



Belarus-Russia: 'Special Bond' Unravels Again

A disagreement over the terms of Russian crude deliveries to Belarusian refiners could escalate and disrupt the flow of 1.2 million b/d of crude via the Druzhba pipeline to European refiners. For now, rumors of a cut in deliveries contrast with official statements that flows are unchanged. The stakes are high, but both sides have reasons not to disrupt crude supply to refiners in Europe.

Conflict Was Brewing in 2009

The warning signs for the current conflict were visible earlier in 2009. In the past year Belarusian policy changes and rhetoric sent strong signals that, as ESAI reported in a July 2009 memo, "may signal a fundamental change of course away from Russia." Belarus sought to improve relations with Europe, embracing the EU's Eastern Partnership program, while President Alexander Lukashenko lashed out at Russia in an unusually harsh tone. As tensions escalated, it was Belarus which moved the dispute into the oil sector. It briefly shut the Unecha-Ventspils product pipeline used to export Russian diesel via the Baltic Sea. The interruption of diesel flows was brief. It hardly resonated in Europe's distillate market given brimming inflows and inventories. These tensions were the "slowly burning fuse" for current developments. The stakes are much higher now...

High Stakes Game Boils Over Again

The current dispute sprouts only in part from the expiration of an aftermath patched together following a previous dispute over crude flows. In January 2007, Belarus slapped a tariff on oil transit, which caused Russia to briefly cut oil flows. Following resolution of that dispute, Russia gave Belarus a 35.8 percent discount on the duty for crude deliveries to Belarusian refineries. Since crude deliveries to Belarus from Russia have not been subject to Russia's full export duty, Belarus has processed Russian crude and exported the 35,000 b/d of crude it produces domestically. In an effort to extract maximum concessions from Russia, Belarus seeks to eliminate the export duty on crude imports. Russia conceded to this point, but with the demand that the products Belarus produces for export be subject to a full export duty.

The dispute is ultimately rooted in the broader issue

of Belarus's ultimate political orientation. Belarus is wrangling over the terms of its entry into a customs union with Russia and Kazakhstan. In the context of those negotiations, Belarus has extracted concessions on the price it pays for gas imports. As part of this game, Belarus is once again offering to allow Russian companies access to privatization of Belarusian refining assets. Thus after warning of a rupture with Russia and closer relations with Europe earlier this year, Belarus more recently has offered Russia the prospect of closer integration in exchange for significant concessions. The process of defining Belarus's relations with Russia on the one hand and the EU on the other has been stalled for years. The game Belarus has been playing with Russia will not end anytime soon. After the latest conflict, energy relations with Russia will still be unresolved. Instead, they will patch over their differences in a temporary agreement. In other words, more conflicts are likely.

Despite the high stakes, both sides have reasons to prevent a meaningful disruption of crude supply to refiners in Europe. Due to the Nord Stream gas pipeline and the Baltic Pipeline System, Belarus will soon become dispensable to Russia as a transit state for both oil and gas. It should avoid escalation to preserve that role. Russia also has incentives to avoid a disruption. It must repair its reputation as a supplier of energy resources to Europe to promote new gas pipelines to Europe and avoid losing market share.

Coming January 21, 2010: ESAI webinar on the future of Russian crude exports. For more information and analysis, contact Andrew Reed (areed@esai.com).