Russian company «Yukos» and sold out to the Polish company «PKN Orlen» in 2006. Also in 2004 Russian company “Mechel” bought Iron and Steel Works in Kaunas. In 2010, investment increased because the crisis was over and the transaction on purchase chemical plant Lifosa in Kėdainiai by Russian «EuroChem» was over too. The high proportion of investment in energy production and distribution is explained in a similar manner as in the case of Latvia: 37% of the company «Lietuvos dujos, controlling GTS Lithuania belong to «Gazprom». Russian investment in Lithuanian financial sector rapidly increased in 2007, but because of crisis in 2008 they quickly decreased in 2008.

Estonia is a country with the most the most diversified flow of Russian investments. No one sector is significantly stands out, as in Lithuania. Nevertheless, should be noted the highest share among all countries on volume of investments in trade and real estate, and a significant amount of investment in the financial sector. Gradually declined investment in manufacturing (to zero in 2012), and production and distribution of energy.

Quite difficult to estimate the number of enterprises with Russian capital. According to various sources, the number of enterprises with Russian

capital in Latvia is about 4.5 thousand, in Estonia – 2.4 thousand. If remove the companies that are not Russian, but have Russian capital, their number decreased markedly. Representation of Russian companies weakly correlated with the volume of Russian investments (tab. 2).

Tab. 2. The number of Russian companies in the Baltic states

Year	Estonia	Latvia	Lithuania
2003	10	93	58
2004	19	99	71
2005	19	91	82
2006	26	129	86
2007	29	146	90
2008	25	153	92
2009	28	175	90
2010	32	228	116
2011	34	240	128
2012	28	261	–

Source: UNCTAD.

Among the largest foreign branches in the Baltic states² only three are allocated: «Severstal AS» (Latvia) and Lukoil Baltija (Latvia and Lithuania). Riga’s plant «Severstal» is one of the largest branches of foreign enterprises in Latvia in the manufacturing sector, and Lukoil Baltija is the largest company on the sale of gasoline in Lithuania.

Enterprises with Russian capital are not the major foreign investor in the Baltic countries. In Latvia in the top twenty of the largest foreign investors is only one Russian company – «Transneftproduct», which has invested in the subsidiary SIA LatRosTrans 51,6 million euros. There are 8 more Russian companies in top-100 foreign investors in Latvia (tab. 3). However, even the total amount of investment from the largest Russian investors in Latvia is not even a one third of the investments of the Swedish bank «Swedbank AB» (tab. 4). In the first ten largest investors in Latvia seven companies belong to financial sector.

Among the directions of investment of major Russian investors in Latvia the main are the financial sector and companies associated with the transport of minerals, because of favorable conditions and simple implementation of financial activity in Latvia, and the convenience of Latvian ports for transportation of goods to Western Europe. “Gazprom” investments should be considered from the political point of view to control the Baltic pipeline in order to reduce costs and increase the impact on the energy

¹ “Rosneft” subsidiary company.

² By UNCTAD.

Tab. 3. Top Russian investors in Latvia in 2014

Nº	Company/person	Investment (mln. euros)	Subsidiary	Sector
1	Transnefteproduct	51.90	SIA LatRosTrans	Oil transportation
2	Property Department of Moscow	28.53	AO Amo Plant	Motor vehicle production
3	Andrey Vdovin	27.86	Bank M2M Europe	Financial
4	Igor Tsyplakov	22.07	Rigensis bank	Financial
5	Mine „Zarechnaya“	20.02	Indtec Baltic Coal SIA	Coal terminal in Ventspils port
6	Gazprom	19.26	AO Latvijas gāze	Gas transportation
7	SMP Bank	15.02	SMP Bank	Financial
8	Igor Kim	11.64	Expobank	Financial
9	„Stroyrazvitie „	10.20	Stroyrazvitie LV	Construction

Source: www.lursoft.lv

Tab. 4. Top foreign companies-investors in Latvia in 2014

Nº	Company	Investment (mln. euros)	Country	Sector
1	Swedbank AB	942.8	Sweden	Financial
2	GE Capital	226.3	USA	Financial
3	DNB BANK ASA	190.8	Norway	Financial
4	Skandinaviska enskilda banken	146.9	Sweden	Financial
5	Rugby Holding B.V.	137.2	Netherland	Financial
6	EKTORNET LATVIA AB	137.0	Sweden	Financial
7	UniCredit Bank Austria AG	127.8	Austria	Financial
8	Tilts communications a/s	101.7	Denmark	Communication
9	BERGVIK SKOG AB	99.5	Sweden	Forestry
10	BITE Lietuva UAB	98.8	Lithuania	Communication

Source: www.lursoft.lv

market of the Baltic States, Poland and Germany. However, there are reports in recent years about the desire of governments of the Baltic countries to buy out the share of “Gazprom” in gas companies, especially in view of the desire of the German shareholders to sell their share of the company “Latvijas gāze”.

Four of top-100 companies in Estonia are Russian subsidiaries. All these companies connected with transportation and storage (tab. 5).

Russian companies actively invest in Estonian ports. „Acron” is the largest shareholder of the terminal complex AS DBT capacity of 160 thousand tons in port Muuga, Tallinn. Also „Acron” has AS BCT

terminal for transportation and storage of ammonia and liquid fertilizers in Sillamae port with capacity of 80 thousand tons, launched in 2009. Besides „Acron”, own terminal in Sillamae for transshipment of liquid chemicals has „EuroChem”. Vopak EOS – a subsidiary of the Russian “Global Ports” engaged in service terminals for storage and handling of liquid cargo. Capitalization of some companies considerably reduced from 2012 (Vopak – from 626 million to 366 million euros, DBT – 73 to 50 million euros). That is connected with the gradual reorientation of Russian trade flows from ports in Estonia to ports in Leningrad oblast. Eesti Gaas is the fourth company, which

Tab. 5. Top companies with Russian capital in Estonia in 2014

Nº	Company	Subsidiary in Estonia	Sector	Capitalization (mln. euros)
7	Global Ports	Vopak E.O.S. AS	Transport	366
18	Global Trans	Spacecom AS	Transport	151
23	Gazprom	Eesti Gaas	Gas transport	138
88	Acron	DBT AS	Transport	50

Source: GILD100.

Tab. 6. Top companies with Russian capital in Lithuania in 2014

Nº	Company	Subsidiary in Lithuania	Sector	Capitalization (mln. euros)
6	EuroChem	Lifosa	Production of mineral fertilizers	1417
10	Gazprom	Lietuvos dujos	Gas transport	970
20	Retal Industries	Neo Group	Production of plastic packaging	648
27	Inter RAO	InterRao Lietuva	Producing and distribution of energy	396
36	Retal Industries	Retal Europe	Production of plastic packaging	242
84	Lukoil	Lukoil Baltija	Oil products	111

Source: GILD100.

specialization is transportation and storage of gas. In next few years, „Gazprom” may lose control of the Estonian gas pipelines because the Estonian government plans to allocate from the jurisdiction of the company Eesti Gaas gas pipelines to bring the law „On Natural Gas” to the requirements of the European Union.

Interests of the Russian capital in Lithuania differ from those in Latvia and Estonia. First it should be noted that half (three of six) companies connected with chemical industry (tab. 6).

The high activity of Russian business in the chemical industry can be explained by several facts. Lithuania is the only Baltic state with oil refinery in Mazeikiai. The presence of a large petrochemical plant contributed to the migration of skilled staff in the field of chemistry, and development of the following stages of the chemical industry. The accumulated potential with interest of Russian companies in entering international markets and increasing production capacities abroad helped to attract Russian capital in the Lithuanian chemical industry. One of the first companies to have passed under the control of the Russian company became the oil refinery in Mazeikiai. More than a half of the company «Mažeikių nafta» until 2006 belonged to the Dutch subsidiary „Yukos”/„Yukos International UK-BV”. However, after the bankruptcy of „YUKOS” oil refinery was sold to the Polish ORLEN.

Originally, plant Lifosa, located in Kedainiai, and belonged to American company «Cargill». After reducing prices for ammonium phosphate on the global market and crisis of the production in 2003, it came under the control of „EuroChem”. Now the modernization of plant is over, and the volume of production is about 1 mln. tons of phosphate fertilizers. Since 2014, the company planned to switch completely to the Karelian raw materials.

The Russian company for the production of plastic packaging „Retal Industries” owns two enterprises in Lithuania: Neo Group and Retal Europe. Capacity of plant NeoGroup is more than 300 thousand tons

per year, and the products are exported mainly to Western Europe, Scandinavia and the Baltic states.

As in the other Baltic countries, „Gazprom” is one of the largest shareholders of the main gas company of the country – „Lietuvos dujos”. The Lithuanian government was concerned about this fact, and in the middle of 2013 the company was separated in two: „Lietuvos dujos” – selling gas and „Amber Grid” – gas transportation. „Gazprom” received 37.1% of the new company, but it is possible to get all shares by the Lithuanian government. According to analysts, there is a possibility of such an operation, while guaranteeing the uninterrupted supply of gas to the Kaliningrad region and an end to litigation.

Inter RAO is represented in Lithuania by subsidiary InterRao Lietuva, engaged in the production and distribution of electricity. In 2007 Inter RAO bought the largest Baltic wind power plant for 53 mln. dollars. This purchase caused by the desire to gain a foothold in the Baltic market and the desire to demonstrate to the international community interest in the development of alternative energy. Also in 2011, was signed an agreement for the sale electricity from currently under construction Kaliningrad NPP from 2017 to 2036 to the Baltic states. This NPP, as well as the agreement may be a barrier to the construction of Visaginas NPP.

3. Summing up

Thus, because of analysis of the main indicators of Russian investment activity in the Baltic states, the following conclusions are:

Russia’s share in foreign trade is maximum in Lithuania (30% of total imports of Lithuania). Lithuania is the only republic with trade deficit with Russia, but in the next years may be trade surplus.

Russia is important, but not the main investment partner of the Baltic states. Absolute amounts of investment are growing, while the share of Russia in

different countries varies in different ways and, depending on the implementation of any project.

Structure of Russian investments is different in all countries, but there is a general trend: in the structure of investment in all countries, especially in recent years, stand out investment in energy production and distribution and in the financial sector.

Major Russian companies are not among the leaders by the volume of investments and capitalization. The main are Swedish and other Western European companies (Swedbank AB invested in 2014 in Latvia nearly 1 billion euros, Transneftproduct – 52 million).

The main interest of Russian business is different in every country: in Estonia – transportation and storage, in Latvia – the financial sector and the transportation of minerals, in Lithuania – chemical industry and transportation of energy. Russian companies are trying to use the profitability of the Baltic ports and a convenient institutional environment for business.

One of the geopolitical interests of the Russian capital in the Baltic states is to control the gas pipelines. In order to comply with the legislation and reduce the influence of "Gazprom" current gas companies should be separated in two: company for gas sale and for gas transportation. This process has already taken place in Lithuania and will take place in Latvia and Estonia.

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