



On 1 January 2020 the Eurasian Economic Union (EAEU) celebrated its fifth birthday amid conflicting ambitions of its members. Comprising Russia, Belarus, Kazakhstan, Armenia and Kyrgyzstan, its aim is to create a rules-based economic union among post-Soviet states and eventually, a common energy market by 2025.

However, rather than implementing a single market with the free movement of goods, services, capital and labour, barriers and restrictions to mutual trade have increased as Russia solidifies its influence in the EAEU region and its Asian and European neighbours. Restrictions of Russian oil supplies to Belarus and obstacles to Kazakhstan's coal exports to Ukraine via Russia have been the most notable examples.

'Now, with new constitutional changes in Russia prioritising Russia's national interests above international obligations, the formation and operation of single markets have fewer chances for success,' says Arseny Sivitsky, Director of Minsk, Belarus-based think tank Centre for Strategic and Foreign Policy Studies.

The initial idea

The EAEU first evolved in 1994 from an idea of former Kazakhstan President Nursultan Nazarbayev, who sought a cohesive economic union of post-Soviet states that would contain Russia's global ambitions. This was followed by a number of Russian-led attempts to integrate post-Soviet economies, notably a mid-2000s effort between Kazakhstan, Belarus and Ukraine. However, this was foiled by Ukraine's 2004–2005 Orange Revolution and in 2011 resulted in

Union of discontents

The Eurasian Economic Union (EAEU) goal of creating a common energy market among post-Soviet states looks very challenging, writes Maria Kielmas.

a customs union between Russia, Belarus and Kazakhstan that Russian President Vladimir Putin hoped to rebrand as the Eurasian Union. Following opposition from Belarus and Kazakhstan, the term 'economic' appeared in the union name and its treaty excluded all political provisions.

To date, the EAEU has made progress mainly on making border crossings easier, explains Mamdouh Salameh, Visiting Professor of Energy Economics at ESCP Europe Business School in London. Customs inspections on internal borders have nearly ceased, and customs procedures and payments on external borders have to some extent been harmonised. 'However, to create a harmonised energy policy within the EAEU, agreements should be reached on issues such as energy trade, harmonisation of energy prices and coordination of energy policies in terms of production and exports, adds Salameh. 'There is also a need for agreement on energy transition from hydrocarbons to renewables and legislation to govern the transition.'

(Left to right) Eurasian Economic Union (EAEU) official flag (left) and national flags of the five countries which are full member states of the EAEU – Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia

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New model needed

The EAEU has adopted some of the terminology and style of institutions such as the European Union (EU), Moscow-based Eurasian Economic Commission and Almaty, Kazakhstan-based Eurasian Development Bank. But in contrast to the EU, which is a union of democracies, the EAEU is a union of autocracies. An EU-style energy market is not on the cards either. 'A harmonised EAEU energy market will be unique and we will have to create a new model because we have a different history to that of the EU energy market,' comments Lidiya Parkhomchik, an expert at the Almaty-based think tank Institute for World Economics and Politics (IWEP). 'Both Russia and Kazakhstan are energy suppliers sharing common infrastructure and long-term supply agreements. Therefore, the energy market for EAEU members is not a matter of source or transit security as for the EU, but is related to financial and economic security.'

Moveable deadlines

The Eurasian Economic Commission has announced that trade rules for a common electricity market should be adopted by 1 July 2022. EAEU member states are anticipated to decide on the organisation responsible for centralised electricity trading by October 2022 and a pricing methodology should be agreed by 2024. However, open access to oil and gas pipeline infrastructure, pricing and trading regulations are all issues that remain outstanding.

Moreover, the economic asymmetry within the EAEU is so skewed in favour of Russia that the Kremlin will always maintain the upper hand. In 2018 the Russian

economy accounted for 84.3% of total EAEU GDP, with the second largest – Kazakhstan – accounting for just 10.6%. This asymmetry will decrease only very moderately over the coming five years, notes Yuriy Kofner, Researcher at the Moscow-based Skolkovo Institute for Emerging Market Research. Russia and Kazakhstan are net exporters of oil and gas while the other three countries are net importers. (Kyrgyzstan produces 1,000 b/d oil.) Kofner believes that the stipulated deadline of creating common energy markets by 2025 is unlikely to be met.

Growing tensions

Meanwhile, tension between member states, especially Belarus and Russia, are growing.

‘Every year, before the New Year, we have to kneel down and beg for petroleum products,’ said Belarusian President Alexander Lukashenko, speaking in late January 2020 to paper mill employees in Shlov, his home region in eastern Belarus. He was referring to an oil supply dispute with Russia that has been escalating since 2016. Russia has been supplying Belarus with 90% of its oil and 100% of its gas demand since the mid-1990s on preferential terms in return for a certain degree of geopolitical loyalty. The country produces a modest 34,000 b/d of oil from the Pripyat Basin, a Belarusian extension of the Dnieper-Donets Basin in Ukraine, which is exported to Germany. Over the 1990s, Minsk and Moscow reached a number of economic, political and military agreements, culminating in a 1999 treaty establishing the Union State of Belarus and Russia.

Up to 2015, discounts on Russian oil imports to Belarus amounted to 50% – but these have become a permanent source of political tensions, economic disputes and ‘energy wars’ between Minsk and the Kremlin, explains Sivitsky. By 2019, the discounts had decreased to 25%, falling to 17% in 2020 and will be eliminated by 2025 when Belarus will have to buy Russian crude at standard market prices. This is the result of a so-called ‘tax manoeuvre’ by the Kremlin which substituted oil export duties with a production tax paid by oil companies directly to the Russian federal budget.

By 2025, Russian domestic refiners will have to pay a standard oil export price for their supplies but will benefit from a series of subsidies called ‘negative excises’ that will keep their costs down. But

these subsidies are only available to refiners subject to Russian tax jurisdiction, so Belarus’ 240,000 b/d Novopoltsk and 320,000 b/d Mozyr refineries do not qualify. The effective oil import price increase is equivalent almost to 5% of Belarus GDP.

Russian ultimatum

In late 2018, Russia made an offer of discounts on Russian oil and gas in exchange for Belarus national sovereignty and integration with the Russian Federation. Kofner thinks that there could be room for a compromise solution within the framework of the Union State. But Lukashenko has rejected the ultimatum and will not voluntarily give up Belarus sovereignty. ‘There is no chance that both parties are going to make concessions to each other, so tensions in relations will grow,’ observes Sivitsky.

The Belarus government has drafted a strategy to buy no more than 40% of its oil needs from Russia by 2024. It further upped tension with Moscow in January by slapping a 6.6% ‘environmental’ tax on oil transit, although it remains unclear how this will function. The task now is to seek out alternative supplies. But this is not straightforward and still requires Russian consent.

Kazakhstan negotiations

Oil supply negotiations between Kazakhstan and Belarus started in October 2018, but there is no solution in sight. ‘Oil supplies via the Druzhba pipeline have to be co-ordinated with Russia, but even if the parties choose another option the issue of price remains,’ notes Parkhomchik. Kazakhstan’s westwards oil exports flow via its Ozen–Atyrau–Samara oil pipeline that links with Transneft’s Druzhba line, also transporting oil westwards. Oil swaps could be one way out of the dilemma, but conditions for such swaps between Belarus and Kazakhstan do not yet exist, she adds.

Kazakhstan, through state oil company KazMunayGaz, conducted a profitable oil swap programme with Iran from the 1990s to 2010, with transit costs of just \$1/b. But when the Iranian side increased the price, Kazakhstan halted the swaps. This was followed by US, EU and UN sanctions against Iran making further swaps impossible despite frequent promises from the Iranian side that the swap programme will resume.

Supplies via Lithuania

Belarus, meanwhile, bought two cargoes of Norwegian oil



that landed at Lithuania’s Baltic port of Klaipėda, and then went on to Belarus. Lithuania and Belarus have had a major dispute since 2008 over the safety of the Russian-designed and financed Ostrovec nuclear power plant, following accident-prone construction along the Belarusian-Lithuanian border just 40 km north of the Lithuanian capital Vilnius. But this disagreement will not affect the transit of oil supplies to Belarus via Lithuanian territory, thinks Sivitsky. Lithuania is eager to help Belarus withstand Russian pressure because, if Belarus loses its independence, this will have dramatic security implications for Lithuania and other neighbouring countries, he adds. The oil transit trade will also be very profitable for Lithuania, but considerably more expensive for Belarus than Russian supplies.

In January 2020, Belarus dispatched offers for oil imports to Azerbaijan, Ukraine, Turkey, and Poland, although no firm orders have been placed. During an early February visit to Minsk, US Secretary of State Mike Pompeo said US oil companies were ready to supply 100% of Belarus oil needs at competitive prices. The problem is not only how a cash-strapped Belarus will pay for such supplies, but it is also subject to US sanctions at various levels since 2008 because of worsening human rights abuses. Pompeo indicated that these sanctions may be lifted, but not in total until April 2021.

So far, major oil and gas producer Uzbekistan is resisting Russian pressure to join the EAEU. With trade wars and political tensions the new normality, the EAEU’s future as a market is questionable. ●

Field operated by Kazgermunai, a KMG (KazMunayGaz)/CNPC (China National Petroleum Company) joint venture, in the Kyzylorda region, south central Kazakhstan

Photo: KMG