

Interpreting Interdependence: National Security and the Energy Trade of Russia, 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. In 1992 Russia supplied 89 percent of Ukraine's oil and 56 percent of its gas; Belarus relied on Russia for 91 percent of its oil and all of its gas.² 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. The cost of energy dependence was obvious to policy makers 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 four-

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² Karen Dawisha and Bruce Parrott, *Russia and the New States of Eurasia* (Cambridge: Cambridge University Press, 1994).

teen 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. Some observers even argued that Russia systematically attempted to use the energy dependence of the other post-Soviet states as leverage to shape their foreign policies.³ In the Ukrainian and Belarusian cases there is little evidence that the Russian government consistently sought to link threats of energy cut-offs to specific foreign-policy objectives; still, with regard to overall foreign policy orientations, Russia rewarded Belarus for its acquiescence and punished Ukraine for its intransigence in Eurasian politics.

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—in its expansive,

³ See 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.

and non-traditional, definition of state security.⁴ 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.⁵

In this chapter 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

⁴ 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," *Nezavisimaya 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): 507–20; 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): 257–86; and Rawi Abdelal, *National Purpose in the World Economy: Post-Soviet States in Comparative Perspective* (Ithaca, N.Y.: Cornell University Press, 2001), chap. 5.

⁵ 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 Security Identity," in *Security Dilemmas in Russia and Eurasia*, ed. Roy Allison and Christopher Bluth (London: Royal Institute of International Affairs, 1998), pp. 153–56; Anatoli Tozik, "V konseptsii natsional'noy bezopasnosti razrabotchiki postavili tochku" (National Security Concept is Finalized), *Narodnaya 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.

century. Finally I evaluate the current policy debate, which revolves around prices, payments, and pipelines.

Pipelines, in particular, present the most complex analytical issues for Russian, Ukrainian, and Belarusian policymakers. Because nearly all of Russia's lucrative gas exports travel through Ukraine, Russia now needs Ukrainian transit routes, though not as desperately as Ukraine needs Russian energy. In order to increase the asymmetry of the Russian-Ukrainian economic relationship and ensure the safe, inexpensive transit of its gas, Russian and gas industry officials have proposed to bypass Ukraine with a new pipeline across Belarus. Belarusian leaders would, of course, be happy to oblige. The curious result of these mutual dependencies is that Russia, Ukraine, and Belarus may be forced into a cooperative, positive-sum relationship exporting outside the post-Soviet space the one product the region offers that the world actually needs in abundance: natural gas. Although the energy trade has divided Russia and Ukraine, the pipelines may be drawing them together without hierarchy.

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."⁶ 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

⁶ 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.

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. Oil, in contrast, was not as important for industrial firms, nor was its supply as technically difficult to cut off as a result of arrears. Furthermore, whereas the end consumer was irrelevant for Russian oil exporters, the ultimate buyer of Russian gas exports was crucial. 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 Soviet Union, and it would take billions of dollars to change the supply scheme.”⁷

All fifteen 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 fifteen states also shared the same currency, the ruble, and thus comprised the so-called “ruble zone.” When a few post-Soviet governments began to make plans to exit the ruble zone, Russian policy makers made it clear that only those post-Soviet countries that remained in the zone would receive energy subsidies. After 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 mat-

TABLE 3.1

Impact on the Terms of Trade of Changing to World Prices

Russia	+79	Tajikistan	-7	Armenia	-24
Turkmenistan	+50	Azerbaijan	-7	Latvia	-24
Kazakhstan	+19	Ukraine	-18	Lithuania	-31
Kyrgyzstan	+1	Belarus	-20	Estonia	-32
Uzbekistan	-3	Georgia	-21	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*, vol. 18, no. 1 (1994): 1–24.

⁷ Korchemkin, “Russia's Oil and Gas Exports to the Former Soviet Union,” p. 130.

ter of months.⁸ The example Russia made of the three Baltic states was obvious to the remaining eleven: autonomy from Russia would have its costs. Economists evaluated the trade-off post-Soviet governments faced, which were similar for Ukraine and Belarus.⁹ (See Table 3.1.)

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: BP, a minority investor in the Russian oil company Sidanko, watched helplessly as several of Sidanko's prized assets were seized through a rival firm's manipulation of Russia's weak bankruptcy courts.¹⁰

⁸ 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, forthcoming 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.

⁹ 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).

¹⁰ See "Russia: Rules of War," *Economist*, December 4, 1999; and Bhushan and Bahree, "How Siberian Oil Field Turned Into a Minefield—BP Amoco Learns Bruising Lesson on Investing in Russia," *Wall Street Journal*, February 9, 2000. Also see Rawi Abdelal, *Russia: The End of a Time of Troubles?* Harvard Business School Case No. 701-076 (2001), p. 10.

During the mid-1990s restraints on the export prices charged by Russian oil firms in the near abroad were partially liberalized, so that each oil firm negotiated independently with Ukrainian and Belarusian importers.

The gas sector was in some respects more straightforward, though not, by the end of the 1990s, less notorious for 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.¹¹ Although many of the gas export deals were handled by a separate trading company, Itera, most observers considered Itera an extension of Gazprom. While Gazprom dealt with exports to the European Union, Itera was responsible for CIS markets. The Russian government's equity and close relationship to the Gazprom board of directors led some scholars to suggest that the firm often acted as another policy lever for the president.¹² However, at other times, particularly in Russian domestic politics, it seemed that the Russian government acted on behalf of Gazprom. There is no scholarly consensus about the extent of Gazprom's influence on public policy, as compared to policy's influence on Gazprom. But in Russia's relations with the other post-Soviet states, at least, the government's foreign policy priorities often trumped Gazprom's narrower commercial concerns. In particular, Gazprom officials frequently complained about the generous terms for gas imports that Belarus received as a result of the integration treaties Belarusian and Russian leaders signed during the 1990s.

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

¹¹ Gazprom controls more than 98 percent of Russia's gas production. With 1,680 trillion cubic feet of proven natural gas reserves, 30 percent of all reserves in the world, Russia has more gas than any other country. See *BP Statistical Review of World Energy*, June 2002, p. 20. On the evolution of the energy sector in Russia, see Fiona Hill and Florence Fee, "Fueling the Future: The Prospects for Russian Oil and Gas," *Demokratizatsiya*, vol. 10, no. 3 (2002).

¹² See, for example, Jan S. Adams, "Russia's Gas Diplomacy," *Problems of Post-Communism*, vol. 49, no. 3 (2002): 14–22.

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 refused, for example, to give in fully to Russian demands about the distribution of Soviet assets, control of the Black Sea Fleet, and basing rights in Sevastopol.¹³ During the rest of the decade, Russia did not systematically attempt to alter specific Ukrainian policies with threats about energy cut-offs, but the Ukrainian government was nonetheless extremely concerned about the possibility of manipulation that their dependence created.

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.¹⁴ 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 not growth, not reform, not development, but 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

¹³ 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.: United States Institute of Peace, 1999), p. 142. For a comprehensive, critical analysis of these issues, see Clelia Rontoyanni, *Russia’s Policies towards Belarus and Ukraine: Towards Integration or Disintegration?*, Ph.D. diss., University of Glasgow, 2001, chap. 2.

¹⁴ 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): 119–56, esp. pp. 144–54.

country's very independence is jeopardized." The policy response was to 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."¹⁵

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.¹⁶

Ukrainian officials quickly became all too keenly aware of their country's profound dependence on low-cost Russian energy. Evhen Baramikov, chief of inter-republic 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."¹⁷ As Deputy Prime Minister for CIS

¹⁵ The plan was reprinted in "Kravchuk's Report Had the Effect of an Exploding Bomb," *Komsomol'skaya pravda*, March 26, 1992, in *Current Digest of the Post-Soviet Press*, vol. 44, no. 12 (1992): 15–16. Also see Sergey Tsikora, "Iz SNG Ukraina ne vykhodit, no ekonomicheskii kurs—menyaet" (Ukraine is Not Leaving the CIS, But Its Economic Course is Changing), *Izvestiya*, 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.

¹⁶ 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).

¹⁷ Quoted in Chrystia Freeland, "Kiev Gripped in Russian Stranglehold—

Affairs Valentin Landik insisted, “world prices for oil is death for us.”¹⁸ 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 Ukraine’s dependence—in “a strictly economic sense, the energy trade with Russia is highly beneficial to Ukraine.”¹⁹

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. The 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.”²⁰ 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

Ukraine’s Economy Will Pay a Heavy Price for Defying Moscow,” *Financial Times*, July 23, 1992.

¹⁸ 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.

¹⁹ 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): 825–43.

²⁰ Kuchma is quoted in an interview in *Komsomol’skaya pravda*, January 5, 1993, in FBIS-SOV-93-005, January 8, 1993, pp. 19–21.

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."²¹ 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."²² 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 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 to fill its gas needs almost regardless of price. Although Ukraine signed a

²¹ Smolansky, "Ukraine's Quest for Independence," p. 73.

²² D'Anieri, "Dilemmas of Interdependence," p. 21.

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.²³ The deal was also undermined by Itera, an ostensibly independent affiliate of Gazprom, which threatened to block deliveries from Turkmenistan to Ukraine unless Ukraine's existing gas debts were resolved.²⁴ Ultimately, as Arkady Moshes points out, Ukraine's attempt to diversify was a "spectacular failure."²⁵ Thus, despite the fact that the government considered energy dependence a problem, it was a problem with which Ukrainians would have to live for some time.

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, but only after Russia had already 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, Belarusians sought primarily to avoid any of the costs associated with independent statehood.²⁶

Thus, in January and February 1994 Russian and Belarusian officials made public their intentions to unify the two states' monetary systems,

²³ See Michael Lelyveld, "Ukraine: Turkmen Gas Accord May Also Benefit Russia," *RFE/RL*, May 21, 2001.

²⁴ 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.

²⁵ Arkady Moshes, "Russian-Ukrainian Relations After Ukraine's Elections," Program on New Approaches to Russian Security Policy Memo No. 82 (1999).

²⁶ Ustina Markus, "Imperial Understretch: Belarus's Union with Russia," *Current History*, vol. 95, no. 603 (1996): 335–39.

including the significant detail that Belarus would continue to receive Russian oil and gas at the subsidized prices Russian consumers and industrialists paid on the domestic market. Then, in April 1994 Vyacheslav 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.²⁷ 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."²⁸ The policies begun 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.²⁹

Although the monetary union was delayed, it was discussed and

²⁷ See Mikhail Berger, "Belorussiya obmenyala chast' svoego suvereniteta na rossiiskie rubli" (Belarus Exchanged Part of Its Sovereignty for Russian Rubles), *Izvestiya*, April 14, 1994; Valery Zhdanko, "Bunny is Ready to Compromise—Russian and Belarusian Experts Discuss Details of the Two Monetary Systems," *Segodnya*, 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," *Segodnya*, 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.

²⁸ 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 sistem Belorussii i Rossii'" (See the Truth: Toward the Treaty of "Unification of the Monetary Systems of Belarus and Russia"), *Belaruskaia niva*, April 27, 1994; and Oleg Stepanenko, "Vyacheslav Kebich: Vykhod iz krizisa—v soyuze s Rossei" (Viacheslav Kebich: The Way Out of Crisis—Economic Union with Russia), *Pravda*, April 29, 1994.

²⁹ Abdelal, *National Purpose in the World Economy*, pp. 142–46; Kathleen J. Mihalisko, "Belarus: Retreat to Authoritarianism," in *Democratic Changes and Authoritarian Reactions in Russia, Ukraine, Belarus, and Moldova*, eds. 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.

negotiated on the occasion of each of their political integration agreements in 1996, 1997, 1998, and 1999.³⁰ Even as the trade links among post-Soviet states collapsed during the 1990s, Belarus actually managed to become more dependent on Russia, whose share of Belarus's exports rose from 42 percent in 1992 to 65 percent in 1998 while its share of imports rose from 54 to 55 percent over the same period.³¹ 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.³²

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

³⁰ 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 Symbolism," *The 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.

³¹ Interstate Statistical Commission of the Commonwealth of Independent States, *Official Statistics of the Countries of the Commonwealth of Independent States* (Moscow, various years).

³² See Irina Selivanova, "Ekonomicheskaya integratsiya 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 *Belorussiya i Rossiya: obshchestvo i gosudarstvo*, ed. D. E. Furman (Moscow: Prava cheloveka, 1998), pp. 320–21. 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. See also Rontoyanni, *Russia's Policies towards Belarus and Ukraine*, pp. 95–96.

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, was, until several recent share tenders, 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 during the 1990s.

As production in many post-Soviet states collapsed, some observers wondered how Belarus managed to maintain high levels of employment and exports to Russia. The answer seemed to lie in the absence of significant change.³³ As a World Bank report indicates, Belarus' 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."³⁴

THE EVOLUTION OF THE ENERGY TRADE OF 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, frequency, even existence of Ukrainian and Belarusian payments, and the ownership

³³ 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.

³⁴ 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. On the extent of these energy subsidies, see also Rontoyanni, *Russia's Policies towards Belarus and Ukraine*, pp. 96–100.

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 even 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. And gas prices are set by the Federal Energy Commission; this much is clear. Scholars have not agreed, however, about Gazprom's strategy—whether it has sought to raise or lower prices within Russia. 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.³⁵

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, but not universally. 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 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."³⁶ Thus, Belarus obtained the "lowest prices for both crude oil and natural gas," while Ukraine faced increasing gas prices as tensions in Ukrainian-Russian relations mounted.³⁷ 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.

³⁵ 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): 130–48.

³⁶ Corina Herron Linden, *Power and Uneven Globalization: Coalitions and Energy Trade Dependence in the Newly Independent States of Europe*, Ph.D. diss., University of Washington, 2000, p. 68.

³⁷ Linden, *Power and Uneven Globalization*, p. 72.

Although independent Russian oil firms were free after 1996 to negotiate export prices independently with Belarus, Belarus continued to pay below market prices until Russian domestic oil prices approached world levels.³⁸ Gas prices, much more important to the Belarusian economy, were the source of intense negotiations. 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.³⁹ 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 \$80.⁴⁰ The IMF estimated the annual energy subsidy provided by Russia to be approximately \$1.2 billion, or 13.5 percent of Belarusian GDP.⁴¹ 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.⁴² If Russian leaders and Gazprom do, however, gradually liberalize prices on the domestic market over the next few years—as they have promised—Belarusians' subsidy will disappear along with the Russians'.⁴³

As with the low Russian domestic prices, Gazprom apparently considered Belarus's low and declining prices for gas a matter of business strategy. That is, rather than simply having low prices for Belarusian consumers forced upon it, Gazprom appears to have considered the ability of Belarus to pay and adjusted its business model accordingly. Clelia Rontoyanni, writing of Gazprom and Itera, suggests that "Russian gas exporters have treated these arrangements less as a necessity (as Belarus would not have

³⁸ Rontoyanni, *Russia's Policies towards Belarus and Ukraine*, pp. 98–99.

³⁹ "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.

⁴⁰ "Gas Prices Lowered for Belarus," *Nezavisimaya Gazeta*, January 28, 2000, in Info-Nova Press Digest, January 28, 2000.

⁴¹ IMF, *Republic of Belarus: Selected Issues*, IMF Country Report no. 02/22 (2002), pp. 38–39.

⁴² Michael Lelyveld, "Russia/Belarus: Energy Agreement Paves Way to Integration," *RFE/RL*, April 16, 2002.

⁴³ See Rontoyanni, *Russia's Policies towards Belarus and Ukraine*, p. 97.

been able to pay higher prices in hard currency in any case) and more as a form of investment.” Compared to Ukraine, Belarus pays for gas relatively regularly, prevents the illegal siphoning of the gas that does transit the country, and offers the potential for a transit route for gas exports to Europe that is more reliable than Ukraine. The deepening of Belarusian-Russian integration ensures for Gazprom a politically stable path to lucrative European markets and an effective bargaining chip with intransigent Ukrainian officials.⁴⁴ Moreover, although Belarusian authorities have been slow to honor the deal, the 1999 Belarusian-Russian integration treaty promises that Gazprom will own the Belarusian gas pipeline network as well as a share in Beltransgaz.⁴⁵

Ukrainian officials have complained bitterly about Russia’s 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 1994.⁴⁶ 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 per thousand cubic meters put Ukrainian manufacturers at a serious disadvantage.⁴⁷ Russian officials simply pointed out that neither the Russian government nor Gazprom was obliged to subsidize Ukrainian firms.

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

⁴⁴ Clelia Rontoyanni, “Belarus and the East,” in *Post-Communist Belarus*, ed.

Stephen White (Boulder, Colo.: Rowman & Littlefield, forthcoming 2002).

⁴⁵ Rontoyanni, *Russia’s Policies towards Belarus and Ukraine*, p. 100.

⁴⁶ Ustina Markus, “Debt and Desperation,” *Transition*, vol. 1, no. 5 (1995): 14–19.

⁴⁷ “Ukraine Demands Lower Gas Price from Gazprom,” *WPS—CIS Oil & Gas Report*, May 26, 1999.

from shares in privatized firms to key components of their respective energy infrastructures. Belarus regularly accepted these offers, though it was always slow to follow through, while Ukraine emphatically refused them.⁴⁸ 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.”⁴⁹ 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.⁵⁰ Indeed, a 1995 law prohibits the sale of such “strategic enterprises,” although Gazprom has been eyeing parts of Ukraine’s energy infrastructure and a number of firms in the metallurgical and chemical industries.⁵¹ As Ukrainian Prime Minister Anatoli Kinakh insisted, “We will never be paying our energy debts with shares of our companies.”⁵²

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.⁵³ Until 1996, the state-owned firm Ukrhazprom was responsible for all gas imports and their distribution to household and industrial customers; since 1996 eight independent

⁴⁸ Belarus’s reluctance to follow through on agreements it signed was greatest with regard to the control over state enterprises. By the summer of 2002 the equity of Belarus’s state-owned firms had not been transferred to Russia. I am grateful to Clelia Rontoyanni for pointing this out.

⁴⁹ 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.

⁵⁰ Smolansky, “Fuel, Credit, and Trade,” p. 54. Also see Balmaceda, “Gas, Oil, and the Linkages between Domestic and Foreign Policies,” pp. 261–62.

⁵¹ Rontoyanni, *Russia’s Policies towards Belarus and Ukraine*, p. 114.

⁵² “Ukrainian Prime Minister Rules Out Debt-for-Assets Deal with Gazprom,” *AFX*, July 4, 2001.

⁵³ Balmaceda, “Gas, Oil, and the Linkages between Domestic and Foreign Policies,” p. 261.

wholesale importers with regional monopolies have been responsible for industrial customers.⁵⁴ 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 Sevastopol do not leave Moscow, but instead are allocated directly to Ukraine's accounts with Russian firms.⁵⁵ 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 simplify the energy trade between Russia and Ukraine. As Smolansky observes, "it is difficult to establish just how much Kyiv owes Moscow and for what."⁵⁶ 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.⁵⁷

At the end of 2000 Russia offered again 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.⁵⁸ The bonds, moreover, paid the lowest interest rate available internationally

⁵⁴ *Ibid.*, 270–71.

⁵⁵ *Ibid.*, 265.

⁵⁶ Smolansky, "Fuel, Credit, and Trade," p. 50.

⁵⁷ 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.

⁵⁸ "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.

and thus, arguably, constituted another form of subsidy.

Meanwhile, Gazprom used its own insurance company, SOGAZ, to insure itself against losses of gas in transit across Ukraine. Clyde & Company reinsured the policy, and paid Gazprom more than \$88 million for losses between November 1998 and December 1999. The International Commercial Arbitration Court at the Russian Chamber of Commerce in Moscow then ordered Naftohaz Ukrainy to pay Clyde & Company its \$88 million, in addition to more than \$100,000 in court costs.⁵⁹

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 with Belarusian tractors and Beltransgaz bills of exchange. At the beginning of 2002 Belarus again owed Gazprom \$220 million.⁶⁰ During the last few years of the 1990s Belarus was allowed to pay more than three-quarters of its gas bills with bartered goods.⁶¹

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 in 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

⁵⁹ See Adams, “Russia’s Gas Diplomacy,” pp. 17–18.

⁶⁰ “Belarus and Russia Negotiated on Natural Gas Prices,” *WPS—Russian Political Monitor*, January 30, 2002.

⁶¹ 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 Gazprom in 1997, 74 percent in 1998, and 93 percent in 1999. See Selivanova, “Ekonomicheskaya integratsiya Rossii i Belorussii,”

compressor facilities to Gazprom.”⁶² There was little need, therefore, for Russian authorities to seek alternate pipelines.

The situation with regard to Ukraine, however, was different. Gazprom succeeded neither in preventing illegal gas takings from nor assuming control of the Ukrainian pipelines. Even a 1999 Russian ban on oil exports to Ukraine failed to settle the issue of illegal takings.⁶³ 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, particularly Ukraine’s energy infrastructure.⁶⁴ 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.⁶⁵ The state of the plan to bypass Ukraine with a new gas pipeline was still unclear at the beginning of 2003.⁶⁶ It is interesting to 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. And Belarus was particularly attractive to Gazprom because it promised lower transit prices: compared to Ukraine’s \$1.09 per thousand cubic meters across one hundred kilometers, Belarus offered a mere \$0.55.⁶⁷ President Lukashenko is eager to

pp. 320–23. See also “Russia Wants More Cash, Fewer Goods for Energy Supplies to Belarus,” *Belapan*, March 9, 1998.

⁶² Korchemkin, “Russia’s Oil and Gas Exports to the Former Soviet Union,” p. 133.

⁶³ Rontoyanni, *Russia’s Policies towards Belarus and Ukraine*, p. 112.

⁶⁴ Charles Clover, “Putin: Good Neighbor or Great-Power Politics?” *Financial Times*, January 23, 2001.

⁶⁵ Jaffe and Manning, “Russia, Energy, and the West,” p. 137.

⁶⁶ “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.

⁶⁷ Moshes, “Russian-Ukrainian Relations After Ukraine’s Elections.”

see the project completed, and confidently announced that when the new pipeline bypassing Ukraine is complete, Belarusians “will live twice as well.”⁶⁸ As Moshes reports, Gazprom estimates that 70 billion cubic meters of Russia’s current 110–120 billion cubic meters of gas exports through Ukraine can be rerouted.⁶⁹

The deal prompted the Ukrainian government to reconsider privatizing its pipeline system and allowing Gazprom some equity stake.⁷⁰ But Ukrainian officials, while insisting that a “third party” should be involved in the privatization, in order to ensure the “energy security” of Ukraine,⁷¹ became increasingly desperate to avoid the building of the new pipeline. Yevhen Marchuk, secretary of the Ukrainian National Security and Defense Council, insisted that “colossal efforts must be made to stop” the bypassing of Ukraine with new pipelines.⁷² The influential publication *National Security & Defence*, of the Ukrainian Center for Economic and Political Studies, produced a special issue on the “EU-Ukraine-Russia Gas Triangle.” Its authors concluded that the Ukrainian government should “stress the inadmissibility of implementation of the project of the Poland-Slovakia pipeline link,” arguing that “such acts should be treated as unfriendly.”⁷³ Gazprom’s investment in a Belarusian gas pipeline of modest capacity (the northern section of the Yamal pipeline to Europe) and operational since autumn of 1999 demonstrated the company’s seriousness about establishing alternate export routes if it does not gain control over the Ukrainian trunk lines.

Ukraine also sought to diversify its access to oil and gas by promoting new pipelines that link its territory to other countries. Ukraine, for example, agreed to participate in the construction of Iran-Azerbaijan-Russia-Ukraine-Europe oil and gas pipelines and a Turkmenistan-Iran-Turkey-Europe gas pipeline. But the projects have not yet moved forward,

⁶⁸ Lelyveld, “Belarus May Offer Little Gas Relief.”

⁶⁹ See Arkady Moshes, “Russian Policy Towards Ukraine, Belarus, and the Baltic States in the Putin Era,” Program on New Approaches to Russian Security Policy Memo No. 123 (2000).

⁷⁰ Lelyveld, “Belarus May Offer Little Gas Relief.”

⁷¹ Quoted in “Ukraine Promises to Pay Off Debts for Russian Gas,” *WPS—CIS Oil & Gas Report*, June 4, 2001.

⁷² Quoted in Adams, “Russia’s Gas Diplomacy,” p. 18.

⁷³ See “Conclusions and Proposals,” *National Security and Defence*, no. 3 (2002): 40–43, at 43.

because neither Ukraine “nor any of its potential partners possesses the financial resources necessary to undertake projects of such magnitude.”⁷⁴

Clearly, then, the gas pipelines constitute a double-edged sword for Russia. Rather than signifying merely Ukraine’s dependence on Russian energy, the two pipelines that carry almost all of Russia’s gas exports to Europe are almost as much a Ukrainian asset as a liability. Russia’s dependence on those pipelines ensures that Ukraine’s supply of natural gas is, in the short term, secure. The importance of the pipelines to the Russian economy also means that the threat of less gas flowing to Ukraine is insignificant until Russia finds alternate export routes to Europe. As Clelia Rontoyanni points out, “Cuts in gas deliveries have barely constituted a credible sanction, since Gazprom cannot afford to interrupt supplies to its European customers.”⁷⁵

The promise of a more cooperative relationship between Russia and Ukraine may be emerging. In the summer of 2002 Russian and Ukrainian presidents Putin and Kuchma signed a statement with German chancellor Gerhard Schroeder outlining the future of Russia’s natural gas exports through Ukraine to the EU. While Russia was unable to abide Ukraine’s management of its gas pipelines, and Ukraine was unable to allow Russian ownership or management of them, the governments of both countries agreed in principle to the creation of an “International Gas Consortium” with EU firms’ involvement to deal with Russian gas exports. The negotiations are likely to be difficult, particularly because Ukraine’s government continues to insist that the consortium will not imply the privatization of the pipeline system, which, according to Prime Minister Kinakh, is a “strategic part of the country’s national heritage.” But this “brilliant idea,” according to Schroeder, at once allays Ukrainian concerns about Russian investment and ownership in its energy sector, Russian worries over its gas transit routes, and European interests in the stability of its gas imports.⁷⁶

⁷⁴ Smolansky, “Fuel, Credit, and Trade,” p. 52.

⁷⁵ Rontoyanni, *Russia’s Policies towards Belarus and Ukraine*, p. 112.

⁷⁶ See “Kuchma, Putin, Schroeder Sign Statement on Using Ukrainian Trunk Pipelines and Gas Supply Safety,” *Interfax-Ukraine*, June 10, 2002; “Creation of International Consortium Not Denoting Privatization of Gas Shipping System—Dubyna,” *Interfax-Ukraine*, June 10, 2002; “Schroeder Considers Brilliant Idea of Creation of International Consortium on Use of Ukrainian

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. (Some Russian observers dubbed the policy, “Russian gas for Belarusian kisses.”) 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 state security, then it will find itself hemmed into a

Trunk Gas Pipelines,” *Interfax-Ukraine*, June 11, 2002; “Ukraine's National Interests Will Be Considered in Creating International Gas Consortium,” *Interfax-Ukraine*, June 18, 2002; “Ukraine Not Planning to Privatize Gas Transportation System,” *Interfax-Ukraine*, June 21, 2002; “First Round of Ukrainian-Russian Talks on Gas Consortium Slated for July 20,” *Interfax-Ukraine*, July 5, 2002; and “Ukraine, Russia, Germany to Discuss Gas Consortium in February,” *Interfax Oil & Gas Report*, December 27, 2002–January 9, 2003. Also see “Hang On to a Good Deal,” *Kyiv Post*, June 13, 2002.

position chosen as much by post-Soviet planners in Minsk as by Soviet planners in Moscow.

The three central issues associated with national security and the energy trade—prices, payments, and pipelines—have clear policy implications for Russia, Ukraine, and Belarus, as well as third parties, particularly the European Union. The decade-long collapse of its economy finally at an end, by the beginning of the twenty-first century Russia had become essentially an exporter of commodities: 85 percent of total exports consisted of oil, gas, metals, chemicals, wood, and pulp. It has become imperative for Russia to use its energy exports to earn hard currency, more than to cultivate influence in the near abroad by subsidizing friendly or punishing unfriendly regimes. Indeed, the priorities of the Russian government increasingly have focused on the following elements: the pursuit of profits on international energy markets; compliance with World Trade Organization rules, including the phasing out of domestic energy subsidies; and the cultivation of an image as a reliable energy supplier for Western markets, rather than a manipulator of the dependences of its smaller neighbors. This rationalization of Russian foreign policy is a central reality of the political economy of Eurasia.⁷⁷

Therefore, as Russian officials attempt to rationalize the country's energy sector, the Belarusian "economic miracle," as much a product of Russian energy subsidies as anything else, is in jeopardy. As Russia's domestic energy prices approach world levels, so will Belarus's. And the long-term ability of Beltransgaz to pay in kind for gas is in doubt. Indeed, in the autumn of 2002 both the Putin administration and Gazprom appeared increasingly uninterested in subsidizing Lukashenko's Belarus. Gazprom announced that it would halve its natural gas exports to Belarus because it had already supplied the agreed-upon amount of gas at subsidized prices for the year. Russian government officials did not object, and Duma lawmakers listened to Gazprom officials explain that the firm had lost \$800 million over the last four years exporting gas to Belarus. Belarusian leaders were outraged, some even suggesting that Gazprom threatened the reduction in exports in order to pressure them

⁷⁷ See especially Celeste A. Wallander, "Economics and Security in Russia's Foreign Policy and the Implications for Ukraine and Belarus," in this volume; and Wallander, *Economic Interests, International Integration, and Russian National Security Policy*, unpublished book manuscript.

to privatize Beltransgaz more quickly. In the end Gazprom resumed its exports at the more rapid rate, but Belarusian officials had become increasingly concerned about the long-term viability of their economic strategy of relying on subsidies from Russia.⁷⁸

The priority for Belarus, therefore, is to ensure that it gets a stake in the Russian energy trade by pushing for an important gas pipeline between Russia and Europe. It is precisely this Belarusian gas route about which Ukrainian officials need to be most concerned, as it would significantly decrease the value of its only assets and sources of leverage: the gas pipelines Soviet planners built and the space in between Russia and its most economically important markets. The Ukrainian government's attempts to convince Russian and Gazprom officials to continue to depend on the Ukrainian transit route imply that it must either relinquish control to Gazprom or to a set of actors that Gazprom can trust to make the necessary investments in improving the pipelines and not to siphon gas illegally. The former is still inconceivable for a Ukrainian government that interprets its economic dependence on Russia as a problem and its energy infrastructure as a vital security interest.⁷⁹ The international consortium EU leaders are pushing forward may solve this dilemma for the Russians and Ukrainians, allowing the two countries to cooperate in one sector that presents them with an opportunity for an obviously positive-sum relationship: energy.⁸⁰

⁷⁸ See "Minsk Upset by Russian Decision to Halve Gas Exports," *Interfax Oil & Gas Report*, November 8–14, 2002; and "Russia Lifts Restrictions on Gas Supply to Belarus," *Interfax Oil & Gas Report*, November 22–28, 2002.

⁷⁹ On the recent evolution of their relations, see Arkady Moshes, "Russian-Ukrainian Rapprochement of 2001: How Viable?" *Security Dialogue*, vol. 33, no. 2 (2002): 157–70.

⁸⁰ On the role of the European Union and other third parties, see Robert Legvold, "The United States, the European Union, NATO, and the Economics of Ukrainian and Belarusian Security," in this volume.