

Interpreting Interdependence

Energy and Security in Ukraine and Belarus

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The economic dependence on Russia that Ukraine and Belarus inherited from Soviet planners in 1991 was enormous. The two new states depended on Russian markets, in which Ukrainian and Belarusian producers sold goods that were uncompetitive in the rest of the world. Ukraine and Belarus also depended on Russia for crucial imports. Energy was the most important of all.

Ukraine and Belarus relied heavily, in particular, on Russian oil and gas. (See Table 1.) Every winter since December 1991 Ukrainian and Belarusian households have worried that an end to Russian gas imports would mean unbearable cold. Ukrainian and Belarusian industrial firms, energy-inefficient behemoths designed by Stalinist planners, required massive amounts of Russian oil and gas to produce. The cost of energy dependence was obvious to policymakers in both states: reduced political autonomy.

The price, however, was negotiable. Even after 1991, the Russian government managed the prices of oil and gas exports to the other 14 newly independent states of Eurasia and thus continued to subsidize their energy consumption. Indeed, Eurasian markets for oil and gas were highly fragmented, with prices lowest within Russia and highest in Lithuania, Latvia, and Estonia, the three Baltic republics that refused to

join the Commonwealth of Independent States (CIS). The Russian government clearly sought to link political acquiescence in its regional hegemony to energy subsidies. While Belarus was rewarded for its commitment to CIS integration with low prices, Ukraine was punished for its assertiveness with higher prices.

Almost regardless of the price, however, Ukraine and Belarus desperately needed Russian energy imports for which they simply could not pay. So energy debts mounted throughout the 1990s. Again Russia chose not to treat all its energy debtors in the near abroad equally. Russia offered Belarus generous repayment terms and, by the late 1990s, accepted Belarusian industrial output as barter for more than 75 percent of its payments. Furthermore, Russia regularly forgave Belarusian energy debts. With Ukraine, in contrast, Russia took a tougher line, demanding payment in cash and threatening cutoffs much more frequently. Clearly Russia treated Ukraine and Belarus differently. Political scientist Daniel Drezner argues that Russia systematically attempted to use the energy dependence of the other post-Soviet states as leverage to shape their foreign policies.¹

Underlying these patterns in the energy trade was a fundamental difference in approach between the Ukrainian and Belarusian governments. The Ukrainian government interpreted energy dependence on Russia as a security threat—as a problem that needed to be solved.² The Belarusian government, in contrast, interpreted dependence merely as a fact of post-Soviet life—neither good nor bad—and a reason to reintegrate economically with Russia.³

¹ Daniel Drezner, *The Sanctions Paradox* (Cambridge: Cambridge University Press, 1999), part 2. For an overview of the international relations of the region, see Celeste A. Wallander, “The International Relations of the Post-Communist States: Global Parameters and Domestic Determinants,” presented at the workshop, “Ten Years Since the Collapse of the Soviet Union: Lessons and Perspectives,” Woodrow Wilson School of Public and International Affairs, Princeton University, October 13–15, 2000.

² Author’s interview, Ministry of Foreign Affairs of Ukraine, Kyiv, June 1998; author’s interview, Administration of the President of Ukraine, Kyiv, June 1998. Also see Vladimir Mayevskiy, “Economy Must Be Secure,” *Pravda Ukrainy*, January 29, 1993, in FBIS-USR-93-023, March 3, 1993, p. 79; Vladimir Buida, “Military Doctrine Adopted,” *Nezavisimaia gazeta*, October 21, 1993, in *Current Digest of the Post-Soviet Press*, vol. 45, no. 42 (1993): 25–26; Charles J. Dick, “The Military Doctrine of Ukraine,” *Journal of Slavic Military Studies*, vol. 7, no. 3 (1994): 507–520; Oles M. Smolansky, “Ukraine’s Quest for Independence: The Fuel Factor,” *Europe-Asia Studies*, vol. 47, no. 1 (1995): 67–90; Smolansky, “Fuel, Credit, and Trade: Ukraine’s Economic Dependence on Russia,” *Problems of Post-Communism*, vol. 46, no. 2 (1999): 49–58; Margarita Mercedes Balmaceda, “Gas, Oil, and the Linkages between Domestic and Foreign Policies,” *Europe-Asia Studies*, vol. 50, no. 2 (1998): 257–286; and Rawi Abdelal, *National Purpose in the World Economy: Post-Soviet States in Comparative Perspective* (Ithaca, N.Y.: Cornell University Press, 2001), chap. 5.

³ See, for example, the analysis of then Belarusian minister of foreign affairs Vladimir Senko, “Foreign Policy of the Republic of Belarus: Directions and Prospects,” *Belarus’ v mire*, vol. 1, no. 1 (1996): 45–46. Also see Viacheslau Pazniak, “Belarus: In Search of a

In this paper I describe the strategic implications of Ukrainian and Belarusian dependence on Russian energy, emphasizing the dramatically contrasting interpretations of the Ukrainian and Belarusian governments and the divergent foreign economic policies that followed. Then I trace the evolution of these two states' energy dependence during the first post-Soviet decade and highlight the Ukrainian, Belarusian, and Russian policy choices that led to the situation as it stood at the beginning of the century. Finally I evaluate the current policy debate, which revolves around prices, payments, and pipelines.

After the Fall

The Soviet Union was endowed with enormous oil and natural gas reserves, which Soviet planners used to promote industrialization, regional integration, and state building. While the constituent republics of the Soviet Union and East European satellite states were allocated oil and gas by planners at effective prices far below those of the world market, energy exports fetched much higher prices. As a result, oil and gas dominated Soviet export earnings, reaching as high as 75 percent of the total. Thus, as energy analyst Mikhail Korchemkin notes, "For nearly forty years, Soviet oil and gas export authorities operated in two entirely different markets—the world market and a separate market consisting of countries with centrally planned economies."⁴ The implicit energy subsidies in Soviet planning were crucial for the process of industrialization.

Gas was particularly important for the industrial sectors of the Soviet republics, and eventually became the single most important resource in the regional economy. Moreover, after the Soviet Union disintegrated in December 1991, it was precisely gas—and the miles of pipelines that transported it—that continued to tie the new states' economies together. Newly independent states whose leaders were interested in the diversification of energy supplies faced an enormous undertaking. According to Korchemkin, "Suppliers and users are linked by pipelines laid without respect to the newly created internal borders of the former

Security Identity," in *Security Dilemmas in Russia and Eurasia*, ed. Roy Allison and Christopher Bluth (London: Royal Institute of International Affairs, 1998), pp. 153–156; Anatoli Tozik, "V konseptsii natsional'noi bezopasnosti razrabotchiki postavili tochku" (National Security Concept is Finalized), *Narodnaia gazeta*, June 6, 1995; Karen Dawisha, "Constructing and Deconstructing Empire in the Post-Soviet Space," in *The End of Empire? The Transformation of the USSR in Comparative Perspective*, ed. Karen Dawisha and Bruce Parrott (Armonk, N.Y.: M. E. Sharpe, 1997); and Abdelal, *National Purpose in the World Economy*, chap. 6.

⁴ Mikhail Korchemkin, "Russia's Oil and Gas Exports to the Former Soviet Union," in *Economic Transition in Russia and the New States of Eurasia*, ed. Bartłomiej Kaminski (Armonk, N.Y.: M. E. Sharpe, 1996), p. 121.

Soviet Union, and it would take billions of dollars to change the supply scheme.”⁵

All 15 post-Soviet states began 1992 with the same prices for oil and gas. But they quickly faced an important foreign economic policy choice that would influence Russia’s willingness to continue to subsidize their energy consumption—whether to introduce a national currency. All 15 states also shared the same currency, the ruble, and thus comprised the so-called “ruble zone.” When post-Soviet governments began to make plans to exit the ruble zone, Russian policymakers made it clear that only those post-Soviet countries that remained in the ruble zone would receive energy subsidies. When Lithuania, Latvia, and Estonia exited the ruble zone and introduced their litas, lats, and kroons in the spring of 1992, Russia raised their energy prices to world levels in a matter of months.⁶ The example Russia made of the three Baltic states was obvious to the remaining 11. Economists evaluated the trade-off post-Soviet governments faced, which were similar for Ukraine and Belarus.⁷ (See Table 2.)

Meanwhile, the leaders of the Russian Federation planned the privatization of its energy firms. The oil sector produced a number of firms, such as Sidanko and Sibneft, that came to be dominated by businesspeople close to the Russian political establishment. Foreign investment in Russian oil firms was limited, and the experience of one Western firm, BP Amoco, made the new Russia notorious for corporate governance scandals. The gas sector was in some respects more straightforward, though not, by the end of the 1990s, less notorious for

⁵ Korchemkin, “Russia’s Oil and Gas Exports to the Former Soviet Union,” p. 130.

⁶ Rawi Abdelal, “National Strategy and National Money: Politics and the End of the Ruble Zone, 1991–94,” in *Monetary Orders*, ed. Jonathan Kirshner (Ithaca, N.Y.: Cornell University Press, 2002); John M. Kramer, “‘Energy Shock’ from Russia Jolts Baltic States,” *RFE/RL Research Report*, vol. 2, no. 17 (1993): 41–49; and Martha Brill Olcott, Anders Åslund, and Sherman Garnett, *Getting It Wrong: Regional Cooperation and the Commonwealth of Independent States* (Washington, D.C.: Carnegie Endowment for International Peace, 1999), pp. 44–45.

⁷ David G. Tarr, “The Terms-of-Trade Effects of Moving to World Prices on the Countries of the Former Soviet Union,” *Journal of Comparative Economics*, vol. 18, no. 1 (1994): 1–24; and Linda S. Goldberg, Barry W. Ickes, and Randi Ryterman, “Departures from the Ruble Zone: Implications of Adopting Independent Currencies,” *World Economy*, vol. 17, no. 3 (1994): 293–322. Political scientist Matthew Evangelista evaluated various theoretical approaches to the post-Soviet energy sector and found that deductive, purely materialist accounts of its politics neglected the influence of institutions; see Evangelista “From Each According to Its Abilities: Competing Theoretical Approaches to the Post-Soviet Energy Sector,” in *The Sources of Russian Foreign Policy After the Cold War*, ed. Celeste A. Wallander (Boulder, Colo.: Westview, 1996); and Evangelista, “Stalin’s Revenge: Institutional Barriers to Internationalization in the Soviet Union,” in *Internationalization and Domestic Politics*, ed. Robert O. Keohane and Helen V. Milner (Cambridge: Cambridge University Press, 1996).

problematic corporate governance. In gas there was only one firm, Gazprom, the largest gas company in the world, in which the Russian government retained a 38 percent stake. The Russian government's equity and close relationship to the Gazprom board of directors led some observers to suggest that the firm often acted as another policy lever for the president.

Ukraine's Strategy

Ukraine's dependence on Russian energy had two crucial political consequences. The first was the threat—both explicit and implicit—that Russia could use the asymmetry of their interdependence to force changes in Ukrainian economic policy, or what the scholarly literature on economic statecraft labels “coercion.” Interestingly, however, most observers agree that Russia's attempts to exploit the coercive power inherent in Ukraine's energy dependence failed, primarily because the Ukrainian government interpreted Russia as a security threat. The Ukrainian government, for example, refused to give in fully to Russian demands about the distribution of Soviet assets, control of the Black Sea Fleet, and basing rights in Sevastopol.⁸

The second, more significant political consequence of Ukraine's energy dependence was its effect on domestic debates about the Ukrainian national interest. Building on the seminal work of economist Albert Hirschman, scholars have identified a more subtle form of power that results from asymmetric interdependence: rather than coercion, economic “influence” involves changing interpretations of self-interest.⁹ Russian economic influence was evident in Ukraine's dramatic policy reversal of 1992–1993.

In March 1992 Ukraine's first post-independence president, Leonid Kravchuk, outlined a new economic program, which the administration presented to the Ukrainian parliament in a closed session. The central goal of the program was neither growth, nor reform, nor development, but instead, economic autonomy from Russia. In the proposal, “Principles of a National Economic Policy for Ukraine,” the government lamented Ukraine's economic dependence on Russia and worried that “the country's very independence is jeopardized.” The policy response was to

⁸ Daniel Drezner, “Allies, Adversaries, and Economic Coercion: Russian Foreign Economic Policy Since 1991,” *Security Studies*, vol. 6, no. 3 (1997): 65–111, esp. pp. 96–105. Also see Anatol Lieven, *Ukraine & Russia: A Fraternal Rivalry* (Washington, D.C.: U. S. Institute of Peace, 1999), p. 142.

⁹ See Albert O. Hirschman, *National Power and the Structure of Foreign Trade* (Berkeley: University of California Press, [1945] 1980). For an application to Ukraine, which I summarize here, see Rawi Abdelal and Jonathan Kirshner, “Strategy, Economic Relations, and the Definition of National Interests,” *Security Studies*, vol. 9, nos. 1/2 (1999–2000): 119–156, esp. pp. 144–154.

be a thoroughgoing structural transformation, the creation of a new Ukrainian currency, and reductions of imports from Russia and other “ruble-zone countries” through “economizing” and “reorientation toward new markets.”¹⁰

The Ukrainian government thus sought to change a material fact of independent statehood that was itself a policy choice of Soviet planners. Prior to the Ukrainian SSR’s industrialization, Ukraine had its own energy industry, based on its abundant coal, which was phased out in favor of lower-cost alternatives in Russia and Central Asia. Particularly after the 1960s Soviet planners allocated oil and gas to Ukraine’s energy-intensive heavy industry at effective prices far below those of the world market. Soviet strategists, who sought to tie the constituent republics closely together, succeeded brilliantly in institutionalizing Ukraine’s economic dependence.¹¹

Ukrainian officials quickly became all too keenly aware of their country’s profound dependence on low-cost Russian energy. Evhen Baramikov, chief of interrepublic trade in the Ministry of the Economy, explained that although Russia “can last a year without our food,” it “can halt Ukrainian industry in a day.”¹² As deputy prime minister for CIS affairs Valentin Landik insisted, “world prices for oil is death for us.”¹³ Clearly Russia was not extracting resources with its policy of subsidizing Ukrainian industry; instead, subsidies purchased influence. As political scientist Paul D’Anieri points out—in a Hirschmanesque analysis of

¹⁰ The plan was reprinted in “Kravchuk’s Report Had the Effect of an Exploding Bomb,” *Komsomol’skaia pravda*, March 26, 1992, in *Current Digest of the Post-Soviet Press*, vol. 44, no. 12 (1992): 15–16. Also see Sergei Tsikora, “Iz SNG Ukraina ne vykhodit, no ekonomicheskii kurs – meniaet” (Ukraine is Not Leaving the CIS, But Its Economic Course is Changing), *Izvestiia*, March 25, 1992; Chrystia Freeland, “Ukraine Plans to Sever Russian Economic Links,” *Financial Times*, March 24, 1992; Alex Shprintsen, “Ukraine Will Speed Up Breakaway from Russia,” *Los Angeles Times*, March 25, 1992; Serge Schmemmann, “Ukraine’s Parliament Votes to Replace the Ruble,” *New York Times*, March 26, 1992; and “Ukraine’s Parliament Approves Plan That Could End Nation’s Use of the Ruble,” *Wall Street Journal*, March 25, 1992.

¹¹ See Helen Boss, “Ukraine’s First Year of Economic Statehood,” in *Economic Transformation in East-Central Europe and the Newly Independent States*, ed. Gabor Hunya (Boulder, Colo.: Westview, 1994); and Leslie Dienes, “Energy, Minerals, and Economic Policy,” in *The Ukrainian Economy: Achievements, Problems, Challenges*, ed. I. S. Koropeckyj (Cambridge, Mass.: Harvard Ukrainian Research Institute, Harvard University Press, 1992).

¹² Quoted in Chrystia Freeland, “Kiev Gripped in Russian Stranglehold—Ukraine’s Economy Will Pay a Heavy Price for Defying Moscow,” *Financial Times*, July 23, 1992.

¹³ Quoted in John Lloyd, “Weak Ukraine Plays into Russia’s Hands: Economic Union Means Giving Moscow Control of Many of the Levers of Power,” *Financial Times*, September 17, 1993.

Ukraine's dependence—in “a strictly economic sense, the energy trade with Russia is highly beneficial to Ukraine.”¹⁴

By the end of 1992 Ukraine was already mired in a profound economic crisis. The Ukrainian economy had collapsed, in part a consequence of the rupturing of economic ties with Russia and the rest of the Soviet Union. Fuel shortages, the closure of foreign markets that had only a year earlier been part of a single, all-union market, and the weak demand for Ukrainian goods in the West all called Ukraine's policy of economic autonomy into question. No one was more upset or vociferous than Ukraine's industrialists, who had protested the government's economic reorientation toward the West as soon as it had begun.

The Ukrainian government, convinced by Ukrainian industrialists and Russian officials, changed course. By late 1992 and early 1993, officials in Kyiv were forced to acknowledge that Russia was Ukraine's most important economic partner. Then prime minister Leonid Kuchma, asked how Ukraine's first year of economic independence had gone, noted the irony: “Strange as it may seem, the upshot has been an awareness of our economic dependence.”¹⁵ The Ukrainian government ended its radical autonomy policies: it cut import and export quotas in May and June 1993, eliminated the value-added tax on trade with Russia and other CIS members in August 1993, and began to cultivate a new economic relationship with Russia, one that would, it hoped, involve continued energy subsidies. According to political scientist Oles Smolansky, the government's awareness of energy shortages led President Kravchuk, “in a major about-face, publicly to express his administration's desire to establish close economic cooperation with Russia.”¹⁶ As D'Anieri argues, “the policy of cutting ties with Russia has now been reversed as the price of economic independence has proved too high.”¹⁷ Thus, although Russia was unable to coerce Ukraine into specific policy changes, it was able to prevent Ukraine from going the way of the Baltic republics, which had epitomized the preferred strategy of the Kravchuk administration in the spring of 1992.

By the beginning of the century, Ukraine's energy needs still far exceeded its domestic supply. Ukraine's 395 million barrels of oil reserves were, at the current level of production, enough for only 25 percent of

¹⁴ Paul J. D'Anieri, “Dilemmas of Interdependence: Autonomy, Prosperity, and Sovereignty in Ukraine's Russia Policy,” *Problems of Post-Communism*, vol. 44, no. 1 (1997): 16–26, at p. 18. Also see D'Anieri, *Economic Interdependence in Ukrainian-Russian Relations* (Albany: State University of New York Press, 1999); and Gregory V. Krasnov and Josef C. Brada, “Implicit Subsidies in Russian-Ukrainian Energy Trade,” *Europe-Asia Studies*, vol. 49, no. 5 (1997): 825–843.

¹⁵ Kuchma is quoted in an interview in *Komsomol'skaia pravda*, January 5, 1993, in FBIS - SOV-93-005, January 8, 1993, pp. 19–21.

¹⁶ Smolansky, “Ukraine's Quest for Independence,” p. 73.

¹⁷ D'Anieri, “Dilemmas of Interdependence,” p. 21.

domestic demand, despite the fact that oil consumption had fallen by more than half—from 813,000 to 346,000 bbl/d—during the 1990s. Ukraine imported its oil primarily from Russia, although Kazakhstan played an increasingly large role. Ukraine also remained an important transit route for Russian oil exports, as the southern branch of the Druzhba pipeline brought oil through the country on the way to Slovakia, Hungary, and ultimately the EU.

Similarly, Ukraine's 39.6 trillion cubic feet of natural gas reserves served only 20 percent of domestic needs each year, with Russia by far the most important source of the other 80 percent. As with oil, Ukraine was an important transit route for Russian gas exports to the West. Although Ukraine received a little more than 1 trillion cubic feet of Russian natural gas as payment for transiting Russian gas exports to Europe, a great deal more disappeared from the pipelines running through Ukraine. Gazprom complained of these "illegal offtakes" and attempted to hold the Ukrainian government financially responsible for the missing gas.

The Ukrainian government's attempts to diversify its dependence met with enormous difficulties, primarily because Ukraine could not afford its gas needs almost regardless of price. Although Ukraine signed a 5-year gas supply deal with Turkmenistan designed to wean the country off Russian gas, its slow payments have continued to hamper the development of this alternative supplier. At the time of the deal, Ukraine still owed Turkmenistan \$250 million for previous gas supplies, and the two governments agreed that payments would be made 50 percent in cash and 50 percent in construction and industrial projects in Turkmenistan.¹⁸ The deal was also undermined by Itera, an independent affiliate of Gazprom, which threatened to block deliveries from Turkmenistan to Ukraine unless Ukraine's existing gas debts were resolved.¹⁹

Belarus's Strategy

Belarusian authorities interpreted energy dependence on Russia not as a problem to be solved, but as a reason for closer cooperation with Russia and the multilateral reintegration of the Soviet economic area. The Belarusian government never came up with a plan for economic autonomy from Russia. Belarus reluctantly issued a national currency, then only after Russia had destroyed the ruble zone in the summer and autumn of 1993, and immediately began negotiations for a reconstituted monetary union with Russia. While many in Ukraine had debated the magnitude of economic sacrifice necessary for autonomy from Russia,

¹⁸ See Michael Lelyveld, "Ukraine: Turkmen Gas Accord May Also Benefit Russia," *RFE/RL*, May 21, 2001.

¹⁹ Ron Synovitz, "Ukraine: Gas Deal with Turkmenistan Reveals Russian Influence," *RFE/RL*, October 5, 2000; Michael Lelyveld, "Moscow Moves Closer to Resolving Ukraine's Gas Debt," *RFE/RL*, November 21, 2000.

Belarusians sought primarily to avoid any of the costs associated with independent statehood.²⁰

Thus, in January and February 1994 Russian and Belarusian officials made public their intentions to unify the two states' monetary systems, including the significant detail that Belarus would continue to receive Russian oil and gas at the subsidized prices Russian consumers and industrialists received on the domestic market. Then, in April 1994 Viacheslav Kebich and Viktor Chernomyrdin, Belarus's and Russia's respective prime ministers, signed a treaty to unify the Belarusian and Russian economies and monetary systems.²¹ As Kebich explained, it was utterly rational for Belarus to agree to Russia's terms because of his country's dependence on Russian energy. Russia, Kebich insisted, "is the only source to satisfy our energy needs."²² The policies began by Kebich were continued by Belarus's first president, Aleksandr Lukashenko. Indeed, the 1994 election produced the surreal contest between Kebich and Lukashenko to prove how much more pro-Eurasian and pro-Russian than the other each was. Belarus's pro-Eurasian foreign economic policy remained popular among Belarusians throughout the decade.²³

Although the monetary union was delayed, it was discussed and negotiated on the occasion of each of their political integration agreements in 1996, 1997, 1998, and 1999.²⁴ Even as the trade links among post-Soviet

²⁰ Ustina Markus, "Imperial Understretch: Belarus's Union with Russia," *Current History*, vol. 95, no. 603 (1996): 335–339.

²¹ See Mikhail Berger, "Belorussia obmeniala chast' svoego suvereniteta na rossiiskie rubli" (Belarus Exchanged Part of Its Sovereignty for Russian Rubles), *Izvestiia*, April 14, 1994; Valery Zhdanko, "Bunny is Ready to Compromise—Russian and Belarusian Experts Discuss Details of the Two Monetary Systems," *Segodnia*, February 3, 1994, in *Current Digest of the Post-Soviet Press*, vol. 46, no. 5 (1994): 24; and Yelena Kolokol'tseva, "Belarus Insists on Cheap Gas from Russia—Talks on Merging 'Bunny' and Ruble are Stalled", *Segodnia*, February 26, 1994, in *Current Digest of the Post-Soviet Press*, vol. 46, no. 8 (1994): 26. Also see Ustina Markus, "The Russian-Belarusian Monetary Union," *RFE/RL Research Report*, vol. 3, no. 20 (1994): 28–32.

²² Quoted in "Kebich Stresses Need for Economic Treaty with Russia," *ITAR-TASS*, September 14, 1993, in FBIS-SOV-93-178, September 16, 1993, p. 45. See also Viacheslav Kebich, "Videt' istinu: K dogovoru ob 'edinenii denezhnykh system Belorussii i Rossii'" (See the Truth: Toward the Treaty of "Unification of the Monetary Systems of Belarus and Russia"), *Belaruskaja niva*, April 27, 1994; and Oleg Stepanenko, "Viacheslav Kebich: Vykhod iz krizisa —v soiuze s Rossii" (Viacheslav Kebich: The Way Out of Crisis—Economic Union with Russia), *Pravda*, April 29, 1994.

²³ Abdelal, *National Purpose in the World Economy*, pp. 142–146; Kathleen J. Mihalisko, "Belarus: Retreat to Authoritarianism," in *Democratic Changes and Authoritarian Reactions in Russia, Ukraine, Belarus, and Moldova*, ed. Karen Dawisha and Bruce Parrott (Cambridge: Cambridge University Press, 1997); and Larissa Titarenko, *Public Opinion in Belarus* (Washington, D.C.: International Foundation for Election Systems, 1999), esp. pp. 3, 36, and 61.

²⁴ See Vladimir Konobeyev, "The Union of Russia and Belarus: New Phase of Cooperation in Foreign Policy," *Belarus' v mire*, vol. 2, no. 2 (1997): 51–53; "Slavic

states collapsed during the 1990s, Belarus actually managed to become more dependent on Russia, whose share of exports rose from 42 percent in 1992 to 65 percent in 1998 and share of imports rose from 54 to 55 percent over the same period.²⁵ The Belarusian-Russian customs union, initiated in January 1995, strengthened the trade links between the two states and reduced oil and gas prices for Belarus. Furthermore, in honor of Belarusian-Russian political integration, inaugurated by 1996 agreement, the Russian government forgave Belarus's debt to Russia, which was approximately \$1.2 billion.²⁶

As in Ukraine, Belarus's oil consumption fell dramatically during the 1990s—from 375,000 to 188,000 bbl/d. Still, in 2000 Belarus imported approximately 80 percent of its oil consumption, primarily from Russia. Although Belarus does not yet serve as an important transit route for Russian gas, 50 percent of Russia's oil exports go through Belarus on the way to the oil terminal in Ventspils, Latvia, as well as to Poland and Germany. Also, one of a handful of important oil companies operating in Russia, Slavneft, is jointly owned by Belarus and Russia.

The relationship between Russia and Belarus with regard to natural gas was much more asymmetric. Belarus depended on Gazprom for all of its gas needs, while Russia's natural gas monopoly depended on Belarus for very little indeed. Beltransgaz, Belarus's state-owned gas distributor, built up enormous arrears to Gazprom.

As production in many post-Soviet states collapsed, some observers wondered how Belarus managed to maintain high levels of unemployment and exports to Russia. The answer seemed to lie in the

Symbolism," *Economist*, April 5, 1997; Alessandra Stanley, "Russia Dilutes a Treaty with Belarus, then Signs," *New York Times*, April 3, 1997; Lee Hockstader, "Belarus, Russia Move toward a New Union," *Washington Post*, April 3, 1997; Michael Wines, "Russia and Belarus Move toward Economic Integration," *New York Times*, December 26, 1998; Wines, "Belarus's Chief Pursues Dream to Revive the Soviet Union," *New York Times*, December 27, 1998; Wines, "Russia and Belarus Agree to Join in a Confederation," *New York Times*, December 9, 1999; and Charles Clover, "Russia and Belarus in New Treaty on Reunification," *Financial Times*, December 9, 1999.

²⁵ Interstate Statistical Commission of the Commonwealth of Independent States, *Official Statistics of the Countries of the Commonwealth of Independent States* (Moscow, various years).

²⁶ See Irina Selivanova, "Ekonomicheskaiia integratsia Rossii i Belorussii i ee vlianie na razvitie narodnogo khozaistva Belorussii" (The Economic Integration of Russia and Belarus and Its Influence on the Development of the National Economy of Belarus), in *Belorussiiia i Rossiia: obshchestvo i gosudarstvo*, ed. D. E. Furman (Moscow: Prava cheloveka, 1998), pp. 320–321. In exchange Belarus renounced claims it had made on the Russian military for the removal of nuclear weapons from Belarusian territory and granted the Russian military the right to use its Belarusian bases free of charge.

absence of significant change.²⁷ As a World Bank report indicates, Belarus's economic performance, far superior to its post-Soviet neighbors, resulted in part from its "political and economic relationship with Russia." According to this view, Belarus avoided economic disaster by reaching agreements to receive Russia's "very large energy subsidies, which according to some estimates amount to 10 percent of GDP, and it has enjoyed an open border providing easy access to the Russian markets together with generous provisions for barter trading."²⁸

The Evolution of the Energy Trade Among Russia, Ukraine, and Belarus

At the end of the first post-Soviet decade three issues dominated the politics of the energy trade among these three Slavic states: the prices Russian producers charged Ukraine and Belarus, the method of Ukrainian and Belarusian payments, and the ownership and placement of the pipelines that carried Russian oil and gas to its lucrative markets outside the post-Soviet region.

Prices

The situation with regard to oil and gas prices within Russia has been extremely complex. For example, Gazprom, a Russian firm not known for its transparency, clearly sells natural gas to domestic consumers at prices much lower than those at which it sells to its European consumers. Gas prices are set by the Federal Energy Commission. Scholars have not agreed, however, about Gazprom's strategy— whether it has sought to raise or lower prices within Russia. Political scientist David Woodruff marshals significant evidence in support of the idea that Gazprom has sought to discriminate among its customers, in particular ensuring that Russian consumers, who can afford to pay less than European consumers, do in fact face lower prices.²⁹

The sources of price differentials of Russia's energy exports have also been complex and frequently unclear. Russia began raising the price of its natural gas exports in 1993. Russia clearly attempted a great deal of price discrimination. According to Corina Linden, "It is clear that CIS members generally enjoyed preferential pricing structures in terms of their energy inputs from Russia. However, CIS membership in itself was not enough to

²⁷ See Matthew Kaminski, "Is Belorussian Dictator's Growth for Real? 'Lukanomics' and Easy Credit Help Nation to Outpace Russia," *Wall Street Journal*, February 23, 1998; and David R. Marples, *Belarus: A Denationalized Nation* (Amsterdam: Harwood, 1999), chap. 2.

²⁸ See *Memorandum of the President of the International Bank for Reconstruction and Development and of the International Finance Corporation to the Executive Directors on a Country Assistance Strategy for Belarus*, Report no. 23401-BY, February 21, 2002, p. 2.

²⁹ David M. Woodruff, "It's Value That's Virtual: Bartles, Rubles, and the Place of Gazprom in the Russian Economy," *Post-Soviet Affairs*, vol. 15, no. 2 (1999): 130–148.

guarantee receipt of subsidies, nor to ensure their continuation. Energy discounts from Russia to various CIS members differed greatly, depending in large part on bilateral relations at the time.”³⁰ Thus, Belarus obtained the “lowest prices for both crude oil and natural gas,” while Ukraine “benefited from below-world-market prices for gas until 1996, when Russian-Ukrainian relations began to sour.”³¹ But the prices changed in fits and starts.

Belarusian-Russian political integration kept the prices faced by Belarusian households and firms lower than elsewhere in the CIS. Belarusian authorities negotiated a price reduction from \$50 to \$30 per thousand cubic meters of gas that took effect in April 1999, with only 10 percent of payments to be made in cash.³² In 2000, for example, although Belarus paid between \$27 and \$30 per thousand cubic meters of gas, Ukraine paid prices that varied between \$50 and \$80, Moldova paid \$79, and Lithuania paid \$80.³³ The IMF estimated the annual energy subsidy provided by Russia to be approximately \$1.2 billion, or 13.5 percent of Belarusian GDP.³⁴ In April of 2002 Putin announced, and Gazprom confirmed, that as of May Belarus would receive a larger discount in its gas prices, which fell from \$30 to less than \$20 per thousand cubic meters, the Russian domestic price.³⁵

Ukrainian officials have complained bitterly about the differential treatment of Belarus. In February 1993, Russian officials notified their Ukrainian counterparts that the price would increase from \$39 to \$85 per thousand cubic meters of gas. The Ukrainian government insisted that such a move would devastate the economy and convinced Russia to set the price at \$60 per thousand cubic meters in 1994.³⁶ But prices kept rising during the middle of the 1990s, reaching approximately \$80 per thousand cubic meters in 1999. President Kuchma complained that the Russian domestic price of \$18 per thousand cubic meters and Belarusian price of

³⁰ Corina Herron Linden, *Power and Uneven Globalization: Coalitions and Energy Trade Dependence in the Newly Independent States of Europe*, Ph.D. dissertation, University of Washington, 2000, p. 68.

³¹ Linden, *Power and Uneven Globalization*, p. 72.

³² “Gazprom Agreed to Reduce Gas Price for Belarus,” *Prime-TASS*, April 1, 1999; “Gazprom Lowered the Gas Price for Belarus,” *WPS-CIS Oil & Gas Report*, April 5, 1999; and “Compromise Agreement Between Gazprom and Belarus,” *WPS-CIS Oil & Gas Report*, April 12, 1999.

³³ “Gas Prices Lowered for Belarus,” *Nezavisimaia gazeta*, January 28, 2000, in Info-Nova Press Digest, January 28, 2000.

³⁴ IMF, *Republic of Belarus: Selected Issues*, IMF Country Report no. 02/22 (2002), pp. 38–39.

³⁵ Michael Lelyveld, “Russia/Belarus: Energy Agreement Paves Way to Integration,” *RFE/RL*, April 16, 2002.

³⁶ Ustina Markus, “Debt and Desperation,” *Transition*, vol. 1, no. 5 (1995): 14–19.

\$30 per thousand cubic meters put Ukrainian manufacturers at a serious disadvantage.³⁷

Payments

No one in Ukraine or Belarus consistently paid Russian oil firms or Gazprom cash for energy supplies. So oil and gas debts mounted. Both the Russian government and officials of private oil and gas firms proposed to trade energy debts for Ukrainian and Belarusian assets, ranging from shares in privatized firms to key components of their respective energy infrastructures. Belarus regularly accepted these offers, while Ukraine emphatically refused them. According to Amy Myers Jaffe and Robert Manning, “Russian companies are allowing Belarus and Ukraine to settle some debt by transferring ownership of industrial assets, such as oil refineries. Of the two, Belarus has been more forthcoming in offering political and industrial accommodation in exchange for debt cancellation.”³⁸ In contrast, the Ukrainian parliament consistently blocked a joint Ukrainian-Russian enterprise to improve the natural gas pipeline on the grounds that even partial Russian ownership of the country’s energy infrastructure was a threat to national security.³⁹ As Ukrainian prime minister Anatoli Kinakh insisted, “We will never be paying our energy debts with shares of our companies.”⁴⁰

Much of Ukraine’s sovereign debt to Russia for energy supplies was incurred between 1992 and 1994, before the government “parceled out the import business to private companies.” The Ukrainian government’s obligations have since increased as a result of its use of sovereign guarantees of private firms’ obligations.⁴¹ Until 1996, the state-owned firm Ukrhazprom was responsible for all gas imports and their distribution to household and industrial customers; after 1996 eight independent wholesale importers with regional monopolies have been responsible for industrial customers.⁴² The 1997 Russian-Ukrainian Basic Treaty arranged for Russia’s lease payments for use of the Sevastopol naval base to offset directly Ukraine’s energy debts to Russia. That is, Russia’s payments for

³⁷ “Ukraine Demands Lower Gas Price from Gazprom,” *WPS-CIS Oil & Gas Report*, May 26, 1999.

³⁸ Amy Myers Jaffe and Robert A. Manning, “Russia, Energy, and the West,” *Survival*, vol. 43, no. 2 (2001): 133–152, at p. 140. Also see Ustina Markus, “Heading Off an Energy Disaster,” *Transition*, vol. 1, no. 5 (1995): 10–13.

³⁹ Smolansky, “Fuel, Credit, and Trade,” p. 54. Also see Balmaceda, “Gas, Oil, and the Linkages between Domestic and Foreign Policies,” pp. 261–262.

⁴⁰ “Ukrainian Prime Minister Rules Out Debt-for-Assets Deal with Gazprom,” *AFX*, July 4, 2001.

⁴¹ Balmaceda, “Gas, Oil, and the Linkages between Domestic and Foreign Policies,” p. 261.

⁴² Balmaceda, “Gas, Oil, and the Linkages between Domestic and Foreign Policies,” pp. 270–271.

Sevastopol will not leave Moscow, but instead will be allocated directly to Ukraine's accounts with Russian firms.⁴³ In 1998 Naftohaz Ukrainy, a new company whose assets include all state-owned assets in the oil and gas industry, including those of Ukrhazprom, was established.

But the Ukrainian government's attempt to rationalize its domestic industry (as well as create opportunities for rents for the well-connected) did not clarify the situation. As Smolansky observes, "it is difficult to establish just how much Kyiv owes Moscow and for what."⁴⁴ At the end of 2000, for example, Ukraine conceded that it owed Russia \$1.4 billion for gas, while Russian authorities and Gazprom, holding the Ukrainian government responsible for all gas used or lost on its territory, claimed the figure was \$2.5 billion.⁴⁵

Also at the end of 2000 Russia offered to exchange Ukraine's gas debt for equity in its transit pipelines, but again Ukrainian officials refused, and instead proposed to establish an international consortium (including Gazprom and "third parties," presumably the EU) to manage the pipelines. In August 2001 Russian and Ukrainian officials finally agreed on a figure for Ukraine's gas debt—\$1.34 billion. Then, in April 2002, Naftohaz Ukrainy issued Eurobonds worth \$1.4 billion to restructure its gas debts to Gazprom until the year 2013, following an October 2001 agreement between the Ukrainian and Russian governments.⁴⁶

In contrast, Belarus not only faced lower prices for gas, but also much more generous repayment options from Gazprom. In April 2001, Gazprom and Beltransgaz signed an agreement to restructure the Belarusian debt between 1997 and 1999, after the previous debt had been forgiven. Of a debt of approximately \$250 million, \$77 million was to be paid off with Belarusian tractors and Beltransgaz bills of exchange. At the beginning of 2002 Belarus again owed Gazprom \$220 million.⁴⁷ During the last few years of the 1990s Belarus was allowed to pay more than three-quarters of its gas bills with bartered goods.⁴⁸

⁴³ Balmaceda, "Gas, Oil, and the Linkages between Domestic and Foreign Policies," p. 265.

⁴⁴ Smolansky, "Fuel, Credit, and Trade," p. 50.

⁴⁵ Michael Lelyveld, "Ukraine: Solution to Energy Problems Not in View Yet," *RFE/RL*, October 19, 2000; Lelyveld, "Ukraine: Latest Proposal on Gas Debts Turned Down," *RFE/RL*, July 3, 2001; and "Ukraine and Russia Continuing Efforts to Reach Agreement on Amount of Restructured Gas Debt," *Oil & Gas Week*, December 16, 2001.

⁴⁶ "Ukraine To Ask Russia to Accelerate Acceptance of USD-1.4-Billion Worth of Bonds Issued for Gas Debts," *Oil & Gas Week*, April 28, 2002. Also see "Ukraine Issues Eurobonds to Pay Off Debts for Russian Gas," *WPS - CIS Oil & Gas Report*, February 13, 2002.

⁴⁷ "Belarus and Russia Negotiated on Natural Gas Prices," *WPS - Russian Political Monitor*, January 30, 2002.

⁴⁸ Michael Lelyveld, "Belarus May Offer Little Gas Relief," *RFE/RL*, November 1, 2000. According to some estimates, barter constituted 80 percent of Belarus's payments to

Pipelines

Clearly the energy infrastructure inherited by Ukraine and Belarus was an important part of their dependence, and the pipelines laid by Soviet planners were crucial. Russian oil and gas firms were eager to control the pipelines. In particular, Russian oil firms relied a great deal on pipelines running through Belarus to the oil terminal in Latvia, while Gazprom relied on pipelines transiting Ukraine to Europe.

Belarus systematically accommodated the demands of Russian oil and gas firms. Even in the first few years of independent statehood, Belarus, according to Korchemkin, managed to increase its use of, and dependence on, Russian gas, primarily by “surrendering all gas pipelines and compressor facilities to Gazprom.”⁴⁹ There was little need, therefore, for Russian authorities to seek alternate pipelines.

The situation with regard to Ukraine was different, however. Gazprom succeeded neither in preventing illegal gas takings from nor assuming control of the Ukrainian pipelines. As energy exports increased in their importance to the Russian economy in the late 1990s, Russian authorities considered ways to diminish Ukraine’s one source of leverage in their energy trade—Ukraine’s ownership of the transit route for Russian gas to Europe. Under Putin, Russian authorities have continued to press Ukraine to allow it to convert gas debt into bonds that then could be converted into shares of Ukrainian state enterprises and Ukraine’s energy infrastructure in particular.⁵⁰ In October 2000, Russian president Vladimir Putin negotiated a strategic energy partnership with the European Union that will provide for increasing Russian natural gas exports to Europe. Part of the deal was to create a new gas pipeline through Belarus, Poland, and Slovakia, bypassing Ukraine.⁵¹ The current state of the plan to bypass Ukraine with a new gas pipeline is unclear.⁵² It is interesting note, though, that the possibility of a second gas transit trunk between Russia and the EU running through Belarus weakens the bargaining position of Ukraine, but directly enhances that of Belarus. President Lukashenko is eager to see the project completed, and confidently announced that when the new pipeline bypassing Ukraine is complete, Belarusians “will live twice as well.”⁵³

Gazprom in 1997, 74 percent in 1998, and 93 percent in 1999. See Selivanova, “*Ekonomicheskaiia integratsiia Rossii i Belorussii*,” pp. 320-323. See also “Russia Wants More Cash, Fewer Goods for Energy Supplies to Belarus,” *Belapan*, March 9, 1998.

⁴⁹ Korchemkin, “Russia’s Oil and Gas Exports to the Former Soviet Union,” p. 133.

⁵⁰ Charles Clover, “Putin: Good Neighbor or Great-Power Politics?” *Financial Times*, January 23, 2001.

⁵¹ Jaffe and Manning, “Russia, Energy, and the West,” p. 137.

⁵² “Gazprom Will Not Build Gas Pipeline Bypassing Ukraine,” *WPS – CIS Oil & Gas Report*, February 6, 2002; “Preparation of Business Plan for Construction of Gas Pipeline Bypassing Ukraine via Poland Continues,” *WPS – CIS Oil & Gas Report*, February 8, 2002.

⁵³ Lelyveld, “Belarus May Offer Little Gas Relief.”

The deal prompted the Ukrainian government to reconsider privatizing its pipeline system and allowing Gazprom some equity stake.⁵⁴ But Ukrainian officials insisted that a “third party” should be involved in the privatization, in order to ensure the “energy security” of Ukraine.⁵⁵

Finally, Ukraine also sought to diversify its access to oil and gas by promoting new pipelines. Ukraine, for example, agreed to participate in the construction of Iran-Azerbaijan-Russia-Ukraine-Europe oil and gas pipelines and Turkmenistan-Iran-Turkey-Europe gas pipelines. But the projects have not yet moved forward, because neither Ukraine “nor any of its potential partners possesses the financial resources necessary to undertake projects of such magnitude.”⁵⁶

Conclusions

The security implications of dependence on Russian energy were determined in part by the interpretations of other post-Soviet governments. The Ukrainian government interpreted dependence on Russia as a security threat, while the Belarusian government did not. Therefore, because Ukraine sought more autonomy, its dependence was limiting. But for Belarus, which not only sought to reintegrate economically but also to ally militarily with Russia, dependence narrowed the government’s policy options to those that it already preferred. In other words, energy dependence presented neither a security threat nor a constraint to the Belarusian government during the 1990s.

Ukraine’s initial strategy—to achieve economic autonomy from Russia and diversify its energy dependence—was reversed in 1992–1993, but not completely. Ukraine occupied a middle ground between Belarusian reintegration and Baltic reorientation. The existing pipelines necessarily limited Ukraine’s alternatives. Even more constraining was the fact that the Ukrainian economy was dependent not just on Russian energy, but on low-cost Russian energy. Ukraine could not have afforded alternative suppliers even if the pipelines had existed.

While Russian authorities and producers punished Ukraine for its intransigence in CIS politics with increased energy prices, they rewarded Belarus handsomely for its acquiescence and consistent support. Belarus’s strategy thus became self-reinforcing—the government interpreted dependence as a reason for further integration, which then resulted in an even higher level of dependence. If a new Belarusian government ever decides that more autonomy from Russia is a necessary component of

⁵⁴ Lelyveld, “Belarus May Offer Little Gas Relief.”

⁵⁵ Quoted in “Ukraine Promises to Pay Off Debts for Russian Gas,” *WPS – CIS Oil & Gas Report*, June 4, 2001.

⁵⁶ Smolansky, “Fuel, Credit, and Trade,” p. 52.

state security, then it will find itself hemmed into a position chosen as much by Soviet planners in Moscow as by post-Soviet planners in Minsk.

**Table 1. Energy Dependence on Russia, 1992
(as percentage of total consumption)**

Country	Oil	Gas
Ukraine	89	56
Belarus	91	100

Source: Adapted from Karen Dawisha and Bruce Parrott, *Russia and the New States of Eurasia* (Cambridge: Cambridge University Press, 1994).

Table 2. Impact on the Terms of Trade of Changing to World Prices

Country	Percent
Russia	+79
Turkmenistan	+50
Kazakhstan	+19
Kyrgyzstan	+1
Uzbekistan	-3
Tajikistan	-7
Azerbaijan	-7
Ukraine	-18
Belarus	-20
Georgia	-21
Armenia	-24
Latvia	-24
Lithuania	-31
Estonia	-32
Moldova	-38

Source: Adapted from David G. Tarr, "The Terms-of-Trade Effects Moving to World Prices on the Countries of the Former Soviet Union," *Journal of Comparative Economics* 18, no. 1 (1994): 1-24.