

SITUATION

Lithuania is the most stable of the former Baltic Soviet Republics. It is a member of NATO, the European Union (EU), World Trade Organization, and a nonpermanent member of the UN Security Council. Lithuania's successful transition to a market-based economy enables it to maintain stable annual growth, complete its transition to the EURO in January 2015 and makes it one of the fastest growing economies in the EU. Accompanying its economic stability, Lithuania experiences a high-level of political stability. In May 2014, Dalia Grybauskaitė was reelected president for a second five-year term by a 59% majority vote. The election was approved by a 90-40 parliament vote.

“Euro adoption is one of the irreversible steps toward integration into Western culture and the Western world. Together with membership in NATO and the EU, joining the single currency ensures our larger security in all respects, both economically and militarily.”

~Lithuanian Finance Minister Rimantas Sadzius

Lithuania's economic, political, ethnic, and religious conditions create a stable operating environment for Höegh LNG's investment and operations in Klaipėda. As a stable, modern European country, Lithuania does not experience the challenges faced by underdeveloped nations. The population is predominantly homogeneous with 84% Lithuanian, 6% Polish, and only 5% Russian (which were granted Lithuanian citizenship). Religion is dominated by Roman Catholic and Russian Orthodox beliefs with less than 0.2% of the population Sunni Muslim, Greek Catholic, and Jewish. The population's distribution across urban and rural areas is balanced and does not experience a youth bulge. However, “in spite of impressive gains in Lithuania's drive toward democracy and a free market economy, corruption remains a serious matter.” Dr. Richard Krickus Additionally, Lithuania's 10.5% unemployment rate creates an environment for social tensions to be exploited.



FINDINGS

Lithuania currently imports 92% of its natural gas from the Russian Federation. Lithuania's dependence on Russian energy is its greatest source of economic instability.

Russian influence is the single most important factor that dominates contemporary geopolitical and economic conditions within Lithuania and the Baltic region.

The ongoing conflict in Ukraine is increasing geopolitical tensions, which have the potential to destabilize the region.

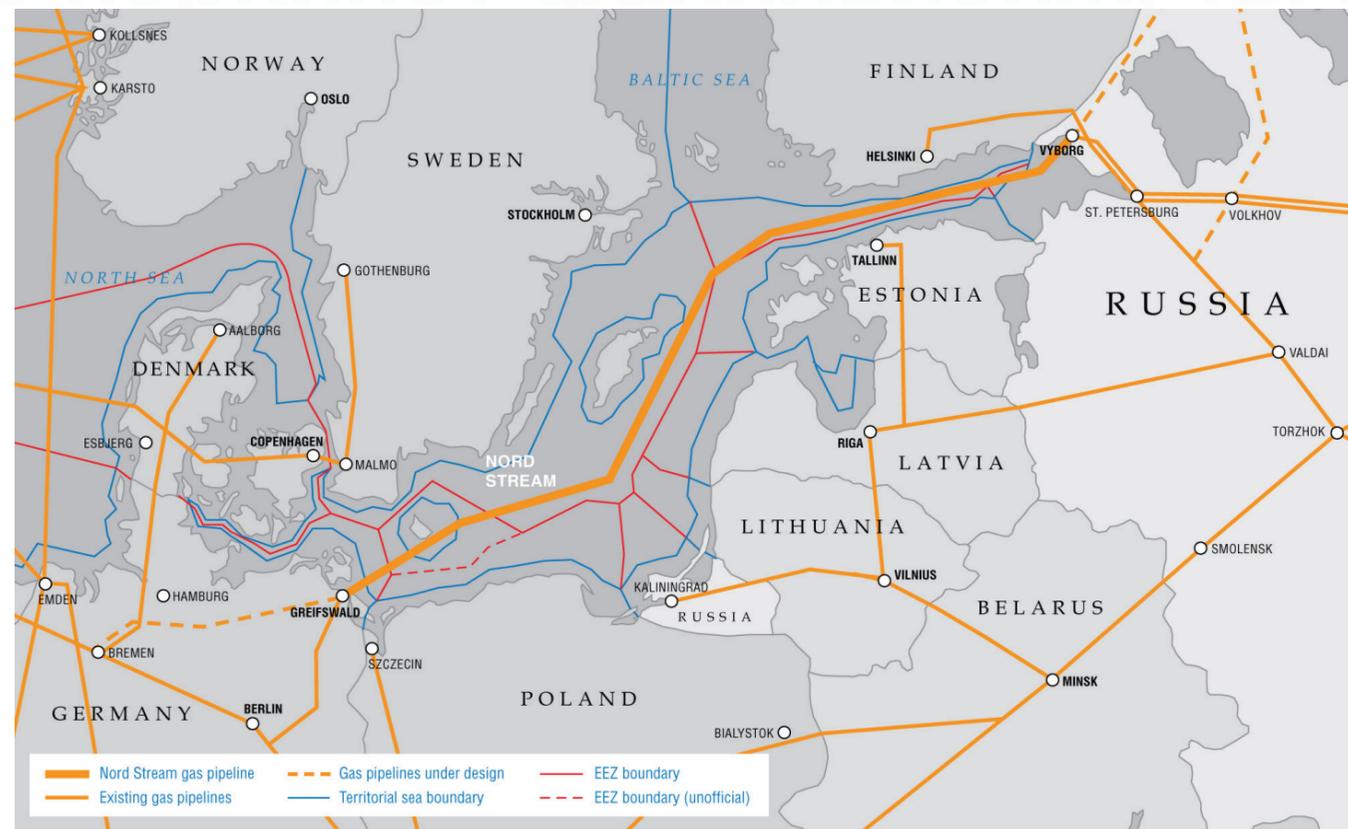
APPROACH

Due to Lithuania's stable environment, ENODO Global's analysis explores the regional economic and geopolitical factors that can negatively impact Höegh LNG's operations in Klaipėda. Our investigation focuses on Russia's dominance over Lithuania's energy markets and its geopolitical influence in the Baltic Sea region. By examining these factors, ENODO is able to identify the drivers of insecurity, inform Höegh of potential threats and set conditions to prevent events that can negatively impact its Lithuanian investment.

FINDINGS

Energy Dependence

Russia maintains a near-monopoly over Lithuania's energy sector and the former Baltic States. Nearly all of Lithuania's energy imports including natural gas, crude oil and coal originate in Russia. However, Russian dominance over Lithuania's energy requirements is being challenged. Lithuania is constructing a power grid with Poland through the LitPol Link interconnection and with Sweden through the NordBalt power link. Both are scheduled to be operational by 2015. Additionally, Lithuania is suing Gazprom in a Stockholm Arbitration Tribunal for more than \$1.6 billion due to claims that Gazprom charged Lithuania 35% more than Germany for natural gas. As a result of its acquiring alternative LNG sources from Norway, Lithuania secured a 20% reduction in the price it pays for Gazprom gas.



When the LNG terminal in Klaipėda becomes fully operational in 2014, imports of natural gas from Russia will be reduced by nearly 50%. Höegh's LNG terminal in combination with the LitPol and NordBalt electric power grids enable Lithuania to gain energy independence from its eastern neighbors and integrate the Lithuanian energy system into European networks. These activities signal a decline in Russia's energy dominance in Lithuania and the region. With over 50% of Russia's GNP originating from the region's consumption of Russian energy supplies, Lithuania's moves can have a destabilizing effect on the Russian oil & gas industry. Considering the economic advantage and tremendous political leverage that Russia's dominance of the EU gas market provides, Moscow is highly unlikely to relinquish its control of the industry.

Although Russia has not taken direct action to counter Lithuania's energy initiatives, it has demonstrated its willingness to do so in the past. In 2006, when Lithuania sold the Baltics' only refinery to a Polish company, Russia halted oil supplies through the Druzhba pipeline, which remains closed today. Recently, in response to the escalation of activity in Kiev, Russia cut gas exports to Ukraine which caused a 60% reduction to European countries, plunging the continent into an energy crisis. Such drastic actions demonstrate the influence Russia places on its energy dominance in the region.

It is unlikely that Moscow will stand idly by as Lithuania forges an energy future independent of Russian gas distribution. As Russia's revenue and influence subside, it will take a more active role to counter Lithuanian moves towards energy independence. Although Russian actions are difficult to predict, as long as Lithuania remains an active EU and NATO partner, direct Russian action against Vilnius is unlikely. However, a Russia's response through its influence and soft power can be expected.

Russian Influence

Lithuania was the first Soviet republic to declare independence from the Soviet Union on March 11, 1990. After a quarter century, fear of Russian reprisal permeates Lithuanian society. At an emergency EU meeting regarding Ukraine, Lithuanian President Dalia Grybauskaitė stated, “Russia is dangerous. After Ukraine will be Moldova, and after Moldova will be different countries.” Fear of Russian influence is reinforced by Russia’s physical presence, soft power, and ability to disrupt trade and commerce in Lithuania and the Baltic region.

In the past, Russia has preferred the “hard approach” finding it most effective for achieving geopolitical goals—either in direct combat like in Georgia in 2008, or by maintaining frozen conflicts in vulnerable states like Moldova and Armenia-Azerbaijan. As demonstrated in Crimea and Eastern Ukraine, Russia is willing to utilize direct action in order to achieve its economic and ethno-political interests. However, due to Lithuania’s EU and NATO membership, the hard approach is not a viable option for Russia. Moscow must therefore rely on other methods to achieve its political and economic objectives.

“Neither the Americans nor Europeans appreciate just how vulnerable the Lithuanians and their neighbors in the East Baltic Sea region feel in the face of the ‘Russia Threat.’”

Dr. Krickus

Lithuania is dependent on Russia for the majority of its trade. **When Russia wants to exert its influence, it does so through economic means.** Lithuania’s exports to Russia amount to a fifth of its total exports and constitute an essential part of its economy. In response to Lithuania’s support for a trade accord with Ukraine, Russia imposed a ban on Lithuanian dairy products, one of the country’s largest exports. Recently on August 7th, Russian Prime Minister Dmitry Medvedev announced a full food embargo on imports from EU, US and other European nations (including Norway). Russia will continue to use energy, commerce and trade, as well as other measures to maintain its influence in Lithuania and the region.

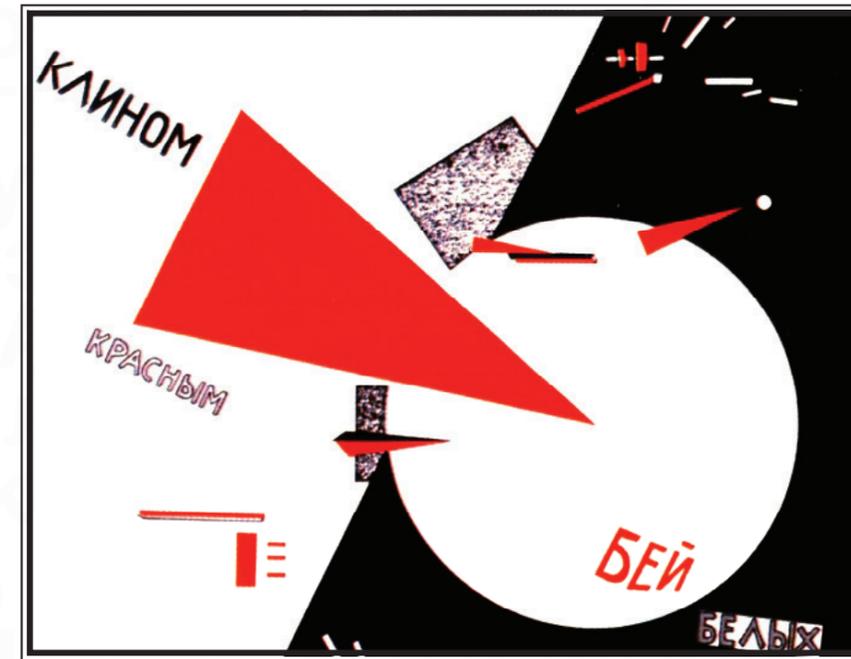
“Soft Power”

Russia has the ability to exert pressure on Lithuania in other forms. Russian “soft power” includes targeted media campaigns, direct investments, and less-defined power structures such as organized crime syndicates (Russian mafia) and former security services (KGB-FSB). These aspects of Russian influence have the desire, ability and means to penetrate Lithuanian organizations and society from the national to the local community level.

“Russia uses propaganda in its foreign policy since time immemorial. It is using propaganda tools not only to maintain its imperial structure, but to potentially pose a huge threat to its neighbors.”

Director of Lithuanian PR Agencies Association,
Lynas Kontrima

Russia effectively employs its state media outlets—TV in particular—to foment discontent among its citizens and Russian citizens within its former states. Russian President Putin recently accused Lithuania of training “extremists” who ousted Ukraine’s President in an “unconstitutional” coup. Russian state television aired footage of a Lithuanian farm where Ukraine’s pro-Western demonstrators supposedly trained. In the absence of a significant ethnic Russian minority or large enough Russian-speaking population, Moscow does not have enough pressure points to directly influence



“Beat the Whites with the Red Wedge” - Lissitzky

Lithuania as it does in Latvia, Ukraine or Moldova. Russia is, however, attempting to strengthen its foothold in Vilnius. In April 2014, a petition to incorporate Klaipėda into the Russian Federation collected 211 signatures. Though the event failed to garner legal justification for a case against Lithuania, the presence and weight of Russia’s soft power practices should not be underestimated.

OUTLIERS

Höegh's Lithuanian investment can be indirectly impacted due to Lithuania's movements toward energy independence. The Russian government or well-connected Russian energy elites may implement activities that can destabilize Lithuania's energy sector and economy. These activities can manifest from several sources:

- Russia's use of Kaliningrad as a venue for a direct confrontation with Lithuania. Actions may include provocative troop maneuvers, air traffic incidents or rail shipments between Russia and Kaliningrad via Lithuanian territory.
- An inadvertent accident caused by a surge in Russian military exercises or unannounced drills in the Baltic Sea. Both of which have previously disrupted the region's shipping industry.
- Cyber intrusion or attacks against Lithuania or Höegh's operations in order to disrupt natural gas distribution. Attacks are likely to mirror the 2013 attacks against Lithuania's news portal DELFI and the 2007 attack on Estonia that temporarily incapacitated the country's electrical and communications facilities.
- An escalation in military activities due to NATO's increased presence in Lithuania which augmented its Baltic air security mission for Estonia, Latvia, and Lithuania at Šilute Air Base. An example of increased military activity by NATO and Russia's response is the July 18th intercept of a US Air Force RC-135 electronic reconnaissance aircraft by Russian fighters from Kaliningrad. The US reconnaissance plane flew into Swedish airspace to avoid the Russian fighters causing a minor international incident with Sweden which is not a member of NATO.

CONCLUSION

Lithuania's stable economy, pluralistic political culture and homogenous population do not present the challenges frequently encountered in underdeveloped countries. Direct and indirect threats to Höegh's operations from Lithuanian civil society are virtually non-existent; Klaipėda citizens support the LNG initiative by a 79% majority and nationally by a 71% majority.

Höegh's threats manifest from sources outside Lithuania's borders. The Russian Federation is waging an unconventional war against Lithuania's energy sector, using Gazprom as its proxy force. With Höegh's FSRU capable of supplying 100% of Lithuania's current demand for natural gas, by extension, Höegh and its suppliers will be targets of Russia's economic avarice and political antagonism.

The Russian government will not initiate hard power actions against Lithuania or Höegh's LNG project in Klaipėda in the near-term. Instead, Russia and Gazprom will use soft power, including their direct economic and political influence and propaganda from national media sources, to create conditions to maintain energy dominance in the region. Due to the project's impact on Lithuania and the region's energy demands, and its symbolic shift to an independent Lithuanian energy policy, a long-term security commitment is instrumental to ensure Höegh's investment. Further investigation and active monitoring should be considered to ensure Höegh's ability to counter threats that manifest or are engineered against this project.



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