

Wrestling from Brotherly Hugs

Prospects for Involving Belarus in Regional Energy Cooperation

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Contradicting dire forecasts of economic crisis and even collapse, “Lukanomics” has managed to lead Belarus into a thirteenth consecutive year of uninterrupted economic growth. This stability, however, has been heavily dependent upon two factors, both connected to the Russia-Belarus union that President Alexander Lukashenko managed to effect in the later years of former Russian president Boris Yeltsin’s administration: first, unlimited access to the Russian market for Belarusian goods and, second, generous discounts on Russian hydrocarbons shipped to Belarus. According to different estimates, implicit subsidies to the Belarusian economy due to subsidized gas prices and the absence of export duties on Russian oil shipped to and processed in Belarus have amounted to 10-20 percent of Belarus’ gross domestic product. In such a context, Belarusian authorities have had minimal motivation for reform.

The Belarus-Russia energy conflict in the winter of 2006-2007, provoked by Russia’s decision to phase out energy subsidies, had profound economic and political implications for Belarus. The gas price hikes and new oil export duties imposed by Russia threatened the very foundations of the welfare state and, hence, political stability. Even though Belarusian authorities ultimately managed to postpone the convergence of gas prices to European levels until 2011, they were forced to allow Gazprom to become a major shareholder of Belarus’ vital transit infrastructure, something that Lukashenko had previously fiercely opposed.

Belarus could no longer count on survival, let alone development, without a

substantial revision of its economic policy and the implementation of at least limited market reforms, including privatization, facilitation of foreign investment, and institutional transformation. As a result, Belarusian authorities began to privatize assets, woo foreign investors, and revamp the country's generous social benefits program. Recently initiated institutional reforms include labor market liberalization and tax reform.

Besides energy price increases, the most profound long-term challenge to the Belarusian economy lies in the prospect of losing its transit and "offshore" status. A brief cessation of oil transit to western Europe via the Druzhba pipeline was used by the Russian leadership in January 2007 as a pretext to accelerate the construction of new transit facilities bypassing the traditional routes via Belarus, Ukraine, and the Baltic states (particularly the North Stream gas pipeline and the Baltic Pipeline System 2). When completed, these new facilities will create surplus transit capacity for Russia and will force competition for transit among states in the region. For Belarus, this will heavily affect transit revenues and the operation of refineries.

Wrestling Away From the Bear's Hug: The North-South Dimension

As part of Belarus' adaptation strategy, authorities began discussing plans and strategies that were popular with the Belarusian national opposition in the early 1990s, namely projects of coordination and closer economic, and perhaps political, cooperation among transit states in the territory stretching from the Baltic to the Black Sea. President Lukashenko, who once made his political career trashing the nationalists, renewed calls for regional cooperation in April 2007, stressing that it "will considerably contribute to the assurance of the sovereign status of our states, and...will raise the geopolitical significance of the Eastern European region."

Lukashenko's statements were well synchronized with those of Lithuanian President Valdas Adamkus, who had declared on February 13, 2007, that Lithuania, Belarus, and Ukraine should form a strategic partnership in the region to minimize their dependence on Russian energy. In particular, Adamkus spoke about the possibility of using Lithuania's Klaipeda port for transmitting oil from Venezuela, Iran, and Africa to Belarus and Ukraine. While the possibility of such transit remains distant, since it requires a serious investment in Belarusian transit infrastructure, the statement clearly signaled a declaration of political intent. It was followed, moreover, by a declaration of the Lithuanian ambassador in Belarus expressing Lithuania's willingness to become Belarus' advocate in the Euro-Atlantic community. At the same time, Belarus expressed renewed interest in cooperation with Ukraine, sending emissaries to Kyiv to discuss energy cooperation.

The desire to engage Belarus stems logically from the efforts of Lithuania and Ukraine to forge a strategic partnership, which would benefit enormously from Belarus' participation in regional cooperation. Efforts to engage Belarus have quietly become a central element of the increasingly pragmatic relations between Minsk and its non-Russian neighbors. As reported by Dzianis Melyantsou and Adrei Kazakevich, Belarusian trade with Lithuania almost doubled from 2002 to 2006, and

Belarus became a major player in Lithuanian transit (30 percent of the Klaipeda port was filled with cargo going in and out of Belarus). As a member of the European Union and the North Atlantic Treaty Organization, Lithuania has advocated a “critical dialogue” with Minsk and was among the states that tried to block the withdrawal of EU trade preferences to Belarus in 2006-2007. As for Ukraine, Kyiv largely abstained from attempts to “export democracy” after the Orange Revolution, continuing a traditionally nonpoliticized approach towards cooperation with Lukashenko’s regime. From 2003 to 2007, bilateral trade between Belarus and Ukraine more than tripled.

Possible Areas of Cooperation

Although Ukraine’s pragmatic approach to its relations with Belarus was a subject of criticism by human rights groups, it may be beneficial for the long-term softening of Lukashenko’s regime. Lithuania and Ukraine are gradually emerging as liaisons between Minsk and the Euro-Atlantic community. Unlike other actors in the West (particularly Poland, which has had a long-standing ambition of shaping the EU’s Eastern policy), the elites of these states are not treated with deep mistrust and suspicion by the Belarusian leadership. Such a predisposition facilitates technical connections and engagement with representatives at low and mid-levels of the bureaucracy. Energy cooperation could thus be a tool for opening up Belarus and its elite to a broader range of influences. Possible areas of cooperation in the future may include:

- 1) Participation of Belarus in the construction of a nuclear power plant in Lithuania or Ukraine;
- 2) The use of the Odessa-Brody pipeline to supply oil to Belarus’ Mazyr refinery;
- 3) The establishment of an “energy bridge” for the purpose of transiting electricity from Ukraine to Lithuania through Belarus;
- 4) Lithuanian investment in Belarusian energy projects, including energy saving technologies, alternative energy sources, and hydroelectric power;
- 5) Oil transit through Lithuania’s Klaipeda port.

First, Belarusian authorities have expressed interest in participating in the “Baltic” nuclear power plant, a joint project of Lithuania, Latvia, Estonia, and Poland. This power plant will be built near the Belarusian border and will utilize Belarusian water resources. Belarus also suggested that the Baltic states use existing Belarusian facilities to connect the power plant to Poland and the EU energy system. Belarusian officials even began to consider whether Belarus would be better off joining in the construction of one or two nuclear reactors instead of building its own nuclear power plant (a project confirmed in 2008 and expected to be completed by 2017). However, serious involvement in the Baltic power plant project was eventually rejected by the Belarusian side as Minsk chose not to commit itself to such close engagement with the EU.

Second, the possibility of supplying oil to the Mazyr refinery in southern Belarus via the Odessa-Brody pipeline could be an important long-term back-up option for the refinery in the event of an unexpected cessation of the delivery of oil through the

Druzhba pipeline. Admittedly, short-term interest in such a project is minimal as Belarusian refineries are more interested in building long-term relations with Russian oil suppliers. Moreover, the destiny of the entire Odessa-Brody pipeline is unclear due to Russia's Baltic Pipeline System 2 project. Still, if the Odessa-Brody pipeline does begin to operate at planned capacity, it will present Belarus with a vital security option if relations with Russia become more complicated.

Third, an "energy bridge" project for transferring electricity from Ukraine through Belarus to Lithuania is intended to reduce the latter's dependence on Russian energy (especially in view of the closure of its Ignalina nuclear power plant and the lag in time before the opening of the Baltic nuclear power plant). Using excess capacity of Ukraine's nuclear power stations, the project would be beneficial for Belarus in two ways: first, Belarus would benefit from the transit of electricity through its territory and, second, it is interested in buying for itself relatively cheap nuclear-generated electricity to help reduce dependence on Russian energy and to compensate for the loss of the Ignalina plant as a source of electricity. The "energy bridge" would require investment of 60 million dollars in various infrastructure facilities.

The obstacles to the fulfillment of the "energy bridge" project are twofold. On the one hand, full transit cooperation will require solving the problem of 200 million dollars in unpaid Soviet-era debt owed by Ukrainian companies to Belarus. Minsk considers this money to be government debt and demands payment from the Ukrainian government, whereas the latter prefers to treat it as a corporate issue. The Belarusian side uses the issue of unpaid debt as a pretext for withholding ratification of the Belarus-Ukraine border agreement, which leaves Ukraine's northern border unmarked, a factor negatively affecting Ukraine's prospects for Euro-Atlantic integration. There is also hesitation on behalf of Belarusian officials who doubt that Ukraine will be able to honor its obligations regarding the sale of excess electric power. They have not forgotten that Ukraine itself briefly experienced a shortage of electrical energy in 2007 due to weather, which led to a cessation of electricity deliveries to Belarus. Nevertheless, the energy bridge remains the most promising and realistic project for regional energy cooperation.

Fourth, Lithuanian companies, as well as companies from other Baltic states, have expressed interest in participating in programs authorized by the Belarusian government to explore alternative energy sources, such as biomass and hydroelectric energy. The Baltic states have made huge progress regarding the use of these energy sources and can provide Belarus with vital expertise and investment. Potential investors privately state that the main barrier to investment is Belarus' unhelpful legislation (including on matters such as pricing and export-import regulations).

Finally, Minsk has considered a proposal to import oil through the Klaipeda port in the context of its attempts to diversify its supply of energy sources from states such as Venezuela and Iran. Although Lithuania confirmed that such transit would be possible, it is premature to predict how realistic such a project is and whether it would be necessary to import oil from distant locations in the short-term. Interest in the project may increase, however, if Russia moves toward a harmonization of its

internal oil prices with world ones, and if Belarus is no longer able to reap profits based on the differential between the export duties for Russian oil bound to Belarus and elsewhere.

Limits to Regional Ties

Aside from the economic uncertainties, implementation of these projects is restricted by both technical and political problems. First, energy cooperation requires a certain level of political contact with the EU, which is problematic due to visa restrictions and other sanctions imposed in response to political repression in Belarus. Second, although regional energy cooperation provides short-term guarantees against erratic methods of pressure like energy blockades, it does not, by itself, eliminate the importance of economic and geostrategic relations with Russia. Securing preferential energy prices and privileged access to the Russian market remains Minsk's top priority.

Furthermore, the Kremlin closely watches developments in the region and corrects policies that run against its interests. This situation has two important consequences for Lukashenko. On the one hand, he faces negative incentives from Moscow whenever he attempts to engage too closely with his neighbors in the north and south. On the other hand, he understands that the Kremlin might not be willing to engage in simultaneous confrontations with Ukraine and Belarus. Hence, as Russia and Ukraine will be engaged in an energy dispute again at the end of 2008, and gas prices will not be determined and agreed upon well in advance, there is a good chance that Moscow will treat Lukashenko preferentially in order to preclude a close Belarusian-Ukrainian partnership. Knowing that, the Belarusian leader is likely to use regional cooperation in order to bargain with Russia in the same way he periodically does with the EU. Accordingly, Lukashenko is likely to blackmail the Kremlin with the prospect of a "westward" (or, in this case, "southward") reorientation in order to convince Moscow to keep preferential pricing for energy resources.

Conclusions

Overall, most of the regional energy cooperation projects discussed above have yet to take off, while the future of Belarusian energy cooperation with Lithuania and Ukraine remains dependent upon the overall context of Belarus-Russia relations. If relations between Belarus and Russia become more pragmatic and marketized, many of the aforementioned projects will have a chance to be implemented, as Belarus will be forced to seek alternatives to cheap Russian energy resources.

Belarus has the potential to be an important factor in regional energy cooperation. However, its participation will be limited by both domestic political factors and by Russian carrots and sticks. The most promising area of regional cooperation, other than the "energy bridge" which remains a realistic possibility even in the medium-term, is cooperation in areas where Russian opposition is least likely and where the engagement of other states is not seen by the Kremlin as a zero-sum game. Such areas primarily include projects aimed at increasing energy

efficiency and developing alternative energy sources. Though unlikely to drastically reduce Russia's influence in the region, Belarusian involvement in less ambitious technical projects may have unexpected consequences for the country. Such engagement can contribute to a change in atmosphere within Belarus' government apparatus by promoting the interests of a more pragmatic younger generation, one uneasy with the prospect of Russia's unlimited domination over Belarus and aiming to normalize ties with the West. By promoting change from within, the gradual engagement of Belarus in regional cooperation, starting with energy, can contribute to a gradual softening and even erosion of Lukashenko's system.

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