

ENERGY POLITICS OF UKRAINE: DOMESTIC AND INTERNATIONAL
DIMENSIONS

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ABSTRACT

ENERGY POLITICS OF UKRAINE: DOMESTIC AND INTERNATIONAL DIMENSIONS

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This PhD thesis aims to analyze domestic and international dimensions of Ukraine's energy politics. The thesis focuses both on the developments at domestic level as well as Ukraine's energy cooperation with the European Union and the Russian Federation. The main research problem of this dissertation is to determine the causal links between domestic and international factors as well as their impacts on the energy politics of Ukraine under Putnam's two-level game approach. The thesis also aims to clarify the role of the oligarchic groups, who represent Russian interests in Ukraine. This thesis comprises seven main chapters. After the introduction, the second chapter develops the theoretical framework of the thesis by discussing the explanatory powers of IR theories and Putnam's two-level analytical approach. The third chapter focuses on the dynamics of Ukraine's energy policy during the period between 1991-2010. The fourth and fifth chapter discusses energy policy under the presidencies of Viktor Yushchenko and Viktor Yanukovich. The sixth chapter analyses the shift in energy politics after Euro-Maidan events. The seventh chapter presents comparative analysis the Ukrainian case with the Belarusian one. The concluding chapter discusses the main findings of this thesis.

Keywords: Energy Politics, Ukraine, EU, Russia, Putnam's two-level approach.

ÖZ

UKRAYNA 'NIN ENERJİ POLİTİKASI: ULUSAL VE ULUSLARARASI BOYUTLARI

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Doktora, Uluslararası İlişkiler Bölümü

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Bu doktora tezi Ukrayna'nın enerji politikalarının ulusal ve uluslararası boyutlarını analiz etmeyi amaçlamaktadır. Tez, hem Ukrayna'nın ulusal düzeydeki gelişmelerini, hem de Avrupa Birliği ve Rusya Federasyonu ile olan enerji işbirliğini ele almaktadır. Bu tezin ana araştırma problemi, Putnam'ın 'İki-seviye Oyun Yaklaşımı' bağlamında Ukrayna enerji politikasındaki ulusal ve uluslararası faktörler arasındaki nedensel bağlantıları açığa çıkarmak ve arasındaki ilişkiyi belirlemektir. Tez aynı zamanda Ukrayna'ya Rusya'nın çıkarlarını taşıyan oligark grupların bu ülkedeki rolünü de ortaya koymayı hedeflemektedir. Bu tez yedi ana bölümden oluşmaktadır. Girişten sonraki ikinci bölümde uluslararası ilişkilerin ana akım teorileri ve Putnam'ın iki-seviyeli analitik yaklaşımı açıklanarak tezin teorik çerçevesi geliştirilmektedir. Üçüncü bölüm, 1991-2010 yılları arasındaki dönemde Ukrayna'nın enerji politikasının dinamikleri üzerinde durmaktadır. Dördüncü ve beşinci bölümler, Viktor Yuşçenko ve Viktor Yanukoviç başkanlığı yönetimindeki enerji politikalarını açıklamaktadır. Altıncı bölümde ise Euro-Maidan olaylarından sonra enerji politikasında meydana gelen değişimler analiz edilmektedir. Yedinci bölümde, bir vaka çalışması olarak Belarus ile Ukrayna'nın enerji politikası çerçevesinde karşılaştırmalı analizi yapılırken, sonuç bölümü ise tezin ana bulgularını ortaya koymaktadır.

Anahtar kelimeler: Enerji politikaları, Ukrayna, AB, Rusya, Putnam iki-seviye yaklaşımı.

*To my mother Svitlana Stelmakh, the strongest woman in my life, without whose faith
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LIST OF ABBREVIATIONS

AA – Association Agreement
AP – Action Plan
bcm – billion cubic metres
CIS – Commonwealth of Independent States
DCFTA – Deep and Comprehensive Free Trade Agreement
EaP – Eastern Partnership
EBRD – European Bank for Reconstruction and Development
EC – European Commission
ECU – Energy Company of Ukraine
EEC – European Energy Community
EIB – European Investment Bank
EITI – Extractive Industries Transparency Initiative
ENP – European Neighborhood Policy
ENPI – European Neighborhood Policy Instrument
ENTSOG – European Network of Transmission System Operators for Gas
EU – European Union
E5P – Eastern European Energy Efficiency and Environmental Partnership
FDI – Foreign Direct Investment
FSU – Former Soviet Union
FTA – Free Trade Agreement
GDP – Gross Domestic Product
GNP – Gross National Product
GECF – Gas Exporting Countries Forum
Goskomstat – State Committee of Statistics in Soviet Union
GSE – Gas Storage Europe Transparency
GTS – Gas Transmission System
IBRD – International Bank for Reconstruction and Development
IEF – International Energy Forum
IFC – International Financial Corporation
IMF – International Monetary Fund
INOGATE – Interstate Oil and Gas Transportation to Europe

IUD – Industrial Union of Donbas
LNG – Liquefied Natural Gas
MFA – Ministry of Foreign Affairs (Ukraine)
NATO – North Atlantic Treaty Organization
NERC – National Electricity Regulatory Commission, since July 2011 – National Commission for Energy State Regulation
NGOs – Non-governmental Organizations
OECD – Organisation for Economic Cooperation and Development
PCA – Partnership and Cooperation Agreement
PECI – Project of Energy Community Interest
PGNIG – Polskie Górnictwo Naftowe i Gazownictwo SA
PwC – PricewaterhouseCoopers
RUE – RosUkrEnergo
RWE – Rheinisch-Westfälisches Elektrizitätswerk
SBU – Security Service of Ukraine (Sluzhba Bezpeky Ukrainy)
SES – Single Economic Space
SIDA – Swedish International Development Agency
SCM – System Capital Management
TACIS – Technical Assistance to the Commonwealth of Independent States
TCU – Technical Coordination Unit
TPES – Total Primary Energy Supply
TRASECA – Transport Corridor Europe-Caucasus-Asia
UESU – United Energy Systems of Ukraine
UGRC – Ukrainian Gas-Resource Consortium
USSR – Union of Soviet Socialist Republics
VAT – Value Added Tax

A NOTE ON TRANSLITERATION

In this dissertation, I used Transliteration System adopted by the Decree of Ukrainian Parliament No. 55 as of January 27, 2010 for transliterating Ukrainian words into English. For Russian words I used the US Library of Congress Transliteration System. However, if using transliteration systems produces confusion or becomes odd and there is commonly accepted version of a personal or geographic name, I preferred to use this commonly accepted word instead of transliterating it.

CHAPTER 1

INTRODUCTION

When winter approaches the agenda of European leaders continues to be preoccupied with the question ‘Will there be gas disruptions again? Will Ukraine be able to secure gas transit? Will Russia use energy as a political tool?’. With years passing questions remain the same, while answers seem to be no clearer. Energy politics of post-Soviet nations, like Ukraine, remain of utmost importance not only for Russia or European neighbourhood, it shows how deeply the problems have been ignored for more than two and a half decades by the majority of international actors. Apart from energy at focus, this thesis also touches upon the most fragile topic of corruption, which is based on energy rents. Recently revived by the disclosure of ‘Panama Papers’¹ corruption seems to top international agenda worldwide and to implicate many international leaders and their influential associates. Ukraine appears to be not only a country, where corruption has been flourishing since independence, but also a bright example how domestic and international politics are tightly interconnected with shady corruptional schemes. This thesis aims to fill the gap and to cast light on the formation and evolution of energy politics in Ukraine. Understanding the nature of energy politics in Ukraine may explain other important political decisions at both levels, domestic and international as well as the impact of interest groups on it.

After the collapse of the Soviet Union newly independent countries being an integral part of the Soviet command economy found themselves economically dependent on Russian Federation. In particular, the possession of the energy resources subordinated post-Soviet countries to Russia. Ukraine was listed among those countries with one little difference. Owning a network of gas and oil pipelines, Ukraine gained the leverage to negotiate the prices for energy resources imported from Russia. Aiming to sell energy

¹ In the case of Ukraine ‘Panama Papers’ revealed that current president Petro Poroshenko attempted to use an offshore company for a pre-sale restructuring of his confectionary business ‘Roshen’. The other person mentioned is Pavlo Lazarenko, whose name is frequently mentioned in this thesis due to his engagement in murky energy schemes, which led to his imprisonment. For more information on Poroshenko’s case see, Mylovanov, Tymofiy, Mylovanova, Zoya. (April 5, 2016). *Here is what the ‘Panama Papers’ tell us about the President of Ukraine*. The Washington Post, <https://www.washingtonpost.com/news/monkey-cage/wp/2016/04/05/here-is-what-the-panama-papers-tell-us-about-the-president-of-ukraine/>, accessed on May 13, 2016.

resources to Western countries, Russia was in need of Ukrainian pipelines to transport energy resources abroad.

During the two decades energy policy developments Ukraine tried to tackle the issues of energy production, consumption and distribution in a fragmented way, dealing with the issues situationally without a clear vision. Some of the sectors, like coal and gas, benefitted from vast subsidization, while the others like renewable energy sources have been clearly underestimated since 1990s. Energy policy of Ukraine faced rather chaotic times when energy strategy, and energy-related legislative acts were lacking compliance.

In the first decade of Ukraine's independence the relations between two Slavic countries evolved from friendly neighborhood with Soviet legacy sentiment to the ones, where pure commercial benefit was mixed together with political ambitions to gain more power in the region. For Ukraine, affordable energy prices appeared to top the agenda as the economy of Ukraine was heavily relying on industry. Energy prices were defining the ability of Ukraine to overcome economic crisis and to get an impulse for the development. For Russia, export of energy resources had gradually transformed into a tool to preserve its authority over former satellite states. The role of the European Union in EU-Ukraine relations during that period was quite limited to cooperation in nuclear sector and few attempts to create tripartite gas Consortium.

In the second decade with Vladimir Putin in power Gazprom's and state's interests merged into quite successful foreign policy tool, where energy was clearly used as a tool, but not only to control former satellites, but also European countries. As Ukraine's efforts to conduct energy reforms lacked coherence, the European Union was invigorated to engage more actively into support for the energy sector liberalization in Ukraine. The lack of transparency introduced various gas trading companies to Ukrainian energy sector and created the foundations for well-established corruption schemes. Unless the energy market faced fully-fledged reforms, the uncertainty and instability stemming from Ukrainian-Russian energy relations could jeopardize EU's energy security.

The EU uses bilateral (Action Plans, Partnership and Cooperation Agreements) and multilateral tools (Eastern Partnership, European Neighborhood Policy, Energy Community) to address energy liberalization in Ukraine. The first significant development took place with Ukraine's accession of the European Energy Community, which took place under Yanukovich's presidency. But for the real reforms to take place Ukraine lived through one more revolution that brought new president to power and a real shift in energy politics was then observed. To conclude I would like to cite one energy expert, who

rightfully pointed out that: ‘As it appears natural gas has no smell. The fetid smell is an additive of politics to the natural gas’².

1.1. Research scope and objectives

This dissertation focuses on the energy politics in Ukraine since 1990s till nowadays. A period of 25 years is chosen intentionally to show the beginnings of the energy politics formation, its chaotic evolution and finally its maturity. Tracing the first years of decision-making in the energy field allows us to see what were the limitations and opportunities at the time. Later period unveils the complexity of introduction of various corruptional schemes into energy sector, which as a result made energy domain rather manually controlled by certain interest groups. The real shift in energy politics was finally observed with the current president in power. The undertaken reforms in certain areas (gas market reform) allow us to trace positive developments in the energy field.

Energy politics presents one of the crucial policy domains worldwide that is by default complicated by the complex interplay of domestic and international factors, which makes it in principle impossible to be comprehended from a(ny) single theoretical perspective available. Complementary use of several theoretical accounts within an adopted analytical perspective is virtually both a necessary and promising research entrepreneurship. This doctoral thesis will therefore draw on a specifically devised synthesis of IR accounts as well as offer Putnam’s two-level analytical approach to assess this intrinsically multifaceted research problem.

In the era of increasing competition for the energy resources Ukraine’s energy politics maintains an essential role for the wider region. Energy politics has crossed its economic limits and was deeply integrated into political spectrum. Energy politics is a domain, which connects politics, economy and international relations.

In the case of post-Soviet countries like Ukraine, energy politics usually was exploited to reach certain economic outcomes via political means. Therefore, this dissertation aims at exploring energy politics at two levels of analysis, domestic and international. Domestic level shows what kind reform was taking place and at what speed. It also reflects the relation with fundamental documents like Energy Strategy etc. As well it includes the hierarchy of decision-making in energy domain, therefore the impact of interest groups is of vital importance.

² Roman Nitsovyeh, Chief Editor of website ‘Ukrainian Energy’, head of Analytical Centre ‘DiXi Group’ in Grygoryeva, Iryna. (February 27, 2013). We say gas, but think politics. *Day*, No. 36, <http://www.day.kiev.ua/uk/article/podrobici/mi-kazhemo-gaz-maiemo-na-uvazi-politika>, accessed on March 28, 2013.

International level reflects the cooperation with two main actors, the European Union and Russia. This dissertation takes cooperation with these two actors separately, though the existence of transnational links is not denied and deserves to be explored in detail in a separate research. International level allows us to find links with domestic level of energy politics and proves that energy politics remains a domain where domestic and international actors are interconnected.

Thesis aims at analyzing the contested phenomenon of energy politics, and in case of Ukraine revealing its complexity by showing the influence of the outside actors the EU and Russia. More importantly, it analyzes how the events that took place during the last two decades affected Ukraine's role as an energy actor at the international stage and to what extent domestic factors played a crucial role.

A more precise focus of this study is set upon EU energy relations with its most important eastern neighbour – Ukraine. Though the place of Ukraine is strongly reflecting security designs of Brussels, one could question EU's unilateral and common position on Ukraine. Regardless a lack of clear EU's strategy in its relations with Kyiv, the energy component could be argued to possess more straightforward goals, which follow the path of deeper integration. This study concludes that energy integration eventually brought Ukraine closer in its aspirations to become a member of the EU.

Relations with Russia prove another tendency, where Ukraine's dependency on cheap Russian gas creates from one perspective dependency on one energy supplier with further ramifications, including political and economic concessions etc. And from the other perspective, creates a favourable ground to keep Ukraine from so crucially needed energy reforms, like energy-efficiency, energy saving, alternative energy resources etc. Russia-connected interest groups play here an important role to keep Ukraine in Russia's orbit.

Centrality of energy in both Ukraine's relations with Russia and the EU was one of the main reasons to choose it as a policy-oriented field of research within Putnam's two-level approach as advanced herewith.

This study has limitations as it mainly focuses on gas politics of the much wider energy policy of Ukraine. Occasionally, it will draw however on examples from other energy political domains, which shall provide broader framework for verifying testable hypotheses.

Interdisciplinary devised, this doctoral research is meant to advance the accounts of Foreign Policy Analysis, International Relations, International Political Economy, and Comparative Politics. This study innovatively offers a systematic and holistic analysis of

Ukrainian energy politics in the context of the country's foreign policy. It presents therefore a theoretically informed empirical research on the interplay of domestic and international factors in policy-making in the energy field as framed by the wider context of Ukraine's foreign policy developments.

This research, with its original approach and findings, presents a valuable source of information and dedicated analysis that can be used by both policy makers and academia. On the one hand, it can provide a theoretically informed policy-oriented reference for decision makers in the countries covered by the study, but also stakeholders involved, in one way or another, to shaping the frameworks for Ukrainian and international energy politics. On the other hand, the offered analytical approach can be used by International Relations, Comparative Studies and International Political Economy scholarship in advancing both broader and narrower research problems all around phenomenon of cooperation in post-Soviet countries or within related area studies. Due to the structured argument, its theoretical embeddedness and extensive empirical mapping, the findings of the thesis may be used as supporting materials in developing graduate and postgraduate courses on Ukrainian or Russian politics, Energy politics and geopolitics, Democratization studies, Conflict and Cooperation Studies etc.

1.2. Research Questions

The main research problem of this dissertation is to determine, what are the links between domestic and international levels of energy politics in Ukraine. By unveiling two competing narratives of the EU and Russia in the relations with Ukraine, this dissertation specifies the direct affect of it on Ukraine's energy policy development. By showing the patterns of (non)cooperation with EU and Russia, I intend to trace the nature of energy politics making in Ukraine.

As this dissertation intends to present the links between two levels of analysis, the research questions include further issues. First, I intend to determine the effect of such domestic factors as the nature of political system, role of the leader and political will to introduce reforms, gap between adoption and implementation of legislation on energy, involvement of interest articulators in energy decision-making, diversification efforts etc. These domestic factors are duly mentioned for the tenure of every president in order to indicate the main factors and trends shaping energy politics.

Second, I also list international factors that affect the dynamics of energy politics, among others, main energy-related foreign policy approaches as well as energy strategy of

the EU and Russia toward Ukraine, engagement of international institutions in energy politics (including IMF, EBRD etc.), affiliation of certain interest articulators to certain international actors, economic factors linkage with cheaper energy resources etc.

Two-level analysis allows me to take a precise look at energy policy making at two levels separately as well as to focus on the causal links between two levels. I argue that reforms in energy sector of Ukraine will be duly implemented only when the interrelation between domestic and international factors will be fully comprehended.

1.3. Argument

My argument lies in defining the causal links between domestic and international factors in order to explain the formation, evolution and shift in Ukraine's energy politics. In case of Ukraine, one of the post-Soviet, energy-dependent country, the interplay of domestic and international factors define the state of energy policy-making. Energy politics crosses the borders of just resource-based domain of economy, and extends its roots deeply into the politics at domestic and international level. This actually makes it rather uneasy for a research, but nonetheless so needed to be scrutinized, as opening the black box will eventually cast light on the unanswered questions of the development in the post-Soviet countries, like Ukraine.

I argue that Putnam's two-level approach duly fits the determined structured argument, since the topic researched by its complexity includes the role of both domestic interest-articulators as well as international institutions. Therefore, taking two levels of analysis provides a unique opportunity to trace the interplay of multiple factors.

By analyzing the contribution of realist and liberal IR theories on energy politics, I also unveil the strong and weak points of geopolitics and rent-seeking theories. Therefore, I argue that each of the theories touches upon important aspects of energy policy-making, but none of it by itself covers the overall complexity of the issue. Therefore, I intend to benefit from the contributions of the above-mentioned theories, while taking Putnam's two-level approach as a basis. By doing this, this doctoral work intends to fill the existing gap and to introduce innovative approach to energy politics.

1.4. Literature review

Before the review of the existing literature on energy politics of Ukraine, I would like to mention that energy issues are mainly represented in academic literature in complex way as energy is both 'essentially ambiguous good because it can be considered as both a

genuine commodity, tradable on the basis of purely commercial considerations, as a service, and as a strategic good to be used as a foreign policy tool'³. Therefore, energy policy of a country is regarded as a strategic area, where availability of energy at reasonable prices affects country's economic competitiveness, domestic capacity and power. In case of highly dependent energy countries like Ukraine, energy availability has drastic effects on country's domestic and international politics. Being a key transit country through pipeline network, Ukraine is locked geographically and subordinated to Russia's energy supply. Nevertheless bearing in mind high level of politicization of energy issues, with this literature review I aim to pinpoint main trends in the literature on energy politics of Ukraine, as well as its limitations. Further based on the critical review of the current trends in literature, I will conclude that with the missing points in literature this thesis aims to contribute to the academic literature by offering its innovative research approach.

This thesis is written based on the analysis of primary and secondary information already published. When primary information, such as contracts in energy sector, was not available publicly due to an extreme secrecy in the field, then information was obtained from secondary sources.

Apart from various primary and secondary legislative acts, the literature includes books, journals, official reports, interviews and other research documents related to the topic. In the due course of writing this thesis I also vastly benefitted from the analytical works of such research institutes as the Batory Foundation in Poland, International Centre for Policy Studies in Ukraine, DiXi Group in Ukraine, NOMOS Centre in Ukraine, Centre for Eastern Studies (OSW) in Poland, Razumkov Centre in Ukraine, Stefan Global Witness in USA etc. It should be mentioned that English language sources about the topic are scarce, especially for the period of 1990-2000. Most of the sources are in Russian or Ukrainian. The sources published until 1996 were acquired in English translation through the database of Foreign Broadcast Information Service (FBIS).

Literature, which unveils the issues related to energy politics in Ukraine, is rather limited. Most of it takes a main research perspective from the position of one of the two main actors. Such scholars as Prange-Gstöhl, Umbach, Wolczuk, Youngs, focus on energy politics of Ukraine through European lenses of energy security⁴, whereas scholars like

3 Westphal, Kirsten. (2006). Energy Policy between Multilateral Governance and Geopolitics: Whither Europe? *European Energy Policy*, Vol. 4, p. 59.

4 See, Prange-Gstöhl, Heiko. (2009). Enlarging the EU's internal energy market: Why would third countries accept EU rule export? *Energy Policy*, Vol. 37; Umbach, Frank. (2011). Ukraine's Energy Security Challenges: Implications for the EU. In T. Kuzio, D. Hamilton (Eds.). *Open Ukraine. Changing Course towards a European Future*. (95). Washington, DC: Center for Transatlantic Relations; Wolczuk, Katarzyna. (2009). Implementation without Coordination:

Abdelal, Andres, Kofman, Loudermilk, D'Anieri research the topic from Russian (in)security perspective of energy politics⁵. Along the main trend Ukraine is placed within the spectrum of energy relations with the main actors like the EU or Russia. Therefore, the focus shifts the research to the interests of Russia or the EU in Ukrainian energy sector. These Russian- and European-centered perspectives neglect domestic energy sector developments in Ukraine, while mostly remain preoccupied with the issues of energy security and geopolitics.

Among others, Schmidtke and Yekelchik focus on a triangle cooperation between these countries⁶. Malygina, Pavlenko, Antonenko, Nitsovykh, Pirani, Stern, Yafimava, Smith produced peculiar case studies raising the importance of gas as a political instrument in international politics⁷. A great amount of literature (mostly analytical reports) is dedicated to Ukraine-Russia gas crises. It is important to indicate main approaches to this case. While some scholars keep on blaming Russia in the gas cut-offs and its monopoly energy policy⁸, the other take pro-Ukrainian perspective pointing at 'geopolitical curse' that pushed Ukraine into becoming a victim of the power politics⁹. While the third group of scholars blamed both as 'at a deeper level the problem is that Ukraine's gas transit system is so old, decrepit, and corrupt that it offers both Ukraine and Russia an overwhelming

The Impact of EU Conditionality on Ukraine under the European Neighbourhood Policy. *Europe-Asia Studies*, Vol. 61, No. 2, March, pp. 187-211; Youngs, Richard. (2007). *Europe's External Energy Policy: Between geopolitics and the Market*. CEPS Working Document, No. 278, November.

5 Abdelal, Rawi. (2004). Interpreting Interdependence: National Security and the Energy Trade of Russia, Ukraine, and Belarus. In Legvold, R., Wallander, Celeste A. (Eds.). *Swords and Sustainance: The Economics of Security in Belarus and Ukraine*. Cambridge: The MIT Press; Andres, R.B., Kofman, M., Loudermilk, M.J. (2011). Solutions for Russian-Ukrainian Gas Brinkmanship. *Journal of Energy Security*, 15 March; D'Anieri, Paul. (1999). *Economic Interdependence in Ukrainian-Russian Relations*. Albany: SUNY Press.

6 Schmidtke, O., Yekelchik, S. (Eds.) (2008). *Europe's Last Frontier? Belarus, Moldova, and Ukraine between Russia and the European Union*. New York: Palgrave Macmillan.

7 Malygina, Katerina. (2010). Ukrainian-Russian Gas Relations After the 2009 Conflict: The Current Situation and Future Prospects, *Russian Analytical Digest*, No. 75, 16 March; Pavlenko, Olena, Antonenko, Anton, Nitsovykh, Roman. War in the Energy Sector as a Second Front. (2015). In Pabriks, Artis, Kudors, Andis (Eds). *The War in Ukraine: Lessons for Europe*. The Centre for East European Policy Studies, University of Latvia Press, Riga; Pirani, S., Stern, J., Yafimava, K. (June, 2010). The April 2010 Russo-Ukrainian gas agreement and its implications for Europe. *The Oxford Institute for Energy Studies*, p. 8, http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/05/NG_42.pdf, accessed October 6, 2012; Smith Stegen, Karen. (2011). Deconstructing the 'energy weapon': Russia's threat to Europe as case study. *Energy Policy*, No. 39.

8 Stern, Jonathan. (2010). The new security environment for European gas: worsening geopolitics and increasing global competition for LNG. In Lévêque, François; Glachant, Jean-Michel; Barquín, Julián; Hirschhausen, Christian von; Holz, Franziska; Nuttall, William J. (Eds.) *Security of Energy Supply in Europe: Natural Gas, Nuclear and Hydrogen*. Edward Elgar Publishing Ltd.: UK, 2010; Smith, Keith C. (2004). *Russian energy politics in the Baltics, Poland, and Ukraine: a new stealth imperialism?* Washington, D.C.: Center for Strategic and International Studies; Perovic, Jeronim. (2007). Russia's Energy Policy: Should Europe Worry? *Russian Analytical Digest*, 3 April, No. 18; Malygina, Katerina. (2010). Ukrainian-Russian Gas Relations After the 2009 Conflict: The Current Situation and Future Prospects, *Russian Analytical Digest*, No. 75, 16 March.

9 Kuzio, Taras. (March 7, 2008). Ukrainian Politics, Energy and Corruption under Kuchma and Yuschenko. How the Gas Issue Plays in Ukrainian Politics and How Ukrainian Politicians Play the Gas Issue. Paper presented at Harvard University.

incentive to make deals and then cheat on them'¹⁰. And moreover, EU's miserable role in moderating and further gas crises management was widely criticized by Smith, Schmidtke and Yekelchyk¹¹, though the first gas crisis in 2005 marked the real start for the EU to revise its energy policy and priorities toward Ukraine.

Among the first group of scholars is Jonathan Stern, who reveals real intentions of Russia during the gas crises. He asserts that 'Russian government was exerting political pressure on the Ukrainian government and president in order to reassert its influence on a country attempting to make a decisive move towards the EU and the North Atlantic Treaty Organization (NATO) and away from Russian political influence'¹². He reaffirms his statement by noticing that there was a 'lack of any public official European censure of Ukraine for taking gas supplies to which it was not entitled'¹³, which indicated that European politicians favored condemnation of Russia.

Indeed Western media vastly sided opinion that Russian actions were of political character¹⁴ and intended on 'blackmailing'¹⁵. Even the US Secretary of State commented that the episode: 'appeared to us to be politically motivated efforts to constrain energy supply to Ukraine. The game just can't be played that way ... when you do it the way it was done, with an obviously political motive, of course it causes problems'¹⁶.

Jeronim Perovic reasserted that for Europeans this gas cut-off was too 'extreme measure' to solve price disputes with Ukraine. Europeans who always paid their bills on time could not fathom why Russians would resort such measure without prior consultation with its European counterparts. Hence, Russia's image turned to 'an increasingly authoritarian and anti-democratic'¹⁷.

10 Andres, R.B., Kofman, M., Loudermilk, M.J. (2011). Solutions for Russian-Ukrainian Gas Brinkmanship. *Journal of Energy Security*, 15 March, p. 2.

11 Smith, Keith C. (2004). *Russian energy politics in the Baltics, Poland, and Ukraine: a new stealth imperialism?* Washington, D.C.: Center for Strategic and International Studies; Schmidtke, O., Yekelchyk, S. (Eds.) (2008). *Europe's Last Frontier? Belarus, Moldova, and Ukraine between Russia and the European Union*. New York: Palgrave Macmillan.

12 Stern, Jonathan. (2010). The new security environment for European gas: worsening geopolitics and increasing global competition for LNG. In Lévêque, François; Glachant, Jean-Michel; Barquín, Julián; Hirschhausen, Christian von; Holz, Franziska; Nuttall, William J. (Eds.) *Security of Energy Supply in Europe: Natural Gas, Nuclear and Hydrogen*. Edward Elgar Publishing Ltd.: UK, 2010, p. 60.

13 Ibid, p. 60.

14 See also Smith (2004), who also demonstrated the real risk that energy dependence on Russia could have far-reaching and dangerous political consequences for her neighbors. Also see, Yergin, Daniel. What Does Energy Security Mean? (July 11, 2006). *Wall Street Journal*.

15 See the European-wide press monitoring, <http://news.bbc.co.uk/1/hi/world/europe/4578000.stm>, accessed on May 7, 2011.

16 *Remarks at the State Department Correspondents Association's inaugural newsmaker breakfast*, Washington DC, January 5, 2006, <http://www.state.gov/secretary/rm/2006/58725.htm>, accessed February 2, 2011.

17 Perovic, Jeronim. (2007). Russia's Energy Policy: Should Europe Worry? *Russian Analytical Digest*, 3 April, No. 18, p. 2.

While second group of scholars reaffirmed the gas crises incentives as 'political', Katerina Malygina pointed out two main reasons for Russia to pursue those gas crises: 'First, it reinforced Ukraine's image as an unreliable transit country and thereby increased support for the alternative Nord Stream and South Stream pipelines. Second, it deflected European attention from Gazprom's financial problems and simultaneously forced the EU and IMF to offer financial support to Ukraine to pay for its gas'¹⁸.

There are only limited attempts to cover domestic factors of energy politics in Ukraine¹⁹, but mostly focusing on the rents extracted by oligarchic groups from energy resource trade²⁰, rather than on its relation with decision-making process at international level.

Margarita Balmaceda's first book explored the energy dependency and corruption politics in Ukraine-Russia relations. The recent book of hers 'Politics of Energy Dependency: Ukraine, Belarus and Lithuania Between Domestic Oligarchs and Russian Pressure, 1992-2012' provided us with a unique comparative scrutiny of three post-Soviet countries through the prism of relations between domestic oligarchs and Russian Federation²¹.

There are several studies that focus on the narrow aspects of energy policy of Ukraine. Some of them raise the topic of complexity of the energy subsidies and its effect

18 Malygina, Katerina. (2010). Ukrainian-Russian Gas Relations After the 2009 Conflict: The Current Situation and Future Prospects, *Russian Analytical Digest*, No. 75, 16 March, p. 6.

19 Balmaceda, Margarita M. (1998). Gas, Oil and the Linkages between Domestic and Foreign Policies: The Case of Ukraine. *Europe-Asia Studies*, Vol. 50, No. 2; Balmaceda, Margarita M. (2008). The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarchs' profits and Ukraine's missing energy policy, 1995 – 2006. Routledge: London; Balmaceda, Margarita M. (2013). *Politics of Energy Dependency: Ukraine, Belarus and Lithuania Between Domestic Oligarchs and Russian Pressure, 1992-2012*. University of Toronto Press; D'Anieri, P.J. (2007). Understanding Ukrainian Politics: Power, Politics, and Institutional Design. Armonk, NY, USA: M.E. Sharpe, Inc.; Korduban, Pavel. (May 12, 2010). Ukraine Wary of Putin's Proposal to Merge National Gas Companies. *Eurasia Daily Monitor*, Vol. 7, Issue 92; Matuszak, Slawomir. The Oligarchic Democracy. The influence of Business Groups on Ukrainian Politics. *OSW Studies*, No. 42, September 2012, p. 41-42, http://www.osw.waw.pl/sites/default/files/Prace_42_EN.pdf, accessed on November 1, 2012; Matuszak, Slawomir, Sarna, Arkadiusz. (March 2013). From stabilization to stagnation. Viktor Yanukovich's Reforms. Centre for Eastern Studies. *Point of View*, No. 32; Pirani, Simon. (June, 2007). Ukraine's Gas Sector. *The Oxford Institute for Energy Studies*, p. 23, <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG21-UkrainesGasSector-SimonPirani-2007.pdf>, accessed on October 14, 2015; Puglisi, R. (2003). The Rise of the Ukrainian Oligarchs. *Democratization*, Vol. 10, No. 3, Autumn.

20 Kapliuk, Ekaterina. Rassledovanie: obogashchenie Aleksandra Yanukovicha. (October 23, 2012). *Forbes.ua*, <http://forbes.ua/business/1340389-rassledovanie-obogashchenie-aleksandra-yanukovicha>, accessed October 30, 2012; Kuzio, Taras. (January 16, 2013). Ukraine Sliding From Oligarchy to Cronyism. *Eurasia Daily Monitor*, Vol. 10, Issue 8; Leshchenko, Serhiy. (January 11, 2013). Sorkin appointed to NBU. Family finished squeezing oligarchs. *Ukrainska Pravda*, <http://www.pravda.com.ua/articles/2013/01/11/6981269/>, accessed on March 17, 2013; Leshchenko, Serhiy. Sunset and/or sunrise of the Ukrainian oligarchs after the Euromaidan revolution? *Euromaidan Press*, <http://euromaidanpress.com/2015/06/02/sunset-and-or-sunrise-of-the-ukrainian-oligarchs-after-the-euromaidan-revolution/>, accessed on December 21, 2015; Matuszak, Slawomir. The Oligarchic Democracy. The influence of Business Groups on Ukrainian Politics. *OSW Studies*, No. 42, September 2012, p. 41-42, http://www.osw.waw.pl/sites/default/files/Prace_42_EN.pdf, accessed on November 1, 2012

21 Balmaceda, Margarita M. (2013). *Politics of Energy Dependency: Ukraine, Belarus and Lithuania Between Domestic Oligarchs and Russian Pressure, 1992-2012*. University of Toronto Press.

on the sector²², other dedicate attention to the energy sector restructuring²³. Few scholars like Manfred Horn try to forecast future energy demand of Ukraine²⁴.

I would conclude that there were made few attempts to take a more comprehensive historical view, which would represent the interaction of domestic and external influences on energy sector of Ukraine. Among others original contribution of Simon Pirani on gas sector's developments till 2006 through the prism of three components, gas transit, gas consumption and gas supply, should be mentioned²⁵.

The mainstream literature mostly exploits realist framework to discuss bilateral relations between Ukraine and Russia, while liberal approach is left for European cooperation in energy domain with neighbouring countries. Capture state literature covers no less significant part of the impact of obstacles on domestic reforms through the influence of the interest groups, but leaves it mostly at domestic level without any further interplay with international domain. This thesis aims to fill this gap though by not purely focusing on the role of the domestic factors, bur rather on the interaction of domestic and external factors.

Energy politics, regardless its importance in international relations, still tends to be researched in a quite limited way and rather following the mainstream obsessive trends of exploiting realism or liberalism. But when we talk about post-Soviet, energy-poor and energy-dependent countries, like Ukraine, a more sophisticated innovative research approach is needed. Undoubtedly, lack of research may be explained partially due to the lack of transparency in the field, which leads to the lack of reliable data for the research, as well as secrecy of energy-related political actions. But this makes this topic no less but rather even more significant for an academic research.

With this literature review I intended to show the mainstream trends of the research on Ukraine's energy politics. By pinpointing the major research areas and its limitations of research, I intend to show the existing gaps in the literature. This review indicates that current research has been still predominated by the application of realist standpoints, which bears its limitations. While such approaches as liberal and rent-seeking have been applied much more rarely with pure focus on the international system (in case of liberalization), or

22 Krasnov, G. V., Brada, J. C. (1997). Implicit subsidies in Russian-Ukrainian energy trade. *Europe-Asia Studies*, 49(5), pp. 825—843.

23 Von Hirschhausen, C., Vincenz, V. (2000). Energy policy and structural reform. *Eastern European Economies*. January-February, No. 38 (1).

24 Horn, Manfred. (1999). Energy Demand until 2010 in Ukraine. *Energy Policy*, 27, pp. 713-726.

25 Pirani, Simon. (June, 2007). Ukraine's Gas Sector. *The Oxford Institute for Energy Studies*, <https://www.oxfordenergy.org/wpcoms/wp-content/uploads/2010/11/NG21-UkrainesGasSector-SimonPirani-2007.pdf>, accessed on October 14, 2015;

domestic structures (in case of domestic actors).

Therefore, this research tries to complement missing points of the existing literature on the topic by offering new analytical framework for analysis. Putnam's two-level game approach allows us to explore factors that are crucial at domestic and international levels, and then to present interplay between the two levels.

1.5. Research design and methodology

To meet the objectives of the study the research design of the dissertation is shaped under the qualitative approach; while quantitative approach is also integrated into the research project design to aggregate formal data.

The thesis uses mainly qualitative research methodology. The focus of qualitative analysis is based on the importance of the problematique per se, where research interpretation plays a crucial role. To achieve qualitative study objectives, I apply mainly holistic approach involving structural and functional analysis. However, to explore the causal linkages in parallel individualistic approach is applied with causal analysis employed carefully.

Much criticism has been observed concerning qualitative methodology mainly by scholars looking through positivist lens. Issues of objectivity and generalization have been at the core of criticism²⁶. Qualitative research involves interpretation by the researcher, which increases the risk of subjectivity and undermines the reliability and validity of the study. Unlike constructivists, who argue that all research is subjective as reality is socially constructed, other qualitative researchers insist that subjectivity can be reduced by allowing the study to be replicated by other researchers²⁷. Therefore, research should be shaped by the application of the same analytical tools based on neutral observation, transparency, well-grounded argumentation with clear reference to the material. In this case researcher's interpretation will lead to intersubjectivity and final research will possess reliability and validity.

By applying explanatory approach I intend to go beyond the traditional descriptive positivist approach. Explanatory approach includes explaining why energy policy of Ukraine was shaped in a particular way, interpreting a cause-and-effect relationship between

26 Marsh, David; Stoker, Gerry. (eds). (2002). *Theory and Methods in Political Science*. 2nd Edition, New York: Palgrave Macmillan, p. 204.

27 Chesebro, James W., Borisoff, Deborah J. (2007). What Makes Qualitative Research Qualitative? *Qualitative Research Reports in Communication*, Vol. 8, No. 1, p. 11.

the variables. Among others this approach enables me to clarify the relationship between domestic and international factors of energy politics in Ukraine.

Interpretive research approach by establishing the meaning of a circumstance transcends the mere description by enhancing ‘people’s understanding of the symbols, artifacts, beliefs, meanings, feelings, or attitudes’²⁸.

The thesis takes an empirical investigative approach to take the picture beyond EU-Ukraine energy relations and to understand the role of the Russian Federation, both governmental officials and interest groups, in the newly emerging unified area of European Energy Community members.

Application of historical approach enables me to trace the continuity and change in energy policy evolution. Therefore, taking the period of Ukraine’s independence I split it into separate chapters covering the presidencies of Kravchuk, Kuchma, Yushchenko, Yanukovych and Poroshenko.

Another method applied in this research is *comparative case study method*, when the phenomenon of energy policy formation is scrutinized by means of empirical examination with its natural occurring context by systematic comparison²⁹ with another case, i.e. Belarus. This method contains comparison, which is ‘focused because it deals selectively with only certain aspects of the historical case ... and structured because it employs general questions to guide the data collection analysis in that historical case’³⁰. This ‘structured-focused’ comparison provides sturdy methodological foundation to host empirical investigation. This method allows the use of various techniques of collecting information by using primary and secondary sources, from government documents, scholarly articles, articles in newspapers to interviews etc.

Belarus is chosen as the most suitable country for comparative analysis due to several reasons. First of all, Belarus as a part of the Soviet system after gaining independence appeared to own a part of the pipeline network. Second, due to poor domestic indicators of energy production and tight economic links with Russia Belarus appeared to depend vastly on Russia as energy supplier. The establishment of integration unions between Belarus and Russia resulted in cementing the role of Belarus as gas transit country, while Russia remained a sole supplier. Third, energy was repeatedly applied as a foreign

28 McNabb, David E. (2004). *Research Methods for Political Science: Quantitative and Qualitative Approaches*. New York: M.E. Sharpe, Inc., p. 106.

29 Kaarbo, Juliet, Beasley, Ryan K. (1999). A Practical Guide to the Comparative Case Study Method in Political Psychology. *Political Psychology*, Vol. 20, No. 2, p. 372.

30 George, A. L. (1979). Case studies and theory development: The method of structured, focused comparison. In P.G. Lauren (Ed.). *Diplomacy: New approaches in history, theory, and policy*. New York: Free Press, pp. 61-62

policy tool in the relations between Belarus and Russia. The comparability feature of Belarus and Ukraine rests on the statement that two countries with a Soviet legacy have common historical background and after the wave of democratization had equal chances to shape their energy policy in closer cooperation with the EU. From the other perspective, the differences between Ukrainian and Belarusian domestic policy making in energy sector as well as differentiated foreign policy communication with the EU led to significantly different outcomes in energy sector development. The proposed method allows us to scrutinize the similarities and differences in the energy game of both countries, taking into consideration existing interdependence on Russian Federation. Therefore, the case study of Belarus is represented with the aim to reconfirm testable hypothesis of the dissertation.

This thesis foresees the usage of further methods for collecting qualitative data: observation, document analysis and filed research by interviewing. Observation method as the least intrusive method aims at producing unbiased records of events while being uninvolved. Document analysis and interview techniques were widely used to obtain the full empirical picture of Ukraine's energy politics. Each of the empirical chapters starts with the internal political developments in Ukraine and charts the trajectory of its further evolution as a result of cooperation with the EU and Russia. With this structure I relied on the Ukrainian and Western media reports and academic literature.

Field research is an important part of this study. As defined by Keyton, 'field experiments are like experiments in terms of researcher control over the manipulation of independent variables and random assignment of participants. However, the research environment is realistic and natural. Participants are not asked to come to a laboratory environment that is used exclusively for experimentation. Rather, the research is conducted in environments with which participants already are familiar'³¹. Fieldwork foresees firsthand observation and interviewing subjects in the field.

In this study 'non-participant field research' approach was used, which employs free-flowing discussion and in-depth interviews with flexible checklists of questions³². Interviews for this research appeared to be essential data-gathering method. Face-to-face structured and unstructured interviews were conducted in 2013 during conferences and personal appointments. After drawing first conclusions based on the secondary sources that consist of published and printed materials a fieldwork was conducted in Kyiv (Ukraine) in May-June 2013.

31 Keyton, J. (2001). *Communication research: Asking questions, finding answers*. Mountain View, California: Mayfield Publishing Company, p. 161.

32 Douglas, J.D. (1976). *Investigative social research: Individual and team field research*. Beverly Hills, California: Sage Publications, p.15.

It is important to mention that while conducting interviews, I encountered several difficulties. Some of the interviewees asked for discretion, the others neither allowed me to tape the interview nor to disclose their names. Nevertheless, I am thankful to the interviewees, who kindly agreed to meet with me, so I was able to find the missing parts of the puzzle. The information obtained during the interviews explains the multi-faceted and complex nature of the topic. While some interviewees being experts in one field were able to fill the missing points of my thesis, the others preferred not to disclose any more information due to the fear for their career. I also encountered the situation when interviewees were rather interested in what I knew about the issue rather than in sharing information with me. To sum up, when it comes to energy field due to high political and financial stakes, Ukraine, though being my motherland, appeared to be quite difficult case to work on. The energy issues still remain a clandestine topic, when it is very hard to reach policy-makers due to the nature of the topic.

To understand well what lies beneath the dynamics of the energy politics in Ukraine the interviews were conducted with the policy-makers, such as the Members of the Parliament (Verkhovna Rada), EU Commission representatives, policy analysts, academics, journalists, foreign diplomatic mission representatives. Those interviews enabled me to test the early findings of my research and to sharpen analytical perspective of my hypothesis. Apart from the national perspective the interviews conducted with the representatives of the EU enabled me to fully scrutinize the foundations of the EU-Ukraine energy relations, conflicting points and misinterpretations. Thus, I highly benefitted from the understanding of the EU's and Ukraine's insights to EU-Ukraine energy cooperation. Hence, in-depth interviews with representatives of the both sides assisted me in testifying the final thesis findings.

Quantitative research strategies, which are usually placed within positivist methodology, are based on the statement that 'If it can't be measure, it can't be studied'³³. To understand a process of energy policy-making I use descriptive approach. The focus of descriptive approach is to map out the dynamics of energy policy making in Ukraine within the timeframe of 1990-2016 in systematic and thorough way, including the circumstances, set of events and attitudes towards this issue. Hereto, I also benefit from statistical data obtained from official sources as supporting data for the research argument.

33 McNabb, David E. (2004). *Research Methods for Political Science: Quantitative and Qualitative Approaches*. New York: M.E. Sharpe, Inc., p. 99.

1.6. Thesis structure

In terms of structure, this thesis consists of eight chapters. The first chapter covers scope and objectives, research questions, literature review, argument and methodology of the thesis. The first chapter ends up with thesis structure.

After the introduction, *Chapter 2* develops the theoretical framework of the thesis by discussing the explanatory powers of IR theories, such as realism and liberalism. Neorealist framework is used to explain the relations between Ukraine and Russian Federation. It highlights how energy power was transformed into foreign policy tool. The relations of Russia as energy supplier and Ukraine as energy consumer and transit country resemble the relations of asymmetric interdependence. This interdependence deepens with Ukraine's reluctance to vast energy sector reforms and creates flourishing foundations for shadow economy. Neoliberal theory is discussed to outline the emergence of close energy cooperation with the EU. EU appears to use its institutional leverage to enforce energy sector reform in Ukraine. The importance of transparent energy sector of Ukraine is emphasized after two Russian-Ukrainian gas wars. Further geopolitics and rent-seeking theories are discussed to find their limitations. Rent-seeking theory, as a part of captured state literature, assists us to understand the establishment of the corruptional schemes in energy sector and their affect on the political system. To sum up, the above-mentioned theories though partially unveil the nature of energy-politics by their own do not cover all the issues involved. Therefore, Putnam's two-level approach is introduced to fit the argument.

In line with the focus of the thesis, *Chapter 3* focuses on the dynamics of Ukraine's energy policy during the period between 1991-2010. The presidency of Leonid Kravchuk and Leonid Kuchma demonstrates how vast was the affect of Russia on Ukraine, while EU's role was minor.

Chapter 4 covers the energy policy development under the presidency of Viktor Yushchenko. Internal political confrontation between Yushchenko and Tymoshenko brought stalemate into the energy sector. Pro-European president faced hostile Russian energy reaction, which led to two gas crises in 2006 and 2009. An updated Energy Strategy of Ukraine to 2030 and launch of reforms needed to become full member of Energy Community symbolized first practical steps forward the adoption of European model of energy reforms.

Chapter 5 discusses energy policy during Viktor Yanukovich's presidency. The first three years of his presidency became a cornerstone in EU-Ukraine relations. This

chapter demonstrates how pro-Russian president, though imitating European integration, nevertheless concluded the necessary preparations for Ukraine to become a member of the European Energy Community. In relations with Russia, Russian-friendly president Yanukovich signs in his first year in the office Kharkiv Agreement, which reflects ‘fleet-for-gas’ formula. More aggressive position of Russia is observed not only on governmental level, but also through affiliated entities in Ukraine. Unresponsiveness of Ukrainian government to allow Russia access to its own GTS, leaves Russia with bypass pipeline projects construction. Meanwhile, EU’s external energy policy defines Ukraine as strategically important country. Through a network of bilateral and multilateral tools, EU pursues an aim to integrate Ukraine into European energy market. Membership in Energy Community is treated as essential step in energy market liberalization.

Chapter 6 covers the most recent developments after the Maidan events. The changes of energy profile of Ukraine after Crimean annexation and war in Donbas led to immediate energy reform. Long awaited energy tariff hikes together with gas supply diversification changed energy dynamics, which were stable for more than two decades. Though clear path of energy reforms is being observed, the impact of interest articulators still keeps energy domain from becoming transparent and subordinate to rule of law. The links between domestic politics and international relations prove that close monitoring of international institutions together with political will of the current government may enable real reform to occur.

In *Chapter 7* I conducted a comparative case study analysis with Belarus. Belarus as former USSR country seems to have benefitted the most from Russian gas exports. During Soviet times Belarus and Ukraine were both receiving gas under very favorable price conditions, which enabled them to stick to the rapid industrial plans. After gaining independence, internal political transformations led to different level of relations with Russia. Belarusian case confirms the tendency where gas leverage was successfully gained by Russia, which led to Belarusian surrender of the transit pipelines. Foreign policy priorities of Lukashenko fed Russian neo-imperialist ambitions, and thus Belarus entered Single Economic Space, Custom’s Union.

The conclusions tie analytical threads that run through entire thesis and assess the overall impact of domestic and international factors on the transformation of energy policy of Ukraine towards greater transparency and reliability.

CHAPTER 2

BUILDING UP THEORETICAL FRAMEWORK

2.1. Concepts and their operationalization

With the growing interest in energy issues and the role of energy policies in International Relations, we still face a lack of well-developed theoretical background. From IR perspective energy policies were rather scrutinized as a part of national and international politics than separately. Not surprisingly, energy policy analysis was predominated by realist paradigm, which was later followed by liberalism. Preoccupation with geopolitical perspective in energy policy analysis serves as a departure point, but does not fully unveil the problematique.

This thesis aims to examine a very complex phenomenon of energy politics of Ukraine through a prism of domestic and international factors, hence it represents a challenge for the application of explanatory power of just one IR school. The core of energy policy dynamics in Ukraine was vastly shaped in 1990s, while EU engagement was rather minor in comparison to direct multi-level Russia's involvement into Ukraine's economy due to the Soviet legacy. These developments are explained by means of explanatory power of neorealist approach. Russia's geopolitical engagement to keep Ukraine within its sphere of interest was vividly observed during that period. Meanwhile, complexity of EU's activity in Ukraine's energy sector especially in 2000s demands wider explanatory power than neorealism could provide. The European Union operates far beyond the boundaries of geopolitical expansion; therefore neoliberal institutional approach is chosen here to cover the missing points of the realist tradition.

Ukraine's energy policy as a part of post-Soviet studies possesses one more peculiar feature. This topic cannot be fully explained only by means of IR Scholarship. The main reason for it is predominant ignorance of domestic factors by two above-mentioned schools. Therefore, this thesis also benefits from the approach based on economic theories developed from 'state capture' concept. Rent-seeking approach in energy sector adjusted to Ukraine by Margarita Balmaceda seems to be suitable as it explains the role of the interest articulators in energy policy formation. Though this thesis's main focus is not interest articulators, but without understanding of their engagement, it is impossible to comprehend energy policy

formation in Ukraine. Rent-seeking approach provides us with a key to trace the continuity and change in energy sector at domestic level.

The aim of the current chapter is to introduce the theoretical framework and conceptual tools to understand the peculiarities of Ukraine's energy policy formation. This chapter seeks to synthesize the theoretical insights of IR school and economic theory. By doing so an attempt to achieve a close correspondence between empirical data presented in the following chapters and the selected conceptual structure is made. A discussion starts with the main standpoints of the realist school to point the geopolitical importance of Ukraine and how it corresponds with EU and Russia's national interests. Realist school also explains the value of the energy resources, and how access to and control of these natural resources increases the probability of conflicts of inter-state, regional and global importance. Next, the limitations of the realist approach are dully considered, which include the military dimension of power and state-centric view of IR. The conflict caused by scarcity of the resources is determined as inevitable; therefore any collaborative efforts are ignored.

Neoliberal approach considers cooperative behavior of the states possible through means of creating institutions, which could actually overcome realist-driven propensity for inter-state war. A part of the liberal literature focuses on the notion of 'good governance', promotion of international energy regimes and institutions and economic liberalization. Among others, energy liberalization is important constituent of cooperative efforts due to the fact that multiple conflicts arise from imperfect markets. Therefore, another group of scholars thoroughly scrutinizes the problems of corruption and lack of transparency, which cause malpractices leading to illiberalism. The need of developing transparency in energy sector by maintaining the principle of openness of information is advocated.

Rent-seeking approach enables us to define how reluctance to change energy dependency creates favorable conditions for the emergence of certain interest groups. This approach is important to understand the role of the interest groups in maintaining energy dependency and resistance to any fundamental reforms. Interest groups by benefitting from illegal schemes of energy trade in short term gain considerable financial assets, which turn them into influential actors. The interests of these actors are represented at the highest level, which gives them power to lobby their preferences.

The theoretical approaches applied in this research are usually viewed as contrasting, but can be also seen as potentially complementary. The reason of it is that while realism focuses on international system in general by not prioritizing domestic factors,

liberalism fills this gap and even transcends it by introduction of institutionalism. Rent-seeking approach provides an explanation of the domestic factors' importance. By usage of these different approaches this research seeks to explain different dimensions of the problem, prioritizing different variables for comprehension of the causes of conflict and cooperation in energy sector. The theories can therefore be applied in parallel, and their inter-theoretical approach will provide this research with more holistic conceptualization of the research problem.

2.1.1. Realist theoretical paradigm

The following paragraphs seek to reconstruct the realist argument in the way to apply it to the object of the study, i.e. energy politics. Regardless some limited applicability of the realist framework, it would provide us with some thoughtful insights to understand the basic realist incentives. All realist theories share core assumptions about the unitary and rational nature of the actors, fixed and conflictual nature of state preferences and the primacy of material capabilities³⁴. Competition for survival is based on the competition for material resources. As Legro and Moravcsik write, 'Interstate politics is thus a perpetual interstate bargaining game over the distribution and redistribution of the scarce resources'³⁵. Therefore, depending on the resources at the state's disposal, in order to reach foreign policy goals state could choose cooperation, threats, sanctions, balancing or war.

Classical realism places state at the core of international system, while international organizations possess secondary importance. The Realists believe that power is a central concept of realist theory. International system is anarchical, where primary motivation of the actors is power and security. The father of modern realism, Hans J. Morgenthau, argues that the competition between states originates from human nature. Classical realism considers human nature to be selfish, so people in order to pursue their own interests are aspired to dominate the others. Therefore, 'powerful states cannot resist using its power over a weak state'³⁶. As interests of one group of states contradict the other, it seems impossible to achieve conditions that would satisfy all states. States' positions on energy resources in the international system depend on the conflicts, bargaining and consolidation of interests of great powers, interaction between energy exporting, transit and energy

34 Legro, Jeffrey W., Moravcsik, Andrew. (1999). Is Anybody Still a Realist? *International Security*, Vol. 24, Issue 2, pp. 12-18.

35 Legro, Jeffrey W., Moravcsik, Andrew. (1999). Is Anybody Still a Realist? *International Security*, Vol. 24, Issue 2, p. 13.

36 Orban, Anita. (2008). Power, Energy and the New Russian Imperialism. Praeger Security International, p. 10.

consuming countries. Within this scenario exporting and transit countries will try to acquire as much as possible leverage to pursue own interests.

Realist school is bound with the notion of sovereign state, which is a dominant actor in the international system. These relations among states are formed within the anarchy of international system. Realists pay great importance to the state and its institutions, which are guided by its national interests in international politics. According to Waltz states are defined as ‘the units whose interactions form the structure of the international political system’³⁷. States are essential because of their ability to establish the governing rules stipulating the behavior of all participants (multi-national corporations, NGOs, trans-national social movements, private individuals and non-state entities) in international system. Other actors apart from states do not play a central role in international system, and tend to be usually subordinated to the institutions of the state with limited capacity to act autonomously.

Along neorealist perspective states as unitary political units are the main actors to define energy relations. They do not only possess the majority of the global energy resources³⁸, but also define the main energy routes. Therefore, the role of states in energy field is strengthening as suggested by Gal Luft and Anne Korin ‘exporters are nationalizing their energy industries, leaving less and less room for the private sector and foreign investors while increasingly using energy as tool to advance their foreign policy agenda’³⁹. Apart from this, states are responsible for the implementation of the legislation on exploitation, taxation, privatization and extraction of energy resources.

The importance of international institutions is usually depreciated by the realist theory. Therefore ‘international organization is above all a tool of national government, an instrument for the pursuit of national interest by other means’⁴⁰. International organizations are based on the treaties made by states, thus states determine the fate of them. The effectiveness of institutions is also a function of states’ willingness to use them as a tool. Neorealist school proceeds that state abroad is capable to act as a single entity. So if foreign activity is controlled by state, state has a capacity to define national interests abroad. As a result all foreign business could be subordinated to national interest perspective.

37 Waltz, Kenneth N. (1979). *Theory of International Politics*. McGraw-Hill: Boston, p. 95.

38 According to Antonio Marquina and Brenda Shaffer state owned energy companies control about 85 % of world oil reserves and 70-80 % of the world natural gas reserves.

39 Luft, Gal and Korin, Anne. Realism and Idealism in the Energy Security Debate. In Luft, Gal and Korin, Anne (Eds). *Energy Security Challenges in the 21st Century*. A Reference Handbook. USA, p. 335.

40 See, Susan Strange cited in Waltz, Kenneth N. (2000). Structural Realism after the Cold War. *International Security*, Vol. 25, No. 1, p. 24.

Realists argue that state pursues two main aims in international relations either to survive or to dominate. So competition for survival/dominance is based on the competition for material sources. Classical realist thought overestimates the importance of military power, when it comes to survival/dominance target. But James E. Dougherty and Robert Pfaltzgraff state that ‘military power did not seem to be the key variable explaining state’s place in the international system. There were projections that concerns about economic security will prevail over those of military security’⁴¹. If military power is downgraded, then energy policy should be upgraded by being placed as an important variable to define state’s power.

States must rely on their own resources to maintain their relative positions in the system. Energy resources among others are used as a tool to maximize its power and ensure survival. State’s rationality differs according to the position it holds in energy structure. There are three main types of states in energy terms: energy producer, transit country and energy consumer. Accordingly the rationality of each state takes different definition. Energy producers seek ‘security of demand’, when the energy resources they produce will be purchased by consumer state at a reasonable price over a long period of time. However, political rationality and economic rationality do not always coincide. Sometimes short-term economic efforts are sacrificed in order to get long-term political and geopolitical benefits. A vivid example is Russia, when after the collapse of the Soviet Union energy resources were sold at below market prices to certain CIS states, including Ukraine, in order to maintain a robust influence in those countries. Thus, from economic perspective actions of Russia could be defined as irrational, but from political perspective strong dependence on cheap energy resources was established with the aim of future leverage.

Consumer countries seek for ‘security of supply’ to obtain energy resources at reasonable price without a threat of disruptions. If we take an example of the EU, then we understand that it represents the interests of the member states. So in terms of absence of common energy policy, EU is prone to act along the interests of the member states unless clear threats are presented to its own energy security.

Therefore, states will cooperate only to further their own interests, and if these interests are threatened they will not cooperate. This appears from the absence of the overarching government, if state’s survival is at risk, cooperation will fail.

States pursue relative gains, which means that they compare themselves to other states. And as Kenneth Waltz summarized: ‘When faced with the possibility of cooperating

41 Op. cit., Orban, Anita. (2008). Power, Energy and the New Russian Imperialism. Praeger Security International, p. 8.

for mutual gain, states that feel insecure must ask how the gain will be divided. They are compelled to ask not ‘Will both of us gain?’ but ‘Who will gain more?’ If an expected gain is to be divided, say, in the ratio of two to one, one state may use its disproportionate gain to implement a policy intended to damage or destroy the other. Even the prospect of large absolute gains for both parties does not elicit their cooperation so long as each fears how the other will use its increased capabilities.⁴²

According to Grieco, neorealists view international cooperation as ‘harder to achieve, more difficult to maintain, and more dependent on state power’⁴³. Finally, international institutions affect the prospects for cooperation only marginally⁴⁴. Nevertheless, if dominant actors support international institutions, then their effectiveness increases. According to realists cooperation is hard to be achieved, as agreements cannot be centrally forced.

As neatly pointed out by Jeffrey W. Legro and Andrew Moravcsik, ‘Realists have long insisted that control over material resources in world politics lies at the core of the realism’⁴⁵. Apart from armed strength, such elements as ‘geography, natural resources, industrial capacity, military preparedness, population, national character and morale, and quality of diplomacy and government’⁴⁶ were also defined as constituents of power. For Morgenthau and Waltz material resources constitute a fundamental ‘reality’ that exercises an exogenous influence on state behavior regardless state preferences, beliefs, and information. Besides, energy resources located within state controlled territory are not only defining power, but also industrial capacity of the state.

The role of energy resources evolved during last decades placing energy policies within wider spectrum of foreign policy tools. Therefore, ‘energy supply policy is as much a part of foreign policy arsenal as other economic tools, military power and diplomatic tactic’⁴⁷. While energy supply heads national security agenda of importing countries, exporting countries are preoccupied with establishment of stable markets.

Realist approach treats energy policy, as the policy where state should be the main decision-maker. It takes energy cooperation between the actors at a state-level by vastly

42 Waltz, Kenneth N. (1979). *Theory of International Politics*. McGraw-Hill: Boston, p. 105.

43 Baldwin, David A. (Ed.) (1993). *Neorealism and Neoliberalism: The Contemporary Debate*. Columbia University Press: New York, p. 5.

44 Waltz, Kenneth N. (1979). *Theory of International Politics*. McGraw-Hill: Boston, p. 115-116.

45 Legro, Jeffrey W., Moravcsik, Andrew. (1999). Is Anybody Still a Realist? *International Security*, Vol. 24, Issue 2, p. 18.

46 Sutch, Peter, Elias, Juanita. (2007). *International Relations: The Basics*. New York: Routledge, p. 49.

47 Shaffer, Brenda. (2009). *Energy Politics*. University of Pennsylvania Press, p. 1.

neglecting domestic factors. According to the realist perspective, state should define energy policy based on state capabilities and acting due to existing international power configuration. In terms of trade, this would mean that countries will act proactively and seek to “create conditions which make the interruption of trade of much graver concern to its trading partners than to itself.”⁴⁸ From this perspective, state should aim to increase energy independence, which will lead to power increase in international politics. Yet realist approach obsessed with state power seems insufficient to explain why Ukraine after gaining independence did not adopt proactive energy policy. Limited nature of realist school does not cover complex multitude of actorship in Ukrainian case, which also includes interest groups. Extreme importance of energy policy from geopolitical importance may reveal further aspects of the problem.

Realist tradition in the contrary to liberalist tradition insists that interdependence increases the likelihood of conflict, which is illustrated by case of Ukraine-Russia asymmetric interdependence energy relations. Theorists like McMillan believe that long-term interdependence gives rise to inherent inequalities among states and dependence⁴⁹. Ukraine in this case is seen as state that after the collapse of the Soviet Union appeared to be politically independent, but economically interdependent. Therefore, the mechanism of interdependence asymmetries provides the state actor, in our case Russia, with the ability to use their relative economic dominance in one area to influence the relationship in another area. In other words, to convert economic power into political power.

2.1.2. Geopolitics and Energy Politics

A part of realist school focused on geopolitical dimension of international relations. If we come to the origins of geopolitics, as noted by Dodds, ‘coined in 1899, by a Swedish professor of political science, Rudolf Kjellen, it has often been taken to signify a hard-nosed or more realistic approach to international politics that lays particular emphasis on the role of territory and resources in shaping the condition of states’⁵⁰.

Classical geopolitics defined Ukraine as a part of the so-called ‘Heartland’. In the words of British father of geopolitics Sir Halford Mackinder it was suggested that: ‘Who rules East Europe commands the Heartland, who rules the Heartland commands the World-

48 See Hirschman, Albert O. (1980). *State Power and the Structure of Foreign Trade*. Berkeley: University of California Press.

49 McMillan, Susan M. (1997). *Interdependence and Conflict*. *Mershon International Studies Review*, Vol. 41, No. 1, May, pp. 34-42.

50 Dodds, Klaus. (2007). *Geopolitics: A Very Short Introduction*. Oxford University Press, pp. 24-25.

Island, who rules the World-Island commands the world'⁵¹. This scholar appeared to be among first to define unique geographic location of Ukraine in the eyes of the great powers.

In the words of another geopolitical advocate Zbigniew Brzezinski, Ukraine is a 'geopolitical pivot'. In his understanding the power of geopolitical pivots lies in its geographic location, which affects the behavior of geostrategic actors. He continues that 'most often, geopolitical pivots are determined by their geography, which in some cases gives them a special role either in defining access to important areas or in denying resources to a significant player'⁵². Indeed, when we look at geographic location of Ukraine from energy perspective, Ukraine's special role is tied to its geographic location between Europe and Russia, when such an instrument as Gas Transit System is to be applied as an instrument to manipulate the behavior of geostrategic players. But from the other perspective, insufficient energy resources created geographic cul de sac, when due to the pipeline infrastructure energy supplies were limited only to be transported from Russia.

Traditionally geopolitics has been focusing on particularistic interests of nation-states, justifying intervening action beyond national borders within realistic perspective. The object of investigation was usually a hegemon or powerful state with the authority, economic clout and military and/or diplomatic prowess to influence the course of international politics⁵³. Brenda Shaffer states that 'energy interests, especially under tight international market conditions, affect the mapping of geostrategic interests'⁵⁴.

Energy negotiations conducted between Ukraine and Russia included bargaining scheme: Russia was threatening to raise the gas price, while Ukraine was automatically raising the question of transit fees. The only difference is that Russia's advantageous geographic position in energy supplies was further transformed into its foreign policy instruments. Russia is one of the powers, which used its energy wealth and leverage to strengthen its regional influence with more vulnerable neighbors. Its raise as an energy power was especially observed during Putin's tenure, when key Kremlin officials were appointed to leadership positions in energy sector. As a result with centralized power, Russia showed its willingness to use gas as a political weapon in conjunction with commercial arguments about price, especially during 2006 and 2009 gas conflicts with

51 Halford J., Mackinder. (1919). *Democratic Ideals and Reality*. Henry Holt and Company: New York, reprint 1942, p. 150.

52 Brzezinski, Zbigniew. (1997). *The Grand Chessboard: American Primacy and Its Geostrategic Imperatives*. New York: Basic Books, p. 41.

53 Dodds, Klaus. (2007). *Geopolitics: A Very Short Introduction*. Oxford University Press, pp. 24-25.

54 Shaffer, Brenda. (2009). *Energy Politics*. University of Pennsylvania Press, p. 30.

Ukraine. Moreover, solid position on Energy Charter Treaty pushed Russia into development of its own principles of energy market.

During first decade of independence Ukraine used energy transit fees in energy price negotiations with Russia many times, but it failed to incorporate its geopolitical energy importance into any kind of strategic vision⁵⁵. Energy Strategy of Ukraine to 2030 though pointing the capacity of Ukrainian GTS did not mention concrete steps in further modernization and utilization of GTS as strategic asset.

The other tendency was the over-estimation of Ukraine's energy potential per se. The real risks from European policy aimed at reduction of energy dependency on Russia were not thoroughly evaluated in Ukraine. Decrease in energy transit to Europe, decline of energy extraction in Russia together with the construction of by-pass pipeline projects though directly endangering Ukrainian GTS did not lead to the revision of Energy Strategy.

Though Brzezinski neatly pointed out that 'for Ukraine, the central issues are the future character of the CIS and *freer access to energy resources*⁵⁶, which would lessen Ukraine's dependence on Russia. In that regard, closer relations with Azerbaijan, Turkmenistan, and Uzbekistan have become important to Kiev, with Ukrainian support for the more independent-minded states being an extension of Ukraine's efforts to enhance its own independence from Moscow⁵⁷'. Two decades of independence proved poor results of cooperative energy initiatives with the above-mentioned states, and dependency happened to follow the unchangeable path until Poroshenko's tenure.

It is important to mention that Ukraine realized geopolitical importance of pipeline infrastructure when it started to lose it. When a part of the energy flows were redirected to the Nord Stream, and Ukraine itself decreased the amount of gas imported from Russia, the geopolitical attractiveness of the GTS paled. The same time the idea of usage of underground gas storages by the EU emerged, though not resolving the question of gas being sold to Europe at the Western border of Ukraine, this idea again raised the geopolitical importance of Ukrainian energy sector in the eyes of strategic counterparts.

First decade of the 21 century brought new understanding of the resource geopolitics. The energy politics in transit states like Ukraine were treated as bargaining chip before gas crises 2006, so that transit services were bargained for more privileged pricing

55 Malygina, Kateryna. (2013). *The struggle over Ukraine's gas transit pipeline network through the lenses of securitization theory*. Paper presented at 8th Changing Europe Summer School 'Export pipelines from the CIS region. National debates, political decision-making and geopolitics', Kazakhstan: Almaty, 11-18 August.

56 Emphasize is mine.

57 Brzezinski, Zbigniew. (1997). *The Grand Chessboard: American Primacy and Its Geostrategic Imperatives*. New York: Basic Books, p. 139.

policy of Russian Federation⁵⁸. But one should accept that after two gas disputes, Ukraine lost this bargaining chip and its leverage position was weakened sharply⁵⁹. Consequently, as reiterated by Brenda Shaffer ‘supply states are much more prone to disruption than arrangements in which exporters and importers have a direct relationship’. Further she insists that in case of Ukraine ‘commercial entities undertook the decision to upset the transit, not considering long-term state interest’⁶⁰.

Prevailing bilateralism in energy relations between EU member states and Russia, enabled Russia to pursue quite successful negotiations with certain EU member states, while Energy Charter Treaty was sidelined. Even though Ukraine-Russia gas crises raised the importance of transit protocol, it did not catalyze common stand of European countries in energy policy.

Every party in this geopolitical energy conundrum possesses its own unique geopolitical preferences and vulnerabilities, which both explicitly and implicitly alter foreign policy agenda.

In order to understand how actors act in international system when it comes to energy markets, one should fully realize the peculiarity of the gas market. The gas market, being territorially locked, is structured regionally and depends on pipeline infrastructure. The biggest gas reserves located in Russia and the Middle East limits the neighboring countries to these gas suppliers. In the era when gas demand grows and construction of new pipelines is affordable only to big powers, energy poor country like Ukraine is left with no other choice but to rely on Russia in its energy imports. This situation led to energy-inefficient and energy-intensive country like Ukraine to deepen its energy dependency on imported energy commodities.

The strong departure point of realist geopolitical tradition is that energy resources, which are key fundamental of energy policy, are defined as essential element of state power. As Gal Luft and Anne Korin outlined: ‘Realists point out that through history, certain commodities, and in particular *energy commodities*⁶¹, minerals, water and food have had a strategic value beyond their market price and as such they have been repeatedly used as tools of foreign policy by exporters and have been among the prime catalyst of armed

58 Pascual, Carlos, Zambetakis, Evie. (2010). The Geopolitics of Energy From Security to Survival. In Pascual, Carlos and Elkind, Jonathan. *Energy Security: Economic, Politics, Strategies, and Implications*. Brookings Institution Press: Washington, DC, pp. 9 – 33.

59 Westphal, Kirsten. (2006). Energy Policy between Multilateral Governance and Geopolitics: Whither Europe? *European Energy Policy*, Vol. 4, p. 57.

60 Shaffer, Brenda. (2013). Natural Gas Supply Stability and Foreign Policy. *Energy Policy*, Vol. 56, p. 120.

61 Emphasize is mine.

conflict⁶². The more resources state possesses, the more powerful it is. State's power depends also on the ability to extract and transport energy resources as well as global demand for them.

To sum up, geopolitical perspective in the field of energy policy analysis is quite speculative and is based largely on assumptions and interpretations. Frequently it lacks a systemic empirical approach and evidence. The drawback of geopolitical thought is that it depicts energy world as confrontation between energy producers and energy consumers. It ignores an essential standpoint that interests of the actors in energy market overlap. Andreas Goldthau and Jan Martin Witte argue that 'lopsided attention to the geopolitical dimension of energy security is based on the myopic and erroneous presumption that global energy politics is necessarily a zero-sum game in which one country's energy security is another's lack thereof'⁶³. This realist perspective reflects state-centered view, where states compete for energy resources, and therefore are locked into competitive struggle with zero-sum outcomes. This approach, while focusing on the interests of the nation-states to take control over energy resources, largely ignores the importance of market forces and the power of institutions, which set the 'rules of the games'. Moreover, this narrow geopolitical lens ignores joint benefits from cooperation between producers and consumers. Finally, European liberalization efforts reiterate that 'price formation is better left with markets and not entrusted to governments'⁶⁴.

2.1.3. Neoliberal institutionalism

Neoliberal institutionalism arose in response to neorealism, when scholars, like Keohane, Nye, Lipson, Axelrod, Stein etc., by revisiting main realist standpoints advocated cooperation between states with the assistance of institutions. This school is traced back to 1960s and 1970s and stands on the notion that 'institutions matter', but in the words of Keohane 'cooperation is elusive enough, and its sources are sufficiently multifaceted and intertwined, that it constitutes a difficult subject to study'⁶⁵.

62 Luft, Gal and Korin, Anne. Realism and Idealism in the Energy Security Debate. In Luft, Gal and Korin, Anne (Eds). *Energy Security Challenges in the 21st Century*. A Reference Handbook. USA, p. 340.

63 Goldthau, Andreas, & Witte, Jan Martin. (2009). Back to the future or forward to the past? Strengthening markets and rules for effective global energy governance. *International Affairs*, Vol. 85 (2), p. 374.

64 Goldthau, Andreas, & Witte, Jan Martin. (2009). Back to the future or forward to the past? Strengthening markets and rules for effective global energy governance. *International Affairs*, Vol. 85 (2), p. 382.

65 Keohane, Robert O. (1984). *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton University Press: Princeton NJ, p. 10.

From this perspective states are no longer central actors of international politics, thus institutions create the framework of principles, norms, rules, or procedures, where politics occur. Indeed as Young implies institutions are ‘recognized patterns of practice around which expectations converge’⁶⁶.

Neoliberals accept that international system is anarchic, which means ‘the lack of common government in world politics’⁶⁷. The anarchy also means the lack of enforcement mechanisms to ensure state compliance with international agreements. Therefore the greatest shortcoming of cooperation behavior among states is their fear of defection. This fear could prevent states from cooperation even if it is rational for them to cooperate. To overcome this fear states should create a sense of legal liability, so that they will have common obligation to stick to the rules. As Keohane emphasizes, ‘even egoistic actors may agree to accept obligations that preclude making calculations about advantage in particular situations, if they believe that doing so will have better consequences in the long run than failure to accept any rules or acceptance of any other politically feasible set of rules’⁶⁸.

Keohane offers an assumption that states are rational egoists, and by rational he means that states possess ‘consistent, ordered preferences, and ... calculate costs and benefits of alternative courses of action in order to maximize their utility in view of these preferences’⁶⁹. In turn, egoism, according to Keohane, ‘means that their utility functions are independent of one another: they do not gain or lose utility simply because of the gains or losses of others’⁷⁰. Therefore, neoliberals determine states as atomistic actors, who seek to maximize their absolute gains, and ignore the gains achieved by others. So that ‘the object is to do as well as possible, regardless of how well the other player does’⁷¹. This contradicts realist’s view, where states are positional, and will be worried if their partners gain more from cooperation than they do⁷².

Apart from states Keohane and Nye suggested that the emergence of non-state actors, like transnational corporations, international organizations etc., had a huge impact on

66 Young, Oran R. (1980). International Regimes: Problems of Concept Formation. *World Politics*, Vol. 32, No. 3 (April), p. 337.

67 Keohane, Robert O. (1984). *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton University Press: Princeton NJ, p. 7.

68 Ibid, p. 13.

69 Keohane, Robert O. (Ed.) (1986). *Neorealism and Its Critics*. Columbia University Press, p. 11.

70 Ibid, p. 27.

71 Grieco, Joseph M. (1993). Anarchy and the Limits of Cooperation: a Realist Critique of the Newest Liberal Institutionalism. In Baldwin, David A. (Ed.) *Neorealism and Neoliberalism: The Contemporary Debate*. Columbia University Press: New York, p. 125.

72 Grieco, Joseph M. (1993). Anarchy and the Limits of Cooperation: a Realist Critique of the Newest Liberal Institutionalism. In Baldwin, David A. (Ed.) *Neorealism and Neoliberalism: The Contemporary Debate*. Columbia University Press: New York, p. 118.

international politics. This marked a major break from the 300-year old post-Westphalian state-centric model⁷³. Institutions are created in response to state interests and they are shaped by distribution of capabilities, but also institutions can ‘change as a result of human action, and the changes in expectations and process that result can exert profound effects on state behavior’⁷⁴. International actors – like NATO or the European Union – ‘can provide information, reduce transaction costs, make commitments more credible, establish focal points for coordination, and in general facilitate the operation of reciprocity’⁷⁵. Keohane and Martin continue that institutions make difference in conjunction with power realities. And depending on the nature of power and interests institutions could affect the outcomes. Hence even Mearsheimer admits that ‘institutions can prevent war regardless of the structure in which they operate’⁷⁶. Therefore on the basis of reciprocity lasting peace could be secured.

Though international system is anarchic, cooperation according to neoliberals is possible. Cooperation should be distinguished from other concepts, according to Keohane and Axelrod: ‘Cooperation is not equivalent to harmony. Harmony requires complete identity of interests, but cooperation can only take place in situations that contain mixture of conflicting and complementary interests. In such situations, cooperation occurs when actors adjust their behavior to the actual or anticipated preferences of others.’⁷⁷ It’s all about the ability of international institutions to mitigate the effects of anarchy. Cooperative behavior is observed only when it is mutually beneficial for both states. According to Robert Axelrod’s: ‘Mutual cooperation can emerge in a world of egoists without central control, by starting with a cluster of individuals who rely on reciprocity’⁷⁸. Reciprocity could be used as a tool to reduce transaction costs, limit strategic options, and provide information to the actors. Indeed exchange of information is critical component for stable relationships.

Cooperation does not always prevail because of malleability of interests, but the state of interdependence creates interests in cooperation⁷⁹. Moreover, the basis of such cooperation has economic roots, as to achieve cooperation in security affairs is much more

73 Dunne, T. (2001). Liberalism. In Baylis, J. & Smith, S. (Eds.). *The globalization of world politics: an introduction to international relations*, 2nd Edition, New York: Oxford University Press, p. 170.

74 Keohane, Robert O. (1989). *International Institutions and State Power*. Boulder, Colo.: Westview, p. 10.

75 Keohane, Robert O. and Martin, Lisa L. (1995). The Promise of Institutional Theory. *International Security*, Vol. 20:1, p. 42.

76 Ibid.

77 Axelrod, Robert & Keohane, Robert, O. (1993). Achieving Cooperation Under Anarchy: Strategies and Institutions. In Baldwin, David A. (Ed.) *Neorealism and Neoliberalism: The Contemporary Debate*. Columbia University Press: New York, p. 85.

78 Axelrod, Robert. (1981). The Emergence of Cooperation Among Egoists. *American Political Science Review*, Vol. 75, June, p. 317.

79 Keohane, Robert O. (1984). *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton University Press: Princeton NJ, p. 8.

difficult, but not impossible. Thus, Charles Lipson argues that ‘it is seriously misleading to assume that security issues do not present the opportunity for significant joint gains, or at least the prevention of joint losses’⁸⁰. Moreover, Keohane and Martin suggest that ‘institutionalist theory should be highly applicable to security issues because its argument revolves around the role of institutions in providing information’⁸¹. The more information is secured, the more utilities could be achieved by the states.

Cooperation requires separate actors, who are not in the harmony, through the process of negotiation to reach conformity with one another. Therefore, ‘intergovernmental cooperation takes place when the policies actually followed by one government are regarded by its partners as facilitating realization of their own objectives, as a result of a process of policy coordination.’⁸² An example of such cooperative behavior in energy sector is oil crises of 1973-1974 and 1979, when separately states failed to coordinate response, but in 1980 this response was successfully achieved through the International Energy Agency.

Robert Keohane develops a theory, where he ‘takes the existence of mutual interests as given and examines the conditions under which they will lead to cooperation’⁸³. It is important to mention that he scrutinizes cooperation between advanced industrialized countries, which does not mean that cooperation between less developed countries is impossible. Rather he takes the area ‘where common interests are greatest and where the benefits of international cooperation may be easier to realize’⁸⁴.

When it comes to interdependence Keohane and Nye stress out that ‘rather than viewing realist theory as an alternative to liberal ‘interdependence theory’, we regarded the two as necessary complements to one another’, as both theories have ‘utilitarian view of the world, in which individual actors pursue their own interests by responding to incentives’⁸⁵. Interdependence implies that action of actors (states and non-states) will impose costs on other members of the system. And affected actors will respond politically according to their capacity in order to avoid the burden of adjustment forced upon them. Therefore, interdependence means that national economies are connected with each other in the way that it creates mutual dependence. Interdependence does not necessary lead to cooperation,

80 Lipson, Charles. (1993). International Cooperation in Economic and Security Affairs. In Baldwin, David A. (Ed.) *Neorealism and Neoliberalism: The Contemporary Debate*. Columbia University Press: New York, p. 71.

81 Keohane, Robert O. and Martin, Lisa L. (1995). The Promise of Institutional Theory. *International Security*, Vol. 20:1, p. 43.

82 Ibid, pp. 51-52.

83 Keohane, Robert O. (1984). *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton University Press: Princeton NJ, p. 6.

84 Ibid, p.7.

85 Keohane, Robert O. & Nye, Joseph S. (1987). Power and Interdependence revisited. *International Organization*, Vol. 41, Issue 4, September, p. 728.

but that patterns of interdependence and patterns of potential power resources in a given issue-area are two sides of one coin⁸⁶.

Institutionalists are positioned to determine that states seek for absolute gains, while realists insist on relative gains. But as Duncan Snidal has shown in his research relative gains are unlikely to have much impact on cooperation if the potential absolute gains from cooperation are substantial⁸⁷. Institutions not only mitigate fears of cheating, but also allow cooperation to emerge and eliminate fears of unequal gains. By disclosing and exchanging transparently information about the distribution of gains, institutions can prevent potential conflicts. Moreover, institutions also create a favorable setting for issue-linkage, which provides new incentives for cooperation and strengthens existing connections. Continued interaction within the same setting produces more opportunities for collaboration, and creates spill-over effect⁸⁸.

When neoliberalists take Prisoner's Dilemma, they conclude that in institutionally arid setting, when actors could communicate, the willingness to cooperate for joint gains is explicitly contingent⁸⁹. As long as each of the participants of the Prisoner's Dilemma keeps its promises, cooperation seems to be much more beneficial for both of them. Moreover, when states interact repeatedly in beneficial or harmful manner, mutual cooperation is their best long-term strategy. Another problem with Prisoner's Dilemma is that it offers usually more than one cooperative solution. And states may not agree on which solution to accept, as each has different distributional implications. In this situation institutions among others may introduce coordinating mechanism. Especially in complex situations involving many states, institutions can step in to provide 'constructed focal points' to make particular cooperative outcomes prominent⁹⁰. Finally, conditional cooperation is much more attractive 'as institutions reduce verification costs, create iterativeness, and make it easier to punish cheaters'⁹¹.

86 Keohane, Robert O. & Nye, Joseph S. (1987). Power and Interdependence revisited. *International Organization*, Vol. 41, Issue 4, September, p. 730.

87 Snidal, Duncan. (1991) Relative Gains and the Pattern of International Cooperation. *American Political Science Review*, Vol. 85, No. 3, September, pp. 701-726.

88 See, Haas, Ernst. (1958). *The Uniting of Europe: Political, Social and Economic Forces, 1950-1957*. Stanford, CA: Stanford University Press.

89 Lipson, Charles. (1993). International Cooperation in Economic and Security Affairs. In Baldwin, David A. (Ed.). *Neorealism and Neoliberalism: The Contemporary Debate*. Columbia University Press: New York, p. 63.

90 Keohane, Robert O. and Martin, Lisa L. (1995). The Promise of Institutional Theory. *International Security*, Vol. 20:1, p. 45.

91 Grieco, Joseph M. (1993). Anarchy and the Limits of Cooperation: a Realist Critique of the Newest Liberal Institutionalism. In Baldwin, David A. (Ed.) *Neorealism and Neoliberalism: The Contemporary Debate*. Columbia University Press: New York, p. 124.

2.1.4. Rent-seeking

The choice of application of rent-seeking concept was made in order to explain the role of oligarchic groups in energy reform process. The literature on rent-seeking falls within broader concept of ‘*state capture*’, which is a modified version of ‘*regulatory capture*’ theory adjusted to post-communist countries. While ‘regulatory capture’ focuses on ‘the process through which special interests affect state intervention in any of its forms’⁹², Joel Hellman in his publication ‘Winners take all’ in 1998 focused on the role of the net winners as biggest obstacles to economic reform in postcommunist transition. In his words net winners are represented as a net of actors ‘from enterprise insiders who have become new owners only to strip their firms’ assets; from commercial bankers who have opposed macroeconomic stabilization to preserve their enormously profitable arbitrage opportunities in distorted financial markets; from local officials who have prevented market entry into their regions to protect their share of local monopoly rents; and to form so-called mafiosi who have undermined the creation of a stable legal foundation for the market economy’⁹³. Indeed those winners were born during transition, benefitting from favorable conditions created through means of rents those actors strengthened their power in a society.

Hellman pointed that winners did not oppose reforms neither they looked for full-scale reversal of reforms, but instead ‘they have frequently attempted to block specific advances in the reform process that threaten to eliminate the social advantages and market distortions and market distortions upon which their own early reform gains were based’⁹⁴. This situation led to ‘*partial reform equilibrium*’. As reforms are implemented partially, the winners benefit from it by boosting income in a short term, while further increase of the income depends on the comprehensiveness of the reform. Hellman also assumes that with time winners could obtain an implicit veto power in the decision-making process especially in the field that affects their rents⁹⁵. Therefore, the efficiency of reform depends on the state’s ability to advance reform regardless the efforts of net winners to maintain their short-term gains by preserving the imbalances of partial reform over time. In general, proponents of the ‘state capture’ literature unveil the impact of powerful economic groups on the policy formation process by specifying their formal and informal methods of influence.

92 See, Dal Bo, Ernesto. (2006). Regulatory Capture: A Review. *Oxford Review of Economic Policy*, Vol. 22, No. 2, p. 203.

93 Hellman, J. (1998). Winners Take All: The Politics of Partial Reforms in Postcommunist Transitions. *World Politics*, Vol. 50, No. 2, p. 204.

94 Ibid, p. 204.

95 Ibid, p. 222.

Margarita Balmaceda by adopting 'state capture' thesis developed a notion of 'rents of energy dependency'⁹⁶. She defines domestic factors as key to established asymmetric energy dependency on Russia. By this she shifts the focus from Russia's economic pressure as main reason of Ukraine's gas dependency to the role of the interest groups in Ukraine. She argues that Ukrainian political and economic elites through gas trade created a system of rents. Increased power of the interest groups resulted in reluctance to reform so lucrative sector. Energy rents of the interest groups not only disabled them from acting in order to break energy dependency, but also to the contrary transformed them into keen supporters of energy status quo. Therefore, understanding the nature of interest groups in Ukraine is a key for understanding 'convoluted energy policies since independence'.

Balmaceda's contribution is immensely valuable for the scholars on energy issues in Ukraine as it takes a view of political economy and public policy to enlist the wider factors shaping the energy domain. In her recent book Balmaceda introduces five intervening factors, which connect political system and the style of energy dependency management⁹⁷. The first factor is a lack of transparency, which is a fertile ground for corruption. Nontransparent environment in energy sector raises the chances for cooperation between the actors in order to sustain the status quo. Second factor covers the mode of energy policy control, which can be democratic or authoritative. In case of lack of democracy, particularistic interests of certain energy groups could find their way for implementation much more easier. Third intervening factor is depicting leader's legitimacy at home as well as his support abroad, which may restrain the country's maneuver from implementing independent energy policy. The network of interest groups create a special mechanism when their interests are adopted through shady schemes of corruption, which constitutes the fourth factor. The last factor deals with the rents of energy dependency, which includes all the profits received from energy resources without the creation of value added.

Balmaceda introduces a cycle of rents model, which includes extraction, distribution and recycling. At the first stage of extraction we observe preferential prices through special tax and duties regimes. The rents of extraction would also include the shift

96 See, Balmaceda, M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarch's profits and Ukraine's missing energy policy, 1995-2006*. Routledge; Balmaceda, M. (1998). Gas, Oil and the Linkages between Domestic and Foreign Policies: The Case of Ukraine. *Europe-Asia Studies*, Vol. 50, No. 2; Balmaceda, M. (2013). *Politics of Energy Dependency: Ukraine, Belarus and Lithuania Between Domestic Oligarchs and Russian Pressure, 1992-2012*. University of Toronto Press.

97 Balmaceda, Margarita M. (2013). *The Politics of Energy Dependency. Ukraine, Belarus, and Lithuania between Oligarchs and Russian Pressure*. University of Toronto Press, pp. 16 – 18.

of energy losses to the state while appropriating benefits privately. Distribution as second element of the model raises the importance of who will accrue the rents (individual, corporation, state budget, intermediary companies with transborder rent sharing capacities). The third element of the model is recycling (reincorporation) of the rents back into the political system. Rent recycling brings us to the main statement of the partial-reform literature, where rent-seekers not only try to safeguard their access to rents, but also to create new sources of rents ('rent swamps'). The last element of recycling rents is essentially important as it defines the nature of the political system in broader way.

Instead of energy policy Balmaceda uses a concept of 'management of energy dependency', which includes all the aspects covering energy issues in a situation of dependency. This management of energy dependency besides official energy policy, also includes unofficial behavior of energy-related actors. Therefore, this concept of rather complex nature as well deals with diversification and energy trade.

2.2. Integrating Putnam's two-level game analytical approach

In this chapter I intend to unveil the main standpoints of Putnam's two-level game approach as an overarching theory. This approach will be duly fitted into the overall structure of thesis as it provides the basis for scrutinizing two levels of analysis as well as interaction between them.

In 1988 Robert D. Putnam came up with a well-known metaphor of the two-level game, national leaders are strategically positioned between two game boards, 'across the international table sit his foreign counterparts, and at his elbows sit diplomats and other advisors. Around the domestic table behind him sit party and parliamentary figures, spokespersons for domestic agencies, representatives of key interest groups, and the leader's own political advisors'⁹⁸. These two tables reflect two different sets of preferences, one at the national level, the other at the international level and while bargaining on these two tables national leader aims to reach an international agreement, which will be further ratified at home. Though the original work dates back almost 30 years, it proved to be a suitable framework, which allows conducting different types of research on the complexity of international negotiations and explains the intertwined nature of domestic and foreign politics. As indeed Putnam stated it: "It is fruitless to debate whether domestic politics

⁹⁸ Putnam, Robert D. (1988). Diplomacy and domestic politics: the logic of two-level games. *International Organizations*, No. 42, 3, Summer, p. 434.

really determine international relations, or the reverse. The answer to that question is clearly “Both, sometimes”⁹⁹.

First of all, it is needed to mention that Putnam’s approach bears importance because of its effort to link domestic politics and international affairs. Though Moravcsik in his introduction to the edited volume does not deny realist vision of three levels of analysis (international, domestic, individual), he projects Putnam’s two-level game as an intersection of all three levels with major focus on domestic and international levels. He continues that in realist perspective domestic preferences are assumed to be rather stable with alike decision-making procedures. Domestic factors are taken into consideration within a nation-state itself. And therefore states are perceived by their relative position in the international system. Therefore, realist school though concedes the existence of domestic politics, but rather fails to prioritize it when it comes to international affairs¹⁰⁰.

If we take a look at the previous attempts to explain interaction between domestic and international politics, we will see that they end up with a list of domestic influences on foreign policy with vague observation that there is a mutual connection between the two. James Rosenau was among the first to mention the existence of such a connection by calling it ‘linkage politics’¹⁰¹. Ernst Haas in particular determined the role of the interest groups on European integration through ‘spillover’ effect¹⁰². Meanwhile, liberalists, such as Joseph Nye and Robert Keohane¹⁰³, paid greater attention to transnational relations, thus overshadowing domestic factors. Recent works of the scholars, like Katzenstein and Krasner, proved the impact of international economy on domestic factors. As Katzenstein stated: ‘The main purpose of all strategies of foreign economic policy is to make domestic policies compatible with the international political economy’¹⁰⁴. These studies though just

99 Putnam, Robert D. (1988). Diplomacy and Domestic Politics: the logic of two level games. *International Organization*, 42, 3, Summer, p. 427.

100 Moravcsik, Andrew. (1993). Introduction: Integrating International and Domestic Theories of International Bargaining. In Peter B. Evans, Harold K. Jacobson, Robert D. Putnam (Eds.). *Double-Edged Diplomacy: International Bargaining and Domestic Politics*. (4). University of California Press, p. 6.

101 Rosenau, James N. (1969). *Linkage Politics: essays on the convergence of national and international systems*. Woodrow Wilson School of Public and International Affairs.

102 Haas, Ernst B. (1958). *The Uniting of Europe: Political, Social and Economic Forces, 1950-1957*. Stanford University Press.

103 Keohane, Robert O. (1987). *Power and Interdependence: World Politics in Transition*. 2nd Edition, Boston: Little, Brown.

104 Katzenstein, Peter J. (Ed.) (1978). *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*. Madison: University of Wisconsin Press, p. 4; Krasner, Stephen D. United States Commercial and Monetary Policy: Unravelling the Paradox of External Strength and Internal Weakness. In Katzenstein, Peter J. (Ed.) (1978). *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*. Madison: University of Wisconsin Press, p. 51 – 87; Krasner, Stephen. (1978). *Defending the National Interest: Raw Materials Investment and U.S. Foreign Policy*. Princeton: Princeton University Press.

partially reveal international-domestic causal connection, while leaving the reciprocal causality without a proper examination.

In Putnam's opinion the faulty logic of state-centric literature lies in the overestimation of unitary role of the state. He states that if we use state as a main decision-maker, then 'we should treat it as a plural pronoun: not 'the state, it ...' but 'the state, they ...'¹⁰⁵. Therefore, state-centric literature seems to be insufficient to reveal all the complexity of the theorizing how domestic and international politics interact. Even though, scholars like Katzenstein, unveil the impact of the international economy on the domestic politics¹⁰⁶, these studies do not explain the reverse logic how the domestic politics become entangled internationally.

Moreover, according to some IR scholars taking two level of analysis could be mutually exclusive, as David J. Singer argued that 'one could not add these two types of statements [systemic and domestic causes] together to achieve a cumulative growth of empirical generalizations'¹⁰⁷. Achen and Snidal mention that domestic factors may be crucial, but empirically obstinate to apply¹⁰⁸. As summed up by Moravcsik, the majority of IR scholars tend to apply international explanations, while using theories of domestic politics when it comes to anomalies¹⁰⁹.

While current domestic theories focus on society, state or state-society relations, they create only limited ties between certain groups (social groups, interest groups, public opinion; decision-making apparatus of the executive; institutions of representation, education) and international relations domain.

Most systemic scholars allow domestic politics to enter the research cycle as an independent, but rather secondary factor, which influences policy. Along this view national leaders are thought to mobilize domestic resources in order to achieve international goals. Three claims should be mentioned here. First, national leaders do not always behave rational. Second, state preferences are not stable. Third, leader is not always ready to mobilize resources.

105 Putnam, Robert D. (1988). Diplomacy and Domestic Politics: the logic of two level games. *International Organization*, 42, 3, Summer, p. 432.

106 E.g., Katzenstein, Peter J. (1985). *Small States in World Markets: Industrial Policy in Europe*. Ithaca: N.Y.: Cornell University Press.

107 Though further in the article he hints that combining domestic and international explanations is still possible under one framework. See, David J. Singer. (1961). The Level of Analysis Problem in International Relations. *World Politics*, 14, October, p. 77-92.

108 Achen, Christopher H., Snidal, Duncan. (1989). Rational Deterrence Theory and Comparative Case Studies. *World Politics*, 41, January, p. 166.

109 Moravcsik, Andrew. (1993). Introduction: Integrating International and Domestic Theories of International Bargaining. In Peter B. Evans, Harold K. Jacobson, Robert D. Putnam (Eds.). *Double-Edged Diplomacy: International Bargaining and Domestic Politics*. (4). University of California Press, p. 6.

Putnam's two-level-game approach assumes that national leaders simultaneously try to manipulate international and domestic politics to get better bargaining position and to reach an agreement. Bargaining position implies strategic interaction, where actors try to influence reactions of other actors abroad as well as at home. Though this framework seems quite compatible with much of the existing approaches, it also significantly differs. Putnam presents two-level game approach as a theory of international bargaining, where national leader is not only constrained by domestic politics, but patterns of interdependence between two levels also create new opportunities for an agreement. The second peculiarity lies in the centrality of national leader. This standpoint unites realist view, where statesman is faced with domestic constraints on mobilization, liberal view, where statesman seeks to receive maximum political support at home, and the view that statesman also perceives his own personal goals. Third distinction is that two-level games imply simultaneous 'double-edged diplomacy', where constraints and opportunities are evaluated in domestic area as well as international one. 'The two-level-games approach recognizes that domestic policies can be used to affect the outcomes of international bargaining, and the international moves may be solely aimed at achieving domestic goals'¹¹⁰. This interactive approach depicts vividly the most important standpoint of Putnam's theory.

Indeed the interaction between the two levels was mentioned before¹¹¹, but the nature of this co-dynamic was rather investigated partially or was posted as a question for further investigation. But with presenting of two-level game approach Putnam tries to find a shift when a metaphor of negotiation at two tables will be turned into analytic construct.

Two-level game approach presumes that there is a 'chief negotiator', who according to the situation could be head of the government, party leader, minister or ethnic-group leader etc. He also states that chief negotiator rather than having his own policy preferences seeks to find a middle way for the agreement to be reached.

Putnam decomposes the process of negotiation into two levels. Level I constitutes a negotiation between the parties, where tentative agreement is reached. While Level II includes the discussions on the ratification of the agreement among each group of the parties. Before the Level I negotiation starts, the process of previous consultations and

110 Moravcsik, Andrew. (1993). Introduction: Integrating International and Domestic Theories of International Bargaining. In Peter B. Evans, Harold K. Jacobson, Robert D. Putnam (Eds.). *Double-Edged Diplomacy: International Bargaining and Domestic Politics*. (4). University of California Press, p. 17.

111 See, Walton, Richard E. and McKersie, Robert B. (1965). *A Behavioral Theory of Labor Negotiations: An Analysis of a Social Interaction System*. New York: McGraw-Hill; Druckman, Daniel. (1978). Boundary Role Conflict: Negotiation as Dual Responsiveness. In I. William Zartman (Ed.). *The Negotiating Process: Theories and Applications*. Beverly Hills: Sage, p. 100-101, 109; Axelrod, Robert. (1987). *The Gamma Paradigm for Studying the Domestic Influence on Foreign Policy*. Annual Meeting of the International Studies Association.

bargaining takes place at Level II. Moreover, the process of negotiations may be repeated several times in order to learn the views of the parties, and later to attempt to alter these views. For the purpose of this thesis chief negotiator at international level will be defined as head of the government or head of the state or those who participated in energy talks on behalf of their respective head of state. At Level II the actors that will play crucial role in further ratification are defined as domestic interest groups or oligarchic groups.

An important link between the two levels is *ratification*. Though stated by Putnam rather as a generalized term, ratification does not always require formal implementation of an agreement, like voting in the parliament. It may also imply the reaction of the constituents at Level II, like approval or disapproval, support or withdrawal of support, concerning the tentative agreement reached at Level I. Ratification process foresees one important adjustment, if tentative agreement is to be approved at Level II with few amendments, it will be possible only if Level I negotiations are reopened. In the case of this research ratification apart from official voting in the parliament will also include support (or lack of it) by public opinion. The role of the EU will be rather evaluated from the perspective of being a facilitator, by offering/cutting aid or imposing/withdrawing sanctions. In this way the EU by imposing international pressure tries to influence positive changes in domestic politics. The role of Russia will be defined as a direct counterpart in energy negotiations with its transnational ties into domestic politics of Ukraine in order to affect outcomes of the international agreement.

The notion of the 'win-set' introduced by Putnam includes a set of possible agreements, which could gain necessary support among the parties. The larger win-set is at Level I, the greater is the probability of an agreement. When the win-sets of two levels overlap, the agreement is more likely to be reached. To the contrary, smaller win-sets pose greater risk of the failed negotiations¹¹².

A situation when ratification of the agreement fails may be caused by *voluntary* or *involuntary defection*¹¹³. A thin difference between two defections may be hard to distinguish in international politics, as national leaders may try to present voluntary defection as involuntary one. But voluntary defection refers to a situation, when chief negotiator revokes the agreement without any enforceable contracts. The ability of the chief negotiator to deliver what he promised may be low due to the inability of the leader to

112 Op. cit., Czaga, Peter. (2000). Domestic Structure Approaches in International Relations. In Segbers, K., Imbusch, K. (Eds). *The Globalization of Eastern Europe. Teaching International Relations Without Borders*. Hamburg, p. 122.

113 Putnam, Robert D. (1988). Diplomacy and Domestic Politics: the logic of two level games. *International Organization*, 42, 3, Summer, p. 438.

guarantee ratification. So the key may be defined in the ability to promise what chief negotiator within his power is able to deliver.

The importance of prior consultations before real negotiations start is important. As shown by several cases in Ukraine prior consultations though being fully successful were soon rejected when becoming public, which made reaching an agreement impossible. Therefore, I intend to show a number of attempts of reaching an agreement, which though favored by both parties failed at implementation phase.

Involuntary defection reflects a situation, when chief negotiator is unable to deliver his promise as ratification fails. Involuntary defection depends on the constraints of the negotiator's credibility, which demonstrates his ability to deliver. Involuntary defection may occur more frequently in the situation when the win-sets are small. Size of the win-set at Level II matters as it corresponds to the distribution of the joint gains. As well as small win-set could be used as a bargaining chip, so the leverage of the win-set may be exploited by the negotiator. The incentive of the chief negotiators to defect may be reduced significantly as the players are expected to meet again¹¹⁴.

Two-level game approach also stipulates the situation of no-agreement. It mostly happens, when the cost of no-agreement is low, but the size of the win-set is smaller. No-agreement usually means the status quo, but may possibly lead to a worsening situation. In Ukraine no-agreement was observed when due to war conditions with Russia energy agreement was treated negatively by public. This situation empowered current government to introduce painful energy reforms, which became rather a big burden for the population. Nevertheless public opinion was still quite homogenous and supportive of no-agreement with Russia and continued paying high gas price for it rather than finding a common ground with the counterpart that initiated illegal war in the Eastern Ukraine and annexed Crimea¹¹⁵.

Putnam determines three constituents of the win-set: *Level II preferences and coalitions; Level II institutions and Level I negotiators' strategies*. To understand the nature of the preferences at domestic level, Putnam offers to apply one of the theories that explain how preferences are formed among the interest groups¹¹⁶.

If preferences of the parties at the domestic level are heterogeneous, then the tentative agreement may face an opposition from domestic actors. Chief negotiator may find

114 Putnam, Robert D. (1988). Diplomacy and domestic politics: the logic of two-level games. *International Organizations*, No. 42, 3, Summer, p. 438.

115 Putnam, Robert D. (1988). Diplomacy and domestic politics: the logic of two-level games. *International Organizations*, No. 42, 3, Summer, p. 438.

116 Czaga, Peter. (2000). Domestic Structure Approaches in International Relations. In Segbers, K., Imbusch, K. (Eds). *The Globalization of Eastern Europe. Teaching International Relations Without Borders*. Hamburg, p. 123.

allies at his opponent's domestic table. This is the situation, when transnational alignments emerge. In case preferences are more homogeneous (boundary conflict), the chief negotiator has greater chances to win ratification at the Level II. Thus negotiator may use implicit threat to maximize his gains and minimize his losses at Level I and also to lower the difference of the expectations among Level II actors.

Depending on the issue, the size of the win-set varies, so as the pressure of the actors, whose interests are affected the most, will increase significantly. In case the issue is politicized, we may observe the active participation of the groups, who are less worried about the costs of non-agreement. Therefore, for the success of the negotiations diplomats prefer to keep the secrecy¹¹⁷.

When we come to a multi-issue negotiation, chief negotiator is faced with tradeoffs. Then chief negotiator without changing the preferences of domestic actors may rather create new policy option, which was out of the table. This linkage Putnam calls *synergistic linkage*¹¹⁸.

The discussions on the state autonomy reflect a situation when chief negotiator has more autonomy from Level II actors, therefore agreement may be reached with greater probability. Same standpoint also means that strong state in terms of autonomy will have weaker bargaining position at international level. Representatives of dictatorship will hardly use argument that the issue will meet domestic pressures.

Putnam insists that his argument of two-level game is simplified because actual negotiation and ratification takes many levels. But his generalization to two levels is necessary to show how the complexity of win-set analysis can be decomposed in order to avoid complexity of multiple-level games.

When we come to the strategies of the chief negotiator, Putnam defines his motives as mixed ones. The larger his win-set, the easier he can conclude an agreement, but he also has narrower choice of bargaining with other negotiator. Leader may use support at home through rally, organized by domestic actors; but it may also hinder the conclusion of the compromised version of the agreement. Thus usually preliminary consultations at home take place in order to find a middle way with domestic actors so the ratification phase will be easier.

117 Ibid, p. 125.

118 Moravcsik, Andrew. (1993). Introduction: Integrating International and Domestic Theories of International Bargaining. In Peter B. Evans, Harold K. Jacobson, Robert D. Putnam (Eds.). *Double-Edged Diplomacy: International Bargaining and Domestic Politics*. (4). University of California Press, p. 15.

Another strategy of key negotiator is to exploit side-payments and generic ‘good will’. Side-payments may come from unrelated domestic sources or may be received as part of negotiation. The value of side-payment is ‘calculated in terms of its marginal contribution to the likelihood of ratification, rather than in terms of value to the recipient nation’¹¹⁹. Higher-level negotiators are likely to dispose more side-payments and more ‘good will’ at home, therefore foreign representatives prefer to negotiate with the head of the government rather than with lower official. In our case side-payments have been usually used before reaching an agreement in order to secure ratification at domestic level. Some of the side-payments included providing Russia with extended rent of the Black Sea Fleet; flexible terms of gas storage facilities; decreased gas transit tariffs etc. Negotiations in energy domain proved that side-payment had been rather an obligatory element of negotiations rather than an exception. Regardless the value of the side-payments for Ukraine the desired outcome of cheaper gas price had been generally presented by chief negotiator to public as a great political accomplishment, which was considered to strengthen political stand of the incumbent.

The question of uncertainty is rightfully raised by Putnam, who concludes that chief negotiators usually are badly informed about domestic politics abroad in normal times and even worse informed during crises. This uncertainty of the size of win-set can play a role of a bargaining chip or a stumbling block during negotiations at Level I. Uncertainty about other side’s ability to ratify the agreement may push one side of the negotiations to demand side-payments from the other side. Negotiator states that his own win-set is ‘kinky’, meaning that what he offered will get enough support at home, but if the deal is to be altered to the favor of his opponent, it is unlikely to be ratified. Kinky win-sets are plausible, when they point at a ‘prominent’ solution, which will be supported domestically. Another important issue is about misrepresentation of information, which can be counterproductive, instead ‘controlled exchange of partial information’ may be much more fruitful.

In two-level game approach *reverberation* is an important attempt to persuade the other side by expanding one another’s win-sets. Partially this mission is fulfilled by ambassadors, who meet with opposition leaders, offer aid to unstable friendly government etc. Reverberation (intentional or unintentional) shows how international pressures change domestic balance (public opinion and the attitude of political groups) and thus influence the international negotiations. As Putnam puts it: “Given the pervasive uncertainty that surrounds many international issues, messages from abroad can change minds, move the

119 Putnam, Robert D. (1988). Diplomacy and domestic politics: the logic of two-level games. *International Organizations*, No. 42, 3, Summer, p. 450.

undecided, and hearten those in the domestic minority”¹²⁰. The paradox of reverberation is observed when certain actors in different states may try to change one another’s perceptions of the cost and benefits of non-/agreement. As a result of it international pressure affects the size of the win-set and may facilitate reaching an agreement. An example of reverberation given by Putnam reveals the nature of the negotiations between the IMF and Italian government in 1977. The final agreement was reached due to the direct consultations held between the IMF and Italian unions and left-wing parties. These consultations modified the demands of the IMF and enabled two negotiators to reach an agreement¹²¹. Suasive reverberation is found more frequently among the countries with close relations and is more likely in economic rather than political negotiations. Though in most cases reverberation by expanding domestic win-set facilitates agreement, it can also be negative and create domestic backlash. Negative reverberation is less common, but still possible if domestic audience views sources of international pressure as negative factor. European Union as a facilitator together with IMF enjoy power of indirect pressure by imposing conditionality in order to facilitate the agreement.

Putnam assumes that treating chief negotiator as an honest broker seems unrealistic. In reality chief negotiator is influenced by the preferences of his constituents as well as his own preferences. The main motives include strengthening of his domestic standing (gaining popularity, political rewards etc.); shifting balance of power to domestic level (using IMF pressure to facilitate reform); pursue his own understanding of national interest. During negotiations chief negotiator will side the preference at domestic level, as his incumbency directly depends on Level II. But certainly the limitation of Putnam’s theory lies in lack of explanation, when negotiator’s preferences oppose his constituents at domestic level¹²².

The first motive of the chief negotiator is to enhance his standing at the domestic level by maximizing his political resources and decreasing political losses. Being tied domestically, the chief negotiator intends to reach an agreement in order to increase his popularity at home with the aim, among others, to be re-elected. Another reason of concluding the agreement lies in the anticipated outcomes, which will turn into political rewards (through fostering economic growth, increasing of DFI, trade turnover etc.). Second motive is to shift the balance of power at domestic level due to external reasons. This

120 Putnam, Robert D. (1988). Diplomacy and domestic politics: the logic of two-level games. *International Organizations*, No. 42, 3, Summer, p. 449.

121 Ibid, p. 454.

122 Mo, Jongryn. (1994). The Logic of Two-Level Games with Endogenous Domestic Coalitions. *The Journal of Conflict Resolution*. Vol. 38, No. 3 (September), pp. 402-422.

situation creates an opportunity for the chief negotiator to make a decision, which he privately supports, but is unable to implement because of domestic pressure. Exogenous factor plays here a role of a facilitator in order to implement certain policy. Third motive includes efforts of the chief negotiator to pursue his own understanding of the national interest at international arena.

If to talk about the cases when a leader may withdraw from an agreement because of personal disagreement, Putnam lists several peculiar cases. If the deal lies within Level II win-sets, but he personally opposes it, he may veto tentative agreement. Thus the actual international bargaining options at the end may be too limited. If agreement though quite likely to be ratified at home will lead to a situation when he will be forced to change his domestic coalition, leader may be reluctant to endorse it. Sometimes domestic constituents are more eager to support an agreement than the leader, though the leader holds veto right, if this veto will threaten his incumbency, the other side of negotiation may use this case as Level I as leverage.

The importance of Putnam's two-level theory lies in the statement that as decision-makers strive to reconcile domestic and international domains simultaneously, the conflict about what national interest will arise inevitably. In the path of negotiations chief negotiator will attempt to carefully consider strategic opportunities and his decisions will ultimately change domestic field as well as international one. The importance of various offers during negotiations such as side-payments, threats, barter, which are an integral part of the decision-making process and may end up with divergent ways of interest implementation. His contribution allows us to distinguish when domestic interests are homogeneous or heterogeneous, and how it fosters/hinders cooperation. By uncovering synergetic linkage between domestic and international politics Putnam shows how moves at one game-table facilitate unexpected coalitions at the second one. It seems quite surprising how solid domestic support at home could weaken international bargaining position abroad and vice versa.

To my mind, unlike state-centric literature, Putnam attempted to state that the existence of other actors is as important as the main decision-maker. Though he mainly ignores the link between supranational and domestic actors, he managed to include other actors into the chain of decision-making process. This invaluable contribution enables me to define interest groups as a part of the energy policy making in Ukraine.

Though Putnam's two-level game theory is mostly used as a metaphor, but simultaneously it provides us with insightful new explanations for important empirical

puzzles (in our case energy politics) that existing theories cannot fully explain. Putnam was criticized harshly for oversimplifying the process, which is rather multi-layered and repetitive, but this oversimplification is a necessary endeavour when it comes to moulding a framework for research. The strong side of Putnam's approach is underlying central concepts and the logic of two level interactions, while leaving substantial flexibility for the scholar in applying method to a particular research problem.

The most compelling aspects of the two-level game approach is that it challenges predominant realist approach, according to which state is unitary rational actor. It provides a framework, where we can observe the impact of domestic constraints on international politics. In other words, it enables us to conceptualize how processes and structures at domestic level affect external behavior. Putnam's approach offers a framework, where countries with different positions manage to converge on a specific agreement and agree to common decisions, while justifying those decisions at home.

Putnam also does not make any distinctions between democratic and autocratic rulers, he implies that regardless the regime type none of the leaders will be fully immune from domestic pressure, which is extremely important when we talk about countries in post-Soviet area.

Undoubtedly Putnam's contribution regardless its novelty and originality possesses several loopholes. Many statements made in his article about double-edged diplomacy lack clarification and require further research to draw peculiar conditions and facts to support it. Though Putnam mentions about domestic constraints that can be used by chief negotiator as a bargaining advantage, he does not elaborate more on precise conditions of this situation. This claim raised a wave of research on how domestic constraints affect bargaining process if two sides face these constraints. Among others Ahmer Tarar investigates that Putnam's statement about domestic constraints as advantage during negotiation is oversimplified. Rather than generalizing, he finds that when one executive's constraint is high, and the other's is only low or medium, than the former gets better deal. But in the situation, when one executive knows both constraints and the other knows only his own constraint with certainty, the executive with high constraint receives less, and the one with low constraint receives more¹²³. Incomplete information can but does not always eliminate the advantage of having a high constraint¹²⁴. Therefore, Putnam's claim about domestic constraints was

123 Tarar, Ahmer. International Bargaining with Two-Sided Domestic Constraints. *The Journal of Conflict and Resolution*. Vol. 45, No. 3 (June), pp. 320-340.

124 Ibid, pp. 320-322.

further scrutinized and more precise conditions were specified from rather general statement made by him originally.

Another two statements made by Putnam were more thoroughly theorized by Keisuke Iida. She expanded Putnam's conclusions by adding the effect of uncertainty into the mix. Putnam's claim that the smaller win-set will more likely lead to the fail of negotiations does not come true, as under the conditions of complete information the size of the win-set becomes irrelevant. In other words, incomplete information about domestic political situation may lead to involuntary defection or no intersection of win-sets, and therefore ratification will be endangered. So Putnam's hypotheses are correct only under conditions of uncertainty or incomplete understanding of the domestic political situation¹²⁵.

Another important part of Putnam's approach, which was further researched, touched upon the interaction between the international process and the formation of domestic coalitions. Domestic groups with a veto power significantly affect the process of international bargaining by increasing the expense of forming a majority domestic coalition. In a negotiation at international level veto power essentially limits the win-sets to those that will be accepted by domestic coalition. Veto power directly affects the ratification process, if the international agreement is within the range of acceptable outcomes of the domestic coalition, then it falls into intersection of the win-sets, and the likelihood of ratification increases. As noted by Prof. Jongryn Mo a change in the relative political power among domestic groups does not necessarily change the composition of the win-set at the international level¹²⁶.

Since Putnam introduced two-level game approach, it has been applied to different cases of international negotiations. Some focused on bilateral relations between countries¹²⁷, some took it to the level of multi-level negotiations within international organizations¹²⁸. Due to its rigorous flexibility Putnam's approach allows us to focus on specific groups and interests affecting international negotiations; to measure influence of public opinion and

125 Iida, Keisuke. (1993). When and How Do Domestic Constraints Matter? Two-level Games with Uncertainty. *The Journal of Conflict Resolution*, Vol. 37, No. 3 (September), pp. 403-426.

126 Mo, Jongryn. (1994). The Logic of Two-Level Games with Endogenous Domestic Coalitions. *The Journal of Conflict Resolution*. Vol. 38, No. 3 (September), pp. 402, 412-13.

127 Boyer, Mark A. (2000). Issue Definition and Two-Level Negotiations: An Application to the American Foreign Policy Process. *Diplomacy and Statecraft*, Vol. 11, No. 2 (July), pp. 185-212.

128 See, Crespy, Amandine; Schmidt, Vivien. The clash of Titans: France, Germany and the discursive double game of EMU reform. *Journal of European Public Policy*, 21:8, pp. 1085-1101; Schmidt, Robert J. Jr. (1996). International negotiations paralyzed by domestic politics: two-level game theory and the problem of the Pacific Salmon Commission. *Environmental Law*, Vol. 26, pp. 95-139; Chiou, Yi-hung. (2010). A Two-level-games Analysis of AFTA Agreements: What Caused ASEAN States to move towards Economic Integration? *Journal of Current Southeast Asian Affairs*, Vol. 1, pp. 5-49.

how it is exploited; to define level of constraints imposed by the actors; to assess referendum as ratification instrument¹²⁹ etc. This flexibility enables researcher to conduct a research within developed framework with a precise focus on a scrutinized research question.

I argue that Putnam's approach is applicable to energy politics in Ukraine due to several reasons. First of all, it sets two-level analysis as a basis for research, by which allows us to define domestic and international factors. Second, two-level approach enables us to define the interactive nature between the levels, thus to trace how development at one level affect the other and otherwise. Third, it defines chief negotiator as an executive who forms national preferences based on domestic level groups preferences, his own understanding of preferences and the affect of international actors on it. This important aspect confirms that chief negotiator shapes national preferences through a complex process and does not purely transcend national interests as defined by realists. Fourth, domestic level groups, in our case oligarchic groups, vastly affect and shape interests of chief negotiator, which indicates the ties between chief negotiator and these groups, as well as transnational ties between domestic groups and international actors. Fifth, Putnam's approach allows us to deconstruct multi-layered process of negotiation into more simplified version of international bargaining, which is essentially important in very complex domain of energy politics. Sixth, flexibility of Putnam's approach ensures the general framework, while contributions of other IR theories and state capture theory are applied complimentarily.

129 Loizides, Neophytos. (2014). Negotiated Settlements and Peace Referendums. *European Journal of Political Research*, Vol. 53:2, (May), pp. 234-249.

CHAPTER 3

ESTABLISHING OF ENERGY POLITICS DYNAMICS DURING FIRST YEARS OF INDEPENDENCE UNDER KRAVCHUK AND KUCHMA'S PRESIDENCIES

Gas consumption in Ukraine has been increasing rapidly during Soviet times due to low energy prices. Not surprisingly Ukraine was the third largest gas consumer in the world after the US and the Russian Federation¹³⁰. Energy sector of Ukraine once a part of an integral economic system of Soviet Union was separated from it, but still left with main gas and oil pipelines, large underground storages of natural gas, deposits of uranium and zirconium and research and technology facilities of the nuclear fuel cycle elements. From the other side Ukraine inherited big industrial complexes vastly dependent on hydrocarbons, which demanded mutually advantageous cooperation with neighbors, but instead led to the transformation of the energy sector into the most opaque one.

This chapter takes a close look at the developments and initiatives in the energy sector launched since independence and covers first ten years. It argues that Ukraine in the effort to prove its independence had implemented rather inconsistent energy policy, which led to the lack of transparency in the energy sector. In an attempt to hold its economic and political independence from Russia, Ukraine pursued policy from alienating Russia to again claiming 'brotherhood relations'. Non-engagement of the West left Ukraine at the energy nexus of Russia. By showing how ineffective domestic policies under Kravchuk and Kuchma as well as void promises of diversification, which left Ukrainian economy totally dependent on Russia's energy supplies, I intend to demonstrate the implications of the evolution of Ukraine's energy sector that shaped the continuity of the interdependence. This chapter focuses mainly on oil and gas, while electricity, coal and nuclear power are covered only to support the main hypothesis.

130 Tsarenko, Anna. (2007). *Overview of Gas Market in Ukraine*. CASE Ukraine, Kyiv, <http://www.case-ukraine.com.ua/u/db/f82724f7db929a608a4571dd86548abc.pdf>, accessed February 2, 2012.

3.1. Ukraine's energy profile

Energy policy of Ukraine addresses the issues of production, consumption and distribution of energy. In Ukraine energy issue is tightly connected to economy due to Soviet legacy and foreign politics. The formation of the energy policy in the first decade of Ukraine's independence explains the paths of continuity, which has not been altered for quite a while.

To understand the pace of energy dependency of Ukraine on Russia, the principle of command economy should be revealed. The former Soviet Union was based on a centrally commanded division of labor, where along the 'vertical fiscal redistribution' poorer republics became net receivers and richer republics became net donors¹³¹. Authorities by setting prices for goods, including energy, independently from market laws were determining where and what kind of products were to be transferred.

According to the numbers revealed by the former Central Statistical Office of the USSR (Goskomstat) for 1987-1990 Union trade the prices for oil and gas appeared to be 2.7 times lower than market ones¹³². This highly underpriced trade proved that oil and gas played a dominant role in the trade transfer mechanism. Oil and gas accounted for 61.5 % out of total indirect transfers in the trade among FSU republics¹³³. The net beneficiaries of the underpriced oil and gas resources were the relatively energy-intensive industrial countries, like Ukraine. As noted by Lucjan T. Orłowski 'more than 50 % of the Russian net transfers in oil and gas trade was received by Ukraine'¹³⁴. Russia's will to export energy under so unfavorable terms was explained by the necessity of industrialization.

Since 1992 gradual dismantlement of indirect transfers meant for Ukraine gradual shift to market prices for energy resources, while still maintaining some barter schemes and vast subsidization responsible for distortion of prices. Ukraine even more than other Soviet republics, was dependent on centralized distribution system. First of all, Ukraine's industrialized economy, which is relying on ferrous metal industry, is the most energy intensive in Europe. Second, as neatly pointed by Michail Korchemkin the system created by Soviets foresaw that 'suppliers and users are linked by pipelines laid without respect to the newly created internal borders of the FSU, and it would take billions of dollars to

131 Orłowski, Lucjan T. (1993). Indirect Transfers in Trade Among Former Soviet Union Republics: Sources, Patterns and Policy Responses in the Post-Soviet Period. *Europe-Asia Studies*, Vol. 45, No. 6, p. 1001.

132 Ibid, p. 1003.

133 Ibid, p. 1003-4.

134 Ibid, p. 1007.

change the supply scheme'¹³⁵. Therefore, any radical alteration of the system was rather elusive due to the lack of the finances to implement these reforms.

Soviet era of cheap energy resources led to a great inefficiency and spendthrift. Ukraine for two decades after independence remained one of the least energy-efficient countries in the region. Nowadays, Ukraine's energy intensity, i.e. the ration of TPES to GDP, is ten times more than the OECD average (in purchasing power parity terms 3.2 times more than on average in OECD countries)¹³⁶.

Lack of sustainability plan so common for all Soviet countries was of no exception to Ukraine. In the first decade together with economy, which shrank by almost 50 %, the production and consumption of energy resources also faced significant decrease¹³⁷. Once heavily subsidized gas sector appeared to be in recession, world market prices were too heavy burden for Ukraine's economy to bear.

Though Ukraine possesses rich mineral resources, none of the domestic resources of coal, gas and oil seems to be sufficient for Ukraine to meet fully country's energy demand. In 1992 Ukraine could meet at best 15-20% of its gas needs and only 8 % of its oil needs¹³⁸. But if we take a look at the ratios of coal, natural gas and oil consumption in the first two decades, we will realize that coal and natural gas account for 70 % of Ukrainian economy¹³⁹. While coal is being produced in Ukraine, two third of gas consumption is imported from abroad. An urgent need for the diversification emerged. It is needed to point out that the problem of energy efficiency or reduction of energy usage was not mentioned at that stage. As Ukraine did not review the approaches of energy usage, industry of Ukraine continued to work with extensive energy usage by inertia. The economy heavily dependent on energy resources remained unreformed, which played into the hands of Russia.

But the positive legacy left after the collapse of the Soviet Union was pipeline network, Ukrainian Gas Transmission System, which turned to be a strategic asset with geopolitical value. It was this pipeline network that made Ukraine one of the biggest transit countries in the world and a bridge for Russian gas to flow into Europe.

The structure of energy policy institutions in Ukraine bears the legacy of the Soviet

135 Korchemkin, Mikhail. (1996). Russia's Oil and Gas Exports to the Former Soviet Union, in Kaminski, Bartolomiej. *Economic Transition in Russia and the New States of Eurasia*. Armonk, N.Y.: M.E. Sharpe, p.130.

136 International Energy Agency. (2012). *Ukraine 2012. Energy Policies Beyond IEA Countries*. IEA, pp.16-17.

137 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 32.

138 Op. cit., Smolansky, O. (1995). Ukraine's Quest for Independence: The Fuel Factor. *Europe-Asia Studies*: Vol. 47, No. 1, p. 68.

139 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 79.

Union and resembles two-level structure. First level deals with large-scale fuel production and generation, while second level deals with residential energy services like district heating and distributed generation¹⁴⁰. Certain ministries under the Cabinet of Ministers and certain committees in the Parliament are in charge of various aspects of the energy sector (See, Figure 1. *Key Energy Policy Institutions of Ukraine*).

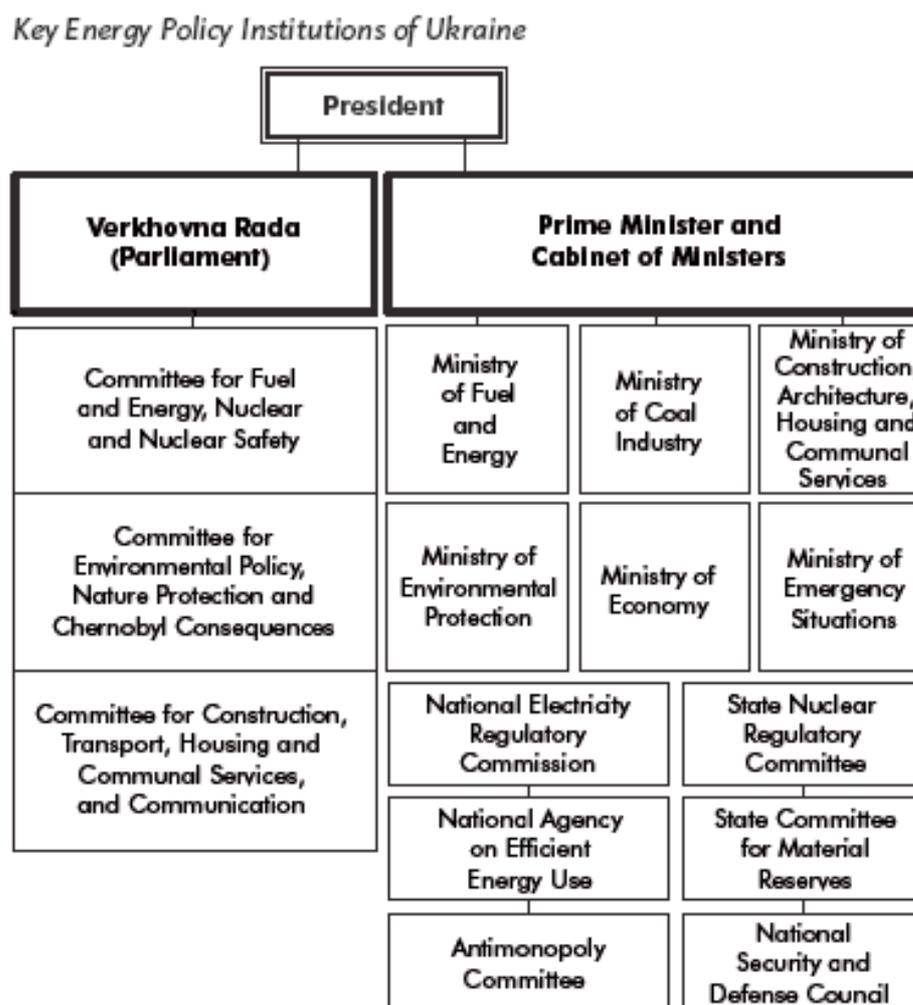


Figure 1. Key Energy Policy Institutions in Ukraine.

Source: International Energy Agency. Ukraine Energy Policy Review 2006.

The key administrative body is the Ministry of Energy and Coal¹⁴¹, which is responsible for the development of the energy strategy and energy-related economic and

140 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 36.

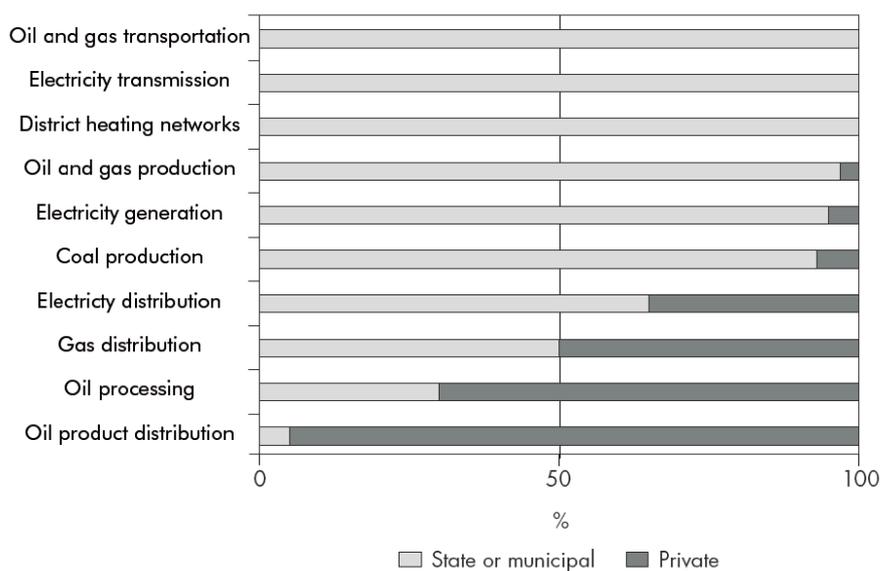
141 The Ministry of Energy and Coal was established by presidential decree on 14 April 2000 by merging the Ministry of Coal Industry, the Ministry of Energy, the State Committee for the Power Industry, the State Committee for Oil, Gas and Oil-refining Industries, and the State Committee for Nuclear Power. Before it held the name of Ministry of Fuel and Energy.

social programs. Having an authority over Naftogaz and Energy Company of Ukraine, the Ministry therefore controls major energy assets in oil, gas, electricity and district heating.

Another very important player in energy sector is the National Electricity Regulatory Commission, which in November 2011 was reorganized into National Commission for State Energy Regulation. While the Commission was initially founded in 1994 to regulate prices and issue licenses in electricity sector, its authority has been extended and now covers entire energy sector¹⁴². NERC is subordinate to the President of Ukraine, who appoints its head, and is accountable to the government. One more limitation of the NERC's independence comes from its budget reliance on the government.

In first fifteen years of independence Ukrainian energy sector faced two main trends of privatization and consolidation¹⁴³. State-owned companies dominated the energy sector in general, except considerable increase of the number of private companies in oil processing, oil product distribution and gas distribution after privatization in the late 1990-s (See, Figure 2. *Ownership Structure in the Ukrainian Energy Sector, Early 2006*).

Ownership Structure in the Ukrainian Energy Sector, Early 2006



Note: Most district heating networks are under municipal ownership. Gas distribution pipelines are state-owned but about 50% of companies that operate these pipelines are in private hands.

Source: IEA estimates based on information provided by the government and other sources.

Figure 2. Ownership Structure in Ukraine's Energy Sector, Early 2006.

Source: IEA

142 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 38.

143 Ibid, p. 40.

The challenges in Ukrainian energy sector resemble the challenges, which countries in the emerging markets face. The greatest problem remained in inefficient energy consumption, which was 2.6 times higher than the worldwide average in 2005¹⁴⁴.

In 2004 the balance of energy consumption indicated the prevalent role of natural gas (42 %), which was followed by oil (17%), heat (14%), coal (13%) and electricity (12%)¹⁴⁵. During 1991-2004 Ukraine's dependence on imported natural gas and oil increased, while coal remains the only energy source produced domestically. The developments in energy sector could be characterized by vast state control, deficit of innovations and investments and weak legislative base. This period proved an established continuity in energy sector, while major structural reforms were postponed. Below I take a general sectoral overview, including natural gas, oil, coal and renewables to show the main developments in the energy sector.

The amount of *natural gas* consumed by Ukraine on annual basis during 1990s was 76 bcm, which placed Ukraine among top ten gas consuming countries in the world. The tendency of natural gas consumption faced decline and decreased from 47 % in 2000 to 40 % in 2010¹⁴⁶. This happened due to energy efficiency improvements in metallurgical sector as well as due to increased energy prices. Gas sector has been the most important energy input for industrial development. It is needed to mention that 56 % of the gas was used by industry and residential sector, while the other 40 % was used by electricity and heat plants¹⁴⁷.

After annexation of Crimea and Donbas conflict the consumption of gas decreased. More importantly supply was redirected from Russia to European Union. While till 2012 Russia was a sole source of imported gas to Ukraine, this state of affairs changed radically as Ukraine suspended its import of gas from Russia and thus limited Russia's role in gas trade. All this pushed Ukraine to downsize its gas consumption. And the share of natural gas in Ukraine's energy mix decreased from 45,3 % in 2002 to 35,1 % in 2012. In 2014 Ukraine imported just 19,4 bcm of gas, which appeared to be lowest figure in the history of Ukraine¹⁴⁸.

144 Müller-Kraenner, Sascha. (2008). *Energy Security: Re-Measuring the World*. Eastscan: London, p. 87.

145 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 67.

146 International Energy Agency. (2012). *Ukraine 2012*. OECD/IEA, p. 101.

147 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 65.

148 International Energy Agency. (2015). Eastern Europe, Caucasus and Central Asia. Energy Policies Beyond IEA Countries. OECD/IEA, p. 336-7, https://www.iea.org/publications/freepublications/publication/IDR_EasternEuropeCaucasus_2015.pdf, accessed on March 9, 2015.

Domestic gas production was meeting between 20 and 25 % of total demand, which appeared to be not sufficient to break the gas dependency on imported natural gas. Lack of investments and innovative technologies suspended the development of the gas extraction sector in Ukraine. Therefore, the number of extracted amount of gas annually was relatively stable and fluctuated from 16 to 20 billion cm (in comparison with its record of 68.7 bcm in 1975)¹⁴⁹.

The rest 75-80 % of gas was imported primarily from the Russian Federation and Turkmenistan. Until 2001 most of the gas demand was imported from Russia, but since then an agreement was signed with Turkmenistan and in 2004-2005 Turkmenistan supplied about 44 % of Ukraine's gas needs¹⁵⁰. Ukraine was paying for Turkmenistan's gas half in barter and half by monetary means. These terms of payment together with price increase lasted till 2005. Since then barter schemes were eliminated and all the payments were to be conducted in cash.

After January 2006 Gas Agreement RosUkrEnergo started to sell mixed gas from Turkmenistan and Russia at a higher price. An important remark to be mentioned is that during 1991-2004 import of natural gas was tightly interlinked with the gas transit. And further gas volumes and price revision was mostly upon Russia's will to transit its own or Turkmenistan's gas through its pipeline network to Ukraine. It's important to mention that gas import till 2006 was exempt from the value added tax (VAT), therefore all the consumers of imported gas were receiving it without VAT according to intergovernmental agreements. These conditions were quite favorable for domestic consumption as well as for export of cheap imported gas abroad. But since 2006 the right to resell imported gas was prohibited under Russian-Ukrainian intergovernmental agreements¹⁵¹.

The structure of Ukrainian gas market until 2006 was monopolistic and heavily regulated by state. Naftogaz controlled all the gas flows. State-owned company 'Naftogaz' founded in 1998 was responsible for international gas purchases, domestic production, transmission and wholesale sales. While regional distributional companies appeared slowly to shift into private hands. First years of independence appeared to be a mushrooming period for various gas trading companies, among which one can name Respublika, Itera, Omrania, EuralTransGas, RosUkrEnergo. These companies played an opaque role in Ukrainian gas sector and created a quite flourishing 'shadow' economy. With murky

149 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 172-3.

150 Ibid, p. 75.

151 Ibid, p. 168.

ownership structure, companies made significant profit.

After gaining independence, Ukraine got very high transit potential. Due to its geopolitical location and a network of gas pipelines, Ukraine appeared to be the largest transit country in the world. Gas transmission system includes a total of 38600 km of pipelines, 72 compressor stations and 13 underground gas storages¹⁵². Gas storages have the capacity of 30.9 bcm of gas and Ukrtransgaz operates twelve of them, while ChornomorNaftogaz operates the Crimemean branch of it. The GTS can transport up to 80 bcm annually for domestic gas consumption and maximum 142.5 bcm as a transit gas to Europe¹⁵³. Thus about 80 % of the gas and 14-17 % of the oil travels through Ukraine to Europe. Transit capacities cemented Ukraine's leverage to counterbalance Russian interests to overtake the control over this strategic asset¹⁵⁴. Ukrainian storage system is a unique asset, which has absolutely no alternatives either in Europe or in Russia. Even new bypass pipelines of Gazprom lack storage capacities. The weak feature of it is that storage system is designed to service Russian Gazprom's exports to Europe. And to redirect its storage usage from main consumer Russia to Europe, Ukraine needs to modernize it and to hold complicated negotiations on revision of transit terms with Russia, as Russia sells its gas on Western border of Ukraine¹⁵⁵.

The amount of *oil* products in 1993 was 28 Mtoe and it halved by 2004. In 2013 oil product imports were 7,1 Mtoe with main supply countries Belarus and Russia¹⁵⁶. This sharp decrease was observed due to the decline in use of heavy fuel oil for electricity and heat production. The share of electricity and heat in total consumption of petroleum products dropped from 26 % in 1993 to 1 % in 2004¹⁵⁷. Transportation remains the largest consumer of oil products with its share increased up to 43 % in 2004¹⁵⁸.

Ukraine is a net oil importer. Domestic production of crude oil covers only 16-20 % of country's demand¹⁵⁹. The majority of sweet crude oil and gas condensate is produced by state-led company Naftogaz of Ukraine. Three fourth of proven gas reserves have been

152 International Energy Agency. (2012). *Ukraine 2012*. OECD/IEA, p. 109.

153 Ibid.

154 Ibid.

155 Socor, Vladimir. (2013). Ukraine's Gas Storage System: A unique Asset in Europe. *Eurasia Daily Monitor*, July 16, Vol. 10, Issue 130.

156 International Energy Agency. (2015). Eastern Europe, Caucasus and Central Asia. Energy Policies Beyond IEA Countries. OECD/IEA, p. 337, https://www.iea.org/publications/freepublications/publication/IDR_EasternEuropeCaucasus_2015.pdf, accessed on March 9, 2015.

157 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 73.

158 Ibid, p. 73.

159 Ibid, p. 185.

depleted, the remaining reserves are difficult and expensive to extract. During 1991-2004 to meet the remaining oil demand Ukraine was importing oil products from Russia and Kazakhstan. The Russian share amounted 96 %, while the rest 4 % was received from Kazakhstan¹⁶⁰.

Ukraine's oil sector faced vast privatization in 1999. As a result private refineries and filling stations appeared to be in Russian ownership, i.e. four out of six refineries were sold to mostly Russian companies. State-owned companies controlled most oil production and transportation. Since 2001 Ukraine increased oil-processing level and therefore became a net exporter of oil products. The problem with refinery sector is that refineries are obliged to pay VAT on imported crude oil, consequently VAT is supposed to be reimbursed. Some of the refineries (Kremenchuk and Drohobych) face problems in reimbursement; therefore this heavy toll remains a big financial burden for the refineries and causes their inefficiency.

As mentioned by International Energy Agency, 'Ukraine was one of the world's leading *coal* producers and consumers from World War II until 1970s'¹⁶¹. Since then Ukraine faced a decline in coal industry. Coal is the only segment of energy sector, which was generously subsidized by the government. The biggest problem in coal sector is that most of the mines in Ukraine are more than 50 years old and lack technologies for renovation the mine sector.

Having the highest share in energy balance of Ukraine coal has been fuelling industrial complex of Ukraine. In the years of 1991-1996 the coal production dropped gradually and then stabilized. Coal sector benefitted from vast state control, which resulted in explicit subsidizing, and led to the price distortion, when tariffs and prices not only did not cover long-term costs, but also even current costs.

The privatization in coal sector was launched in 1996, which showed positive trend and some privatized mines attracted investments. Coal production faces vast challenges, such as out-of-date equipment, which places Ukrainian coalmines at the second position of most dangerous mines in the world¹⁶².

Total coal's share in total primary energy supply has increased from 32 % in 1990 to 34,7 % in 2012. Coal is vastly consumed by two sectors: electricity plants and metallurgy. The share of coal used in metallurgy increased from 32% in 1993 to 48 % in 2004. With total amount of 164 active mines, 7 % of them in 2005 were in private

¹⁶⁰ Ibid, p. 185.

¹⁶¹ Ibid, p. 241.

¹⁶² International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 20.

ownership and produced about 40 % of the coal¹⁶³.

After the conflict in Donbas raw coal production faced 22,4 % decline, while coking coal output fell by 32,1 %¹⁶⁴. This happened due to the fact that activity of the majority of mines was disrupted by conflict in Donbas. Despite the fact that Ukraine is significant coal producer, it had also imported 10,1 Mtoe in 2013, while exported 3,4 Mtoe for Bulgaria, Turkey etc.¹⁶⁵

The potential for *renewables* is enormous. As estimated in the draft Updated Energy Strategy of Ukraine to 2030 the total potential of renewable energy sources in Ukraine is about 25 terawatt-hours of electricity and 2 million tones of biofuels¹⁶⁶. Among water and wind power, biomass has the highest prospects to be developed. Biogas could replace about 2.6 billion cm of natural gas imports, and even biogas power plants could replace electricity generated from nuclear power. In 2011 several renewable energy projects were implemented, which brought 400 megawatts of generation capacity. As a result the share of renewable energy in total primary energy supply has grown from 0.5 % in 1990 to 2 % in 2010¹⁶⁷. According to the draft Energy Strategy the percentage of renewable energy should reach 10 % with required total investment needs about 24 billion USD for the period 2011-2030.

Recently adopted legislation has introduced attractive green tariffs for electricity produced from renewable energy sources. These green tariff rates are set at the level higher than in many European countries. Therefore, more sufficient cost-and-benefit analysis should be performed to avoid the danger of triggering growth at an uncontrolled rate. Another shortcoming is that only certain types of biomass is covered by the legislation in the way that it offers green tariffs, while biogas is excluded.

A decrease of total final energy consumption primary due to economic depression was observed in all sectors during 1991 – 2004. The main consumers of energy remain industry and residential sectors. Altogether their share fluctuated from 80 % in 1993 to 68 % in 2004. Important to notice, though industry clearly experienced a drop about – 40 %, nonetheless energy-intensive industries, such as metallurgy, mining and chemicals declined

163 Ibid, p. 42.

164 International Energy Agency. (2015). Eastern Europe, Caucasus and Central Asia. Energy Policies Beyond IEA Countries. OECD/IEA, p. 335, https://www.iea.org/publications/freepublications/publication/IDR_EasternEuropeCaucasus_2015.pdf, accessed on March 9, 2015.

165 International Energy Agency. (2015). Eastern Europe, Caucasus and Central Asia. Energy Policies Beyond IEA Countries. OECD/IEA, p. 337-8, https://www.iea.org/publications/freepublications/publication/IDR_EasternEuropeCaucasus_2015.pdf, accessed on March 9, 2015.

166 International Energy Agency. (2012). *Ukraine 2012*. OECD/IEA, p. 200.

167 Ibid, p. 197.

at a lower rate, which led to the growth in the overall energy intensity of the economy in 1990s¹⁶⁸.

Ukraine has been severely affected by global economic crises in 2008, which led to a deep recession. With industrial output collapsing almost 22% in 2009 Ukraine faced sharp drop in investments, consumption and production. With IMF loan Ukraine managed to tackle some urgent financial problems, but as further reforms were stalled, IMF refused to provide loans. In accordance to World Bank Report in January 2012 there are ‘structural weaknesses left unaddressed ... Despite export led recovery over the past two years, output is still below pre-crisis levels and *the economy remains vulnerable to volatile commodity prices* and dependent on foreign financing’¹⁶⁹.

3.2. Ukraine’s energy policy under Kravchuk

Kravchuk’s presidency is important in order to understand what uncertainty Ukraine faced after gaining independence and why structural reforms in energy sectors were not implemented. By concisely drawing up main features of Kravchuk’s presidency, I argue that political instability and profound economic challenges created a deadlock, when a chance for structural reforms was missed instead a focus on political collisions was observed. Unlike Baltic States, Ukraine appeared to be unable to fundamentally reject Soviet approach to energy sector, which led to further deepening of the economic crisis.

3.2.1. Domestic policy

After the collapse of the Soviet Union, Ukraine faced numerous challenges in political, economic, security and other spheres, which commenced the long-term transitional period of reforms and stagnation. With the need for a new legislation and Constitution as well as urgent economical reforms, and even more struggling for its factual independence from Russia, the question of energy was mistakenly taken as of secondary importance.

Nevertheless Ukraine inherited rich infrastructure measured in terms of 38 thousands kilometers of high-pressure trunk pipelines (and distribution network of 211 thousand kilometres) and 13 underground storage facilities capable of holding 33 cubic

168 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 63-64

169 *World Bank*. (2012). *Country Partnership Strategy 2012-2016 for Ukraine for the Period FY12-FY16*, World Bank, Washington DC., p. IV.

meters of gas¹⁷⁰. Oil pipeline network comprised 4.7 thousand kilometers with an input capacity of 114 million tones per year and 56 million tones of output capacity¹⁷¹.

Ukraine's Soviet Constitution remained in effect until 1996, when a new one was adopted. The parliament of Ukraine (*Verkhovna Rada*) had been elected under the Soviet regime in 1990 and remained in power until 1994. No real break up with the either Soviet rules or *nomenklatura* had been observed during first years of independence. Within this period Ukraine had 'a four-headed government with executive authority unclearly divided among president, prime minister, parliament, and parliamentary speaker'¹⁷².

Unlike the potential and promising expectations of Ukraine to become 'the richest countries of the world'¹⁷³, Ukraine's macroeconomic collapse ranked among the worst in the former Soviet Union and Eastern Europe, exceeded just by those nations torn by civil war¹⁷⁴. In March 1992 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 economic autonomy from Russia. By lamenting Ukraine's economic dependence on Russia, 'the country's very independence is jeopardized'. The solution to the problem should have been structural transformation, the creation of a new Ukrainian currency, and reduction of imports from Russia by 'reorientation toward new markets'¹⁷⁵. Along with new economic program energy complex structure was defined as 'ineffective and economically dangerous'. The long-term goal was determined at correcting the system by substantial investment¹⁷⁶.

By announcing this program, government was aware of Ukraine's industry being totally dependent due to a legacy of the Soviet Union on lower-cost energy alternatives from Russia and Central Asia. It could count as the most successful strategy of the Soviet planners to tie Ukraine to the Soviet Republics. Yevhen Baramikov, chief of interrepublic

170 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 210.

171 Natflogaz Ukrainy, 2007.

172 D'Anieri, P.J. (2007). *Understanding Ukrainian Politics: Power, Politics, and Institutional Design*. Armonk, NY, USA: M.E. Sharpe, Inc., p. 80.

173 Better Late than Never, Maybe. (1995, July 22). *The Economist*, p. 21.

174 Slay, B. (1996). An Economy at the Crossroads. *Transition*, 2(23), November 15, pp. 51-55, 64.

175 Freeland, C. Ukraine Plans to Sever Russian Economic Links. (1992, March 24). *Financial Times*; Shprintsen, A. Ukraine Will Speed Up Breakaway from Russia. (1992, March 25). *Los Angeles Times*; Schmemann, S. Ukraine's Parliament Votes to Replace the Ruble. (1992, March 26) *New York Times*.

176 Government 1993 Economic Program Outlined. (February 17, 1993). *Moscow INTERFAX*, as cited by FBIS-SOV-93-031, 18 February, 1993.

trade in the Ministry of the Economy, once pointed out that Russia ‘can last a year without our food’, while ‘it can halt Ukrainian industry in a day’¹⁷⁷.

To address the energy problem Kravchuk tried to explore new possibilities, which unfortunately turned to be unsuccessful. According to a presidential decree of December 1992 a Ukrainian tanker fleet was to be created as well as the necessary infrastructure facilities to import oil. The commission chaired by Pavlo Kudyukin, a chief of the Black Sea Shipping Company, was to submit a Draft National Program for Creating Ukraine’s Tanker Fleet till February 15, 1993 and defined the following measures needed for its implementation¹⁷⁸. Forty vessels were to be constructed at German shipyards with the participation of Ukrainian shipbuilders within the period of several years. The fleet would eventually be capable of transporting up to 40 million tons of oil a year. German firms agreed to finance this grand project, and 80 % of the project was promised to be free of charge¹⁷⁹. Among potential suppliers of petroleum prime minister Yuliy Ioffe mentioned Bulgaria, Tatarstan, Kazakhstan and Oman.

Meanwhile, Ukrainian economy faced a profound economic crisis, and weak demand for Ukrainian goods in the West questioned Ukraine’s policy of economic autonomy. By the end of 1992 officials were left no other choice but to acknowledge that Russia remains Ukraine’s most important economic partner. Prime minister Leonid Kuchma ironically concluded that ‘many tried their utmost to bring economic relations between the two states [Ukraine and Russia] to the stage of ‘cold war’, but this attempt ended with full awareness that ‘we are dependent on Russia’¹⁸⁰. Consequently, in May and June 1993 import and export quotas were cut, and in August 1993 the value-added tax on trade with CIS members was also eliminated. As noted by Oles Smolansky, Kravchuk was left no other choice rather than to express his administration’s desire to establish close economic relations with Russia. In particular, Kravchuk called for closer cooperation between Ukraine and Russia in ‘the fuel and energy sector’, to be achieved by granting ... Ukraine concessions and ... establish[ing] joint ventures’¹⁸¹.

177 Op. cit., Freeland, C. Kiev Gripped in Russian Stranglehold – Ukraine’s Economy Will Pay a Heavy Price for Defying Moscow. (1992, July 23). *Financial Times*.

178 *Kiev Holos Ukrayiny*. (1992, December 19), as quoted in FBIS-SOV-92-252, December 31, 1992, p. 3

179 Ukraine Planning Large Oil Tanker Fleet. (January 28, 1993), *Moscow Teleradiokompaniya Ostankino Television First Program Network*, as quoted in FBIS-SOV-93-018, January 29, 1993.

180 Kuchma on Links with Russia. (January 5, 1993). *Moscow Komsomolskaya Pravda*, as quoted in FBIS-SOV-93-005, January 8, 1993.

181 Op. cit., Smolansky, O. (1995). Ukraine’s Quest for Independence: The Fuel Factor. *Europe-Asia Studies*: Vol. 47, No. 1, p.73

3.2.2. Ukrainian-Russian relations

In the first years after independence Russian oil and gas production decreased drastically, which directly affected Ukraine's industry. In order to secure future supplies, Prime Minister Vitold Fokin in early March 1992 travelled to western Siberia to negotiate direct deals with oil and gas-producing enterprises. As a result 6 million tons of Tyumen oil was to be delivered in March and April in barter exchange for 6.5 million tonnes of food products. Moreover, each month Tyumen should have delivered 3,9 tonnes of oil. Apart from food products Ukraine was obliged to deliver 110 tonnes of pipes. Fokin concluded that 'Ukrainian energy program is to be completely oriented toward Tyumen Oblast and Western Siberia as a whole'¹⁸². Those promises were left to be unfulfilled and meanwhile the shortage of energy resources was fully felt by the industry.

In September 1992, the Russian Minister of Economics Andrei Nechaev announced that in 1993 the amount of oil shipped to the members of CIS will be decreased as petroleum from 400 million tons to 340¹⁸³. In the mid-November president Yeltsin announced that the former republics, which had withdrawn from the 'rubble zone' (Ukraine was among them), should pay hard currency for the petroleum and natural gas they purchased from Russia. Yuliy Ioffe, Ukraine's deputy prime minister in charge of fuel and energy complex, travelled to Moscow and negotiated 2 million tons of oil to be delivered till the end of the year. But long-term forecast turned to be rather gloomy¹⁸⁴.

In January 1993, Prime Minister Leonid Kuchma conducted further negotiations on energy issues with Viktor Chernomyrdin. Russia agreed to supply only 15 million tons, but out of 15 only 7,5 million were guaranteed. This meant that Moscow was cutting by half the amount of oil and the situation with gas did not differ that much. Though Chernomyrdin declared that Russia was not 'malevolently bent on curtailing Ukraine's energy resources' and the situation should not be treated as one with political context, but rather the decline

182 Prime Minister Talks with Tyumen Oil Producers. Fokin on Energy Program. (March 7, 1992). *Moscow TASS International Service*, as quoted in FBIS-SOV-92-046, March 9, 1992.

183 Government to Halve Oil Exports to CIS Members. (September 28, 1992). *Moscow Interfax*, as quoted in FBIS-SOV-92-189, September 29, 1992, p. 10.

184 Op. cit., Smolansky, O. (1995). Ukraine's Quest for Independence: The Fuel Factor. *Europe-Asia Studies*: Vol. 47, No. 1, p.73

appeared due to ‘the fall in oil extraction’¹⁸⁵, Kyiv was convinced that its rejection of the CIS provoked this ‘punishment’.

Further negotiations in February 1993 led to a new agreement on oil and gas deliveries. It specified an export of 60.3 billion cubic meters of natural gas and 20 million tons of petroleum in 1993. The price for gas was at the level of 15 600 rubles (approximately 37.50 USD) per 1000 cubic metres. The important part of the agreement was the determination of the tariffs for transit through Ukrainian territory. But as no petrol was delivered, ‘oil whip’ turned to be the ‘biggest headache’ of the government¹⁸⁶.

Due to Russia’s domestic changes in economy, in February, 1993 Gazprom introduced so-called world market prices for the sale of gas to CIS states. Ukraine was offered a price of 85 USD for 1000 cubic metres of gas. Kyiv reciprocally offered the increase of the transit tariffs for Russian gas, which amounted 3 USD for 1000 cubic metres per 100 kilometres (while actual market rates was about 1.4 USD). The Deputy Prime Minister Aleksandr Shokin mentioned that this issue was the result of the failed negotiations, as a result ‘Kiev had rejected Moscow’s offer for part of shares of the gas pipeline to Western Europe via Ukraine to be sold to Russia’s Gazprom in return for cheaper gas imports from Russia’¹⁸⁷. While the situation was reaching its peak, the Surgut conference was aimed at easing the situation.

An attempt to manage the fuel crisis on the territory of former USSR was made in early March 1993 by the former 12 Soviet republics who introduced in Surgut an ‘Intergovernmental Oil and Gas Council’. It could have been named as a prototype of OPEC for post-Soviet countries. The aim of the Surgut Conference was to gather CIS members in the intention to extract more energy, which included pooling financial, physical and human resources in order to help Russia develop its oil and gas reserves. The chairman of the Russian State Committee on Economic Relations with CIS countries Vladimir Mashchits insisted on only one way of grand investments that can develop oil and gas complex of the former USSR. To emphasize this notion Russian minister of fuel and energy Yuriy Shafranik noted the disproportion between Russia who fulfilled its export commitments and the CIS that only managed to fulfill 10 % of their commitments. The debt of Russia from

185 Chernomyrdin, Kuchma Cited (January 16, 1993). *Rossiyskiye vesti*, as quoted in FBIS-SOV-93-011, January 16, 1993, p. 1.

186 Moscow Agrees With Ukraine on Gas Prices. (February 5, 1993). *Moscow Interfax*, as quoted in FBIS-SOV-93-024, p. 10.

187 Shokin on Russian-Ukrainian Fuel Price Issue. (February 17, 1993). *Moscow Teleradiokompaniya Ostankino Television First Program Network*, as quoted in FBIS-SOV-93-031, February 18, 1993, p. 14.

fuel and energy sector amounted 1.8 Tn rubles. As a result of the summit Russia expected more comprehensive and efficient scheme of CIS contributions into the development of the energy sector. But as summit did not touch upon supply problems of Russian fuel and energy to Ukraine, the energy deadlock pursued. The weak point was that no mechanism of the implementation of Surgut decisions existed. Even more there was no solution found to the definition of the prices to be paid by CIS republics as well as ways of deliveries of gas and petroleum by other republics to Russia. Therefore, an attempt to drag Russia out of the crisis was fated to fail¹⁸⁸.

Meanwhile, Ukrainian government passed a resolution on the participation of Ukrainian enterprises in the exploitation of Siberia's petroleum resources. The oil produced from these wells would be delivered to Ukraine in addition to the 20 million ton annual quota previously allocated by Russia. In total 40 million tons of petroleum included annual quota, another 8.8 million tons should be provided by barter and 11.2 million tons should be 'bought at world prices'. For all this Ukraine took an obligation to pay 400 billion rubles (600 million USD) a month¹⁸⁹. The next round of negotiations ended in stalemate, as Ukraine was not able to raise these financial sources. Leonid Kuchma in his speech to the Supreme Council concluded that Ukraine's 'total dependence ... on Russia' is 'a key factor in Ukraine's economic development'. In the short term Ukraine was left to accept world prices, which directly eroded Ukraine's economy. As a result Ukraine found itself 'on the verge of a large-scale social upheaval'¹⁹⁰.

In June 1993 Russia temporary discontinued the delivery of oil. Four out of six Ukrainian refineries reduced their limited production. This crisis brought Kravchuk to Moscow, the negotiated price for petroleum was raised gradually: from 80 USD per ton in the third quarter of 1993, 90 USD in the fourth, and 100 USD in the first quarter of 1994. The same applied to the natural gas prices: from 42 000 (40 USD) per 1000 cubic metres in July 1993 to 80 USD in January 1994. This agreement was characterized by the Ukraine's acting prime minister Yufim Zvyahilskyy as 'very advantageous for Ukraine', which

188 CIS 'Oil Summit' Begins in Surgut 1 March. (March 1, 1993). *Moscow Interfax*, as quoted in FBIS-SOV-93-039, March 2, 1993, p. 4.

189 Official Briefs Supreme Soviet on Russian Gas Deal. (March 16, 1993). *Moscow Interfax*, as quoted in FBIS-SOV-93-050, March 17, 1993, p. 46.

190 Kuchma's Parliament Speech Addresses Economic Situation. (April 13, 1993). *Nezavisimaya Gazeta*, as quoted in FBIS-SOV-93-070, April 14, 1993, p. 64.

actually drew the irony that from January 1994 Ukraine undertook to pay Russia world price¹⁹¹.

July and August did not show any stability as well, oil deliveries were suspended as well as the gas supply was reduced. In the late 1993 – beginning of 1994 it became obvious that Russia in order to make Ukrainians ‘rethink the wisdom of their sharp break with Russia’¹⁹² will use energy as an instrument to implement its foreign policy objectives.

The beginning of 1994 brought news from Moscow. Bearing in mind Ukraine’s inability to pay hard currency, Kremlin now preferred ‘non-traditional’ methods of repayment, including the participation of Russian enterprises, primarily Gazprom, in the privatization of Ukrainian production capacities. After another round of so-called ‘very advantageous for Ukraine’ negotiations, Deputy Premier Aleksandr Shokhin mentioned Moscow’s interest in a 30-40 % shareholding of Kremenchuh refinery and Khartsyzsk pipe-making plant. Should Ukraine decline these terms, ‘Russia will reach agreements with Belarus, Slovakia and Hungary, and Ukraine will end up the loser’. Though December agreement was praised as a victory for Ukraine: Kremenchuh refinery will keep operating at full capacity thanks to Russia’s input, and the price for the produced high quality oil will be only 75 USD per ton (well below the market price). One more tiny condition was mentioned, Russia was taking a lease of the underground reservoirs in western part of Ukraine, which was also depicted as beneficial for Ukraine. Moreover, Russia indicated very pragmatic policy by conversion of debts into ownership of the ‘shares in enterprises, mainly those which Ukraine obviously does not need while Russia does’¹⁹³.

This December agreement was just the beginning of the new wave of the negotiations, which no more would look like a negotiation between beggar and a rich, but rather would reflect Russia’s pragmatic vision on taking control over Ukrainian gas sector. An example could serve March protocol of 1994 on Russian participation in Ukrainian gas-related enterprises. According to Russian version of the agreement, Moscow would receive ‘a share in the authorized stocks of the gas transportation infrastructure enterprises (51 %) and in a number of factories in which Gazprom is interested (51 %)’. These included the

191 Shokhin Denies Concessions Given. (December 25, 1993). *Moscow Izvestiya*, p. 2, as quoted in FBIS-SOV-93-246, December 27, 1993, p. 20.

192 D’Anieri, P. J. (1999). *Economic Interdependence in Ukrainian-Russian Relations*. Albany: SUNY Press, p. 74.

193 Shokhin Denies Concessions Given. (December 25, 1993). *Moscow Izvestiya*, p. 2, as quoted in FBIS-SOV-93-246, December 27, 1993, p. 20.

export gas pipeline to Europe, underground storage tanks and Odessa port factory¹⁹⁴. But due to the opposition in the parliament those agreements were vetoed.

According to Balmaceda during Kravchuk presidency Russia interchangeably applied three main elements of energy ‘carrot-and-stick’ approach. First, large Ukraine’s energy debt provided Russia with leverage over the Ukrainian economy. Instead of complaining about growing debt of Ukraine, Russia remained silent with the aim to use this ‘rain check’ in the near future not only for political and economic concessions, but also for managing concrete issues such as Black Sea Fleet, Ukraine’s nuclear weapons or gas transit system¹⁹⁵.

Second, by offering relatively favorable conditions of payment for gas (discounts, credits, barter deals), Russia insured that Ukraine would remain even more dependent on it. Consequently, the appearance of various schemes including Ukrainian allies created a system where the benefits of Ukrainian interest groups in maintaining the profitable schemes turned to be more important than Ukraine’s energy security.

And third, the policy of cut-off of supply was the ultimate step to reach the unconcealed goals. Before the Massandra summit (September, 1993), Gazprom reduced gas supplies to Ukraine by about 25 %¹⁹⁶. It should have pushed Ukraine to accept Moscow’s offer concerning the full control of the Black Sea Fleet, surrendering Ukraine’s nuclear weapons and signing Nuclear Non-Proliferation Treaty¹⁹⁷ in exchange for the erase of Ukraine’s gas debt. Although President Leonid Kravchuk initially agreed to the deal, but furious reaction of the parliament precluded ratification of the agreement, which followed by Russia’s considerable cut off the gas supplies during fall and winter 1993-1994¹⁹⁸. However, Russia didn’t achieve the ultimate goal, but it raised a question of possibility of further partial cutting off the gas supplies in order to achieve its interests as well as it raised a wave of militant nationalism.

194 State To Pay for Gas in Money, Property. (March 11, 1994). *Moscow Segodnya*, p. 1, as quoted in FBIS-SOV-94-048, March 11, 1994, p. 35.

195 Balmaceda, Margarita M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia’s power, oligarchs’ profits and Ukraine’s missing energy policy, 1995 – 2006*. Routledge: London, p. 26.

196 D’Anieri, P. J. (1999). *Economic Interdependence in Ukrainian-Russian Relations*. Albany: SUNY Press, p. 74, 78.

197 A Trilateral Agreement on nuclear warheads between the USA, Ukraine and Russia was later settled separately.

198 The first cut off took place in February 1993, when the debt of Ukraine amounted 138 billion of rubles. See, Ivanova, E. (2001, November 27). *Gazovaya promyshlennost. Kommersant*, No. 48 (449), p. 2.

As stated by John Loyd the signing of the agreement on giving up the nuclear weapons and Non-proliferation Treaty was affected by reduction of supplies and by the promises of the low prices, which ‘played a significant, if not crucial part, in that deal’¹⁹⁹.

During the first four years of independence of Ukraine, Russia tried to use ‘energy weapon’ as a foreign policy tool, but by not receiving direct positive outcomes, later it concentrated on developing more indirect methods, including establishing ties with local allies.

3.2.3. Diversification attempts of energy supplies

In the late 1980s USSR consumed about 65 million tons of petroleum and oil-related products a year. And only 10 million were produced in Ukraine itself, the rest was mainly supplied from Western Siberia. Taking into consideration Ukraine’s proven reserves and its extraction capabilities, Ukraine could at best meet 15-20 % of its annual gas requirements and only 8 % of its oil needs²⁰⁰. As a result, it was concluded that Ukraine would have to import over 60 million tons of petroleum, over 115-120 billion cubic meters of natural gas and some 35 million tons of coal²⁰¹.

To solve an energy problem Kyiv made several attempts to diversify its sources of fuel by locating suppliers outside the former USSR. The alternative source suppliers included Turkmenistan, Azerbaijan, Kazakhstan and Iran.

In January 1992 Turkmenistan, Ukraine’s second-largest supplier of natural gas²⁰², signed agreements with several former Soviet republics providing for gas deliveries during the first quarter of 1992 at the price of 870 rubles (approximately 8 USD) per 1000 cubic metres. Although, Ashgabat warned that the price increase 8000 rubles (approximately 73 USD) is to be expected during the second quarter²⁰³. Consequently, Ukrainian Prime Minister Vitold Fokin travelled to Ashgabat to conduct negotiations with President Saparmurad Niyazov. The initial price after personal negotiations with Niyazov was lowered to 800 rubles. But as Fokin insisted that the above amount should also include

199 Loyd, J. Ukrainian Offered Debt Swap for Nuclear Deal. (1994, January 13). *Financial Times*, p. 2.

200 Op. cit., Smolansky, O. (1995). Ukraine’s Quest for Independence: The Fuel Factor. *Europe-Asia Studies*: Vol. 47, No. 1, p. 68.

201 Hutsalo, S. Republic’s Prospective Oil Suppliers Listed. (March, 1992). *Uryadovyyi kuryer*, p. 7, as quoted in FBIS-SOV-92-068, April 8, 1992, p. 48-49.

202 25 % of the natural gas consumed in Ukraine was provided by Turkmenistan.

203 Agreements Signed on Supply of Gas to CIS. (1992, January 22). *Moscow Postfactum*, as quoted in FBIS-SOV-92-018, January 28, 1992, p. 70.

transportation, the Turkmen officials dismissed this offer. Finally, after unsuccessful negotiations the price including transportation was left at the level of 1600 rubles (about 15 USD), which appeared to be a major blow to Ukrainian economy. Ukraine from its side ‘suspended the delivery of machines, metal, sugar and other products to Turkmenistan’, but abstained from closing the pipeline, located on its territory, through which Turkmen gas was being exported to Western Europe.

This situation forced Turkmenistan to solve two urgent problems: to reorient its trade, which was negatively affected by Ukraine’s boycott; and to find an alternative route to export natural gas to West European customers. But to bypass CIS and to build new pipeline through Iran, ending in the Mediterranean coast of Turkey, Turkmenistan lacked time and pipes, which for that time were being produced in the only former Soviet republic of Ukraine. Therefore, the resolution of Turkmen-Ukrainian temporary disagreements was only a matter of time. Hence, Ashgabat provided the delivery of gas for the last quarter of 1992 in the amount of 8 billion cubic metres at the initial price of 3000 rubles (approximately 12 USD) for 1000 cubic metres²⁰⁴.

With Azerbaijan the relations also didn’t achieve that much success. Although in December 1992 President Abulfaz Elchibey visited Kyiv and signed a treaty of friendship and cooperation between the two states, with regard to fuel problem the agreement was reached make barter operations ‘oil for food’, which was to be defined later.

After the visit of Leonid Kuchma to Almaty, Kazakhstan decided to sell Ukraine 500 000 tons of oil, which was a trifling amount for Ukraine, but left a place for future energy cooperation.

Another promising energy trading partner was the Islamic Republic of Iran. In January 1992 Iranian Foreign Minister Ali Akbar Velayati arrived in Kyiv and signed a ‘memorandum of understanding’, which foresaw economic cooperation. Even further on 29 January 1992 Kyiv and Teheran concluded agreement, according to which Iran was undertook to deliver to Ukraine 4 million tons of petroleum and 3 billion cubic metres of gas a year. In return, Ukraine undertook to supply Iran with petroleum products, chemicals, building materials, machinery and machine tools²⁰⁵.

204 Op. cit., Smolansky, O. (1995). Ukraine’s Quest for Independence: The Fuel Factor. *Europe-Asia Studies*: Vol. 47, No. 1, p.73.

205 Tsikora, S. Without Waiting for Tyumen Oil, the Ukraine Is Buying Iranian. (February 4, 1992). *Moscow Izvestiya*, p. 1, as quoted in FBIS-SOV-92-024, February 5, 1992, p. 72.

Another agreement signed by Ukraine, Iran and Azerbaijan touched upon the construction of three gas pipelines, initially designed to carry natural gas from Iran's southern fields to Europe via Azerbaijan and Ukraine. The construction was planned to start in 1992, with the first pipeline becoming operational in 1996. The initial capacity of 25 billion cubic meters per year was to be increased up to 75 billion. The equipment to build the pipeline was supposed to be provided jointly by Iran and Ukraine. The shares in the project were divided as follows: 10 % for Azerbaijan, 45 % for Ukraine and 45 % for Iran. The estimated cost of the construction was about 7 billion USD²⁰⁶.

Though promising in nature the project soon was about to reach a decay. Having no hard currency, Ukraine would have to sell some of its products to Iran as well as logistical problems related to the construction demanded a long negotiation and tough bargaining. With the official visit of the president Leonid Kravchuk in April 1992 more details of the tripartite gas pipeline project were unveiled. The first pipeline was scheduled to be built within a three-year period. The financial obligations were to be divided between Ukraine and Iran with share of 5.5 billion USD each and Azerbaijan's share of 1 billion USD²⁰⁷. Ukraine, facing harsh years of vast economic crisis, puzzled international society by the sources from where Ukraine would take this sum of money to invest into the project.

Though in February 1993 the cabinet of ministers had allocated 1.8 million USD to the state corporation Ukrhaz to form the Ukrainian part of the statutory fund in the joint Iranian-Azeri-Ukrainian company, the implementation of the agreements of Ukrainian-Iranian cooperation was delayed. It became clear that Ukraine failed to make its contribution to the venture. The reasons could have been numerous beginning with strained relations between the Ukrainian government and the parliament, economic problems, Russian pressure and ending with factual absence of financial resources needed for the project²⁰⁸.

Though gas projects were not realized, petroleum cooperation seemed to have more grounds. On 12 February 1993 two countries signed a new economic cooperation agreement. It specified that in 1993 Iran would supply Ukraine with 4 million tons of petroleum in exchange for sugar and wheat. During March visit of Deputy Foreign Minister

206 Tehran Signs Gas Export Agreement With Ukraine. (February 13, 1993). *Tehran Voice of the Islamic Republic of Iran, First Program Network*, as quoted in FBIS-NES-93-030, February 17, 1993, p. 55.

207 Op. cit., Smolansky, O. (1995). Ukraine's Quest for Independence: The Fuel Factor. *Europe-Asia Studies*: Vol. 47, No. 1, p.71.

208 Kiev Allocates \$1.8 Million To Build Gas Main to Iran. (February 2, 1993). *Moscow Interfax*, as quoted in FBIS-SOV-93-021, February 3, 1993, p. 34.

Mahmud Va'ezzi with the chairman of the joint Iranian-Ukrainian Economic Commission Yukhnovsky discussed 'the delivery of oil products from Iran to Ukraine, and ... technical method of mutual settlements'. Va'ezzi when asked about when oil is to come to Ukraine, angrily pointed out that 'There are 'no 'ifs' on our part. As soon as Ukraine is ready to receive the cargo, the deliveries will start'²⁰⁹. But all these numerous high-level meetings as well did not produce any concrete result. But even if all obstacles could have been overcome, Ukraine would have received not more than four million tons of oil, which constituted less than 15 % of Ukraine's demands. In either way, Ukraine would be left in Russia's energy ties.

The simultaneous transitional processes that took place in Ukraine and in the CIS countries challenged Kravchuk's presidency. The parallel processes of the CIS creation and unwillingness of Ukraine to fully participate in the new union made Ukraine's position even more vulnerable toward Russia. Kyiv officials during first years of independence spent more time in Moscow's cabinets negotiating the fuel prices and conditions of deliveries, than actually restructuring the highly energy-dependent economy.

The imprint of Soviet Union legacy was vividly seen in Ukraine's case. One should understand that the demise of Soviet 'command economy' and the disruption of its trading networks brought the decline in industrial production. USSR's prices for fuel were alienated from world market prices for raw material and fuel. Moreover, as USSR was producing huge quantities of fuel, no attention was paid to the need of wastefulness practices decrease. Ukrainian industrial dinosaurs possessing old manufacturing equipment were still alive only because of state subsidies. Their production was not competitive at European market, and therefore the CIS market was the only one left. This all plunged Ukraine into deep economic crisis with worst-managed economy among the former Soviet countries.

Situation was exacerbated by the inconsistencies in political system, which were characterized by the fragmentation of state apparatus, paralysis of decision-making and continuous tag of war between executive and legislative branches. The economic program presented by Kravchuk based on independence from Russia did not last long and ended with paternalistic policies toward large industrial enterprises, unprecedented hyperinflation accompanied by massive asset tunneling, fiscal mismanagement and fraud. National program of privatization during this period was never actually implemented.

209 Danylenko, S. There Are No Ifs on Our Part. Iranian Official Promises Oil Deliveries to Start Soon. (March 18, 1993). *Kiev Holos Ukrayiny*, pp. 1-3, as quoted in FBIS-SOV-93-054, March 23, 1993, p. 32.

The use of barter operations and other rents during 1992-1993 generated even higher amount of rents in Ukraine than in Russia²¹⁰. During this time few attempts of diversifications with Iran, Turkmenistan and other CIS countries were made, but did not prove to be successful because of the lack of infrastructure needed for alternative imports. Lacking real financial sources to invest into new projects, these efforts faced a deadlock. The time of Russia's concessions reached its peak with Ukraine's debt gradually increasing. It was Ukraine that in August 1993 first offered Russia a small section of the oil pipeline situated on Ukrainian territory, as well as a 45 % share in four of its six major refineries. Not surprisingly, at Massandra meeting Russian president stated that Moscow would accept the Ukrainian portion of the Black Sea Fleet as well as control over Sevastopol as payment for the debt incurred for imports of Russian petroleum and gas²¹¹.

To conclude, the events of 1991-1994 illustrated that lack of structural reforms and the erosion of intensive energy-reliable and noncompetitive economy of Ukraine. Russia's control over access to fuel left Ukraine in the position of 'total dependence'. From barter operations Ukraine shifted to providing Russia with access to key industrial enterprises. Even more the policy 'gas for Fleet', as observed at Massandra Meeting, proved total capitulation of already blurred energy policy of Ukraine.

3.3. Ukraine's energy politics under Kuchma

Kuchma's presidency highlighted new era of pragmatic cooperation with Russia. After unsuccessful attempt of Kravchuk to distance himself from Russian influence, Kuchma won the elections by successfully applying Russian card. His two terms of presidency though showed different tendencies. During his firm term in power, he established Naftogaz as a state company, which provided him with a tool to manually control the most essential sector of Ukrainian economy. Kuchma's unlimited control over the energy sector initiated the raise of the interest groups, which after a while turned into oligarchic clans. The authoritative nature of Kuchma's power enabled him to become an arbiter of energy games. Therefore, vast corruptional networks cemented a system of opaque shadow economy.

210 Aslund, Anders. (2009). *How Ukraine became a market economy and democracy*. Peterson Institute for International Economy, p. 56.

211 Op. cit., Smolansky, O. (1995). Ukraine's Quest for Independence: The Fuel Factor. *Europe-Asia Studies*: Vol. 47, No. 1, p. 85.

1997 Black Sea Fleet Agreement introduced new formula fleet-for-gas, where political concessions were exchanged for cheaper energy prices. Moreover, the end of the 90-s was a period of privatization, when not only big oil processing factories were sold to Russian investors, but also important metallurgical sector appeared to be tempting for the Eastern neighbor. Following the example of gas sector, Kuchma created vertically-integrated companies in electricity and coal sectors. Closed nature of Kuchma's regime tied with shadow deals with Russia appeared to be at the epicenter of criticism, which eventually brought up vast public protests.

3.3.1. Political system under Kuchma and its implications on energy policy

Paul D'Anieri characterizes the political system under second president of Ukraine as 'electoral authoritarianism'²¹², or 'hybrid state' combining both elements from authoritarianism and democracy. Steven Levitsky and Lucan A. Way insist on the definition of the 'competitive authoritarianism'²¹³, where institutions are being manipulated by the regime through well-developed system of bribes, illegal activities and violation of law. Even the notion of 'semi-presidential' or 'presidential-parliamentary' system was scrutinized from the point of view of duality of the functions of president and prime minister²¹⁴.

The neo-patrimonial regime established under Kuchma could be characterized by Hellman's 'partial reform equilibrium'²¹⁵, which sealed the alliance between the president and the economic elite. Transition from this regime according to Bratton and van de Walle leads to two scenarios, first, increasing discontent because of the misuse of resources and, second, emergence of the new elite formed by the outsiders²¹⁶.

Though the definitions of political system created under Kuchma are various, the common equation will include the notion of blurred division of powers between the president, the parliament, and the government. If we go further, the notion of the 'captured state'²¹⁷ will add another important variable to the equation, such as certain actors (further

212 D'Anieri, Paul. (2001). Democracy Unfulfilled: The Establishment of Electoral Authoritarianism in Ukraine. *Journal of Ukrainian Studies*, 26, No. 1, pp. 13-25.

213 Levitsky, S., Way, L. A. (2002). The Rise of Competitive Authoritarianism. *Journal of Democracy*, 13, No. 2, p. 52.

214 Protsyk, O. (2003). Troubled Semi-Presidentialism: Stability and the Constitutional System in Ukraine. *Europe-Asia Studies*, 55, No. 7, p. 1077.

215 Hellman, J. (1998). Winners Take All: The Politics of Partial Reforms in Postcommunist Transitions. *World Politics*, Vol. 50, No. 2, pp. 203-234.

216 See, Bratton, M., Van de Walle, N. (1994). Neopatrimonial Regimes and Transitions in Africa. *World Politics*, Vol. 46, No. 4, pp. 453-489.

217 World Bank. (2000). *Anticorruption in Transition: A Contribution to the Policy Debate*. Washington, D.C.: World Bank.

named as interest groups), who gain such a power, that their interests start to value more than the interests of the country.

Kudelia defines the tenure of Kuchma as the period when he ‘acted to reinforce the dominance of the informal norms and the centralization of formal powers helped him to monopolize control over informal levers in his own hands’²¹⁸. And in this situation as accurately defined by Balmaceda a president turns to be ‘an interest articulator’ in such a system. The president played usually ‘a complex role, moving between his role as arbiter within various interest groups and as representative of his own interests ... or interests of his close associates’²¹⁹.

3.3.2. Domestic energy reforms and the establishment of Naftogaz

The reforms conducted under Kuchma’s presidency set the pace for the development of the energy sector. The feature of the first private companies that entered energy business was their favorable advantage of possessing state guarantees for fuel purchases, which as a result led to the greatest increase of the state debt.

One of the first attempts to solve the problem of gas non-payment was made by commercial corporation ‘Respublika’, which was established by Ihor Bakai. Ukraine’s debt 671.9 million USD to the Turkmenistan (though 800 million USD in total)²²⁰ was ought to be paid off by the ‘Respublika’ through barter operations. ‘Respublika’ possessing license to import gas from Turkmenistan barely met no risks as repayment programs and import were guaranteed by the state. Although ‘Respublika’ imported 9.2 bcm gas from Turkmenistan at the Turkmen-Uzbek border at the price of 50 USD per 1000 cm, it failed in its task of clearing Ukraine’s gas debt. As the result of this scandalous situation ‘Respublika’s debt was covered by the state bank²²¹ and the company itself was eliminated from the gas market²²². After the bankruptcy of Respublika Ihor Bakai formed Interhaz,

218 Kudelia, Serhiy. (2012). The sources of continuity and change of Ukraine’s incomplete state. *Communist and Post-Communist Studies*, 45, p. 421.

219 Balmaceda, M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia’s power, oligarch’s profits and Ukraine’s missing energy policy, 1995-2006*. Routledge, p. 39-40.

220 This sum is mentioned in a bilateral treaty as of 5 November 1994 ‘Uhoda mizh Uriadom Ukrainy ta Uriadom Turkmenistanu pro restrukturyzatsiiu derzhavnogo borhu Ukrainy Turkmenistanu za 1993 rik’.

221 Rozporiadzhennia vid 13 zhovtnia 1994 ‘Pro nadannia banku ‘Ukraina’ garantiinykh zoboviazan’ shchodo pohashennia kredytiv, nadanykh korporatsii ‘Respublika’ dlia opłaty postavok pryrodniogo hazu iz Turkmenistanu’.

222 Interesting to mention that activities of the Respublika have never been investigated, moreover all the records belonging to Respublika were destroyed in a fire in 1995.

which supplied gas to Ukraine in 1996. Bakai was appointed by Kuchma as the first deputy chairman of the state committee for the oil and gas industry, which later became a part of Naftogaz²²³.

In October 1994 Leonid Kuchma stressed the necessity to launch economic reform as the gas debt was growing. Therefore, Kuchma in his address to Verkhovna Rada pointed out: ‘... more than one billion USD is needed to pay the Russian Federation and Turkmenistan just for gas. We do not have such a sum. So, do think about the outcome if we break off negotiations with international organizations’²²⁴. Backed by the IMF, in March 1995 Kuchma got an approval from Gazprom to restructure 1.4 billion USD debt²²⁵. Soon after several attempts have been made to enter energy market of Ukraine by applying policy of debt-for-equity swap. The parliament of Ukraine in January 1996 banned the privatization of the gas transit sector and prevented Gazprom from converting 1.4 billion USD of Ukrainian debt into equity in gas sector. One more condition of the debt repayment process was Haztransit project. One of the reasons Russia insisted on Haztransit was ‘as long as Gazprom does not have control over the pipeline, Ukraine can siphon off Russian gas from the pipeline and thus make up for suspended supplies, factually reducing Gazprom’s ability to use the threat of a stoppage in deliveries as a bargaining chip in the setting of prices’²²⁶. The joint venture of Haztransit between Ukraine and Russia, which aimed to ease the debt payment process, but which actually did not come to existence.

Pavlo Lazarenko was the one who launched the reform program of the energy sector. Aiming to satisfy all the interested sides, Lazarenko proposed a program that would reduce the state company’s role and stop further accumulation of the state debts to Russia and Turkmenistan. The reform aimed at creation of ‘regionally divided distribution system’, which according to Joel S. Hellman was merely client-based and benefitted only certain circles²²⁷. It is worth mentioning that several factors pushed Lazarenko to initiate energy sector reform as this reform was actually expected by international and domestic actors. First of all, it was IMF, vastly criticizing the state guarantee for the gas traders’ import

223 See, Global Witness. (2006). *It's a Gas: Funny Business in the Turkmen-Ukraine Gas Trade*. Washington, DC, April, p. 33.

224 Address of the President to the Parliament. (1994, October 13). *Golos Ukrainy*.

225 Russia’s eagerness to restructure Ukraine’s debt was explained by the IMF granting Russia a large stand-by credit. See, Balmaceda, M. (1998). Gas, Oil and the Linkages between Domestic and Foreign Policies: The Case of Ukraine. *Europe-Asia Studies*, Vol. 50, No. 2, p. 262.

226 Op. cit., Balmaceda, M. (1998). Gas, Oil and the Linkages between Domestic and Foreign Policies: The Case of Ukraine. *Europe-Asia Studies*, Vol. 50, No. 2, p. 262.

227 Hellman, J. (1998). Winners Take All: The Politics of Partial Reforms in Postcommunist Transitions. *World Politics*, Vol. 50, No. 2, pp. 203-234.

payments as one eroding the state budget²²⁸, insisted on market-oriented reform of the gas sector. Second, Gazprom concerned by Ukraine's non-payment preferred to deal with more capable to pay gas traders rather than Ukrhazprom. Third, the newly elected president Leonid Kuchma, maintaining weak position both in the parliament and government, was seeking for partners to cooperate, among others appeared Pavlo Lazarenko, who heading a pro-presidential fraction 'Unity' (Yednist), was appointed a prime-minister and therefore authorized by Kuchma launched energy reform.

During 1995-1996 the system of gas import faced restructuring and became more decentralized. Private gas traders by introducing lucrative barter schemes could guarantee gas supplies to enterprises and household consumers, and at the same time they were more willing to cut-off the non-paying consumers. Instead of easing the difficulties in the energy sector, gas traders brought the situation when wholesale importers of gas divided the areas of control at regional scale and concluded contracts with factories to initiate the barter deals²²⁹. Each gas trader, who was in charge of making profits of the deals, supplied the whole region, containing rich and poor consumers. Moreover, gas traders conducted direct purchase agreements with Gazprom. The state (namely, state company Ukrhazprom) was left merely with just household consumers usually not able to pay, while private intermediaries captured by private interests, made lucrative profit of state's preferential regulatory support. Complex barter deals proved to be difficult for the government to track and even harder to tax. As a result gas traders obtained a unique opportunity for illicit financial gain. Remarkably, this time private intermediaries got state guarantees for the repayment process only for one month and afterwards they were eliminated. This meant that gas traders were left alone to manage complicated trade deals bearing the risk of being sometimes unable to sell the products of the factories ready for the barter deals. These principles of the gas trading left no mercy for the weak and the strongest survived.

Energy sector under Lazarenko was opened to new gas intermediaries, but only few (Table 1) were determined as fully capable of not only organizing the supply process, but also of paying cash for the used volumes of gas. Under Kuchma among numerous gas intermediaries, which entered energy market of Ukraine, one can name Respublika, Omrania, ITERA Ukraine, Eural Trans Gas, United Energy Systems (IESU) and RosUkrEnergO. Murky structures and no direct official stake of either Russia or Ukraine

228 Bisat, Amer. (1996). Ukraine's Gas Arrears: Issues and Recommendations. *IMF Paper on Political Analysis and Assessment*, April.

229 Though initially this idea was about the right of free choice for the buyer and for the seller, it rather created lucrative monopolistic schemes for certain private intermediaries. See, Interview with Pavlo Lazarenko, Yeremenko, Alla. (1996, April 20). *Avtor pravil igry. Zerkalo nedeli*.

characterized most of these intermediaries. Private businessmen lacking ties with energy sphere and starting their company with penny capital in short term made huge profit. Moreover, the absence of annual independent audit reports proved that these structures worked for the benefit of certain people who initially aimed at hiding the information.

Table 1. Regional distributors of the Natural Gas in 1996

Name of the Oblast	Annual amount distributed (bcm)	Name of the Distributor	Source (bcm)
Odesa, Kherson, Vinnytsia, Poltava, Zaporizhzhia, Rivne, Khmel'nyts'kyi	7.8	Interhaz	Gazprom (10.0)
Donets'k, Kharkiv, Mykolayiv, L'viv, Ternopil, Sumy, Zhytomyr, Kyiv, Ivano-Frankivs'k, Luhans'k, Crimea	16.81	Itera	Turkmenistan (23.0)
Dnipropetrovs'k, Donets'k, Cherkasy	25.2 (12.3 for industrial consumers and 12.9 for household consumers)	United Energy Systems of Ukraine	Gazprom (25.1)
Chernivtsi, Volyn', Poltava, Kyiv, Kyiv Oblast	3.5	Olhaz	Gazprom
Kyiv, Chernihiv, Zakarpattia, Kirovohrad	3.22	Ukrhazprom, Motor Sich, Ukrzakordonnaftohaz	Gazprom
Factories of Donets'k	2.4	Direct contracts	Gazprom

Source. Derzhavnyi komitet naftovoi, hazovoi ta naftopererobnoi promyslovosti Ukrainy 'Derzhnaftohazprom', cited by Kolesnik, Yevgeniy. (1996, January 27). Kto ostalsia na trube. *Zerkalo Nedeli*.

The most controversial element of energy reform was granting two largest regions in terms of gas consumption to only two gas traders, namely Itera²³⁰ and United Energy Systems. These regions rich in metallurgy and machine-building enterprises were titbit for the gas traders and guaranteed high profit. Especially, United Energy Systems of

230 Itera International Energy LLC was registered in Jacksonville, Florida in 1994. The founder Igor Makarov, former cyclist champion, entered the gas industry 'by accident'. By 2000 Itera had grown into the fourth largest gas company in the world. See, Global Witness. (2006). *It's a Gas: Funny Business in the Turkmen-Ukraine Gas Trade*. Washington, DC, April, p. 34.

Ukraine (*Yedyni Enerhetychni Systemy Uktainy, UESU*) headed by Yuliya Tymoshenko, proved the case of successful lobbying from the side of Lazarenko²³¹.

But not everyone was satisfied with Lazarenko's reform. Before the introduction of the energy reform, 'Industrial Union of Donbas' (*Industrialnyi Soyuz Donbasa, IUD*) was created (December 1995) with the aim to become a sole supplier of natural gas to the whole Donets'k Oblast'. Therefore the demand to provide IUD a license to supply gas was negotiated with Lazarenko and a compromise was reached – two giant metallurgy complexes in Donets'k as well as turbine engine manufacturer 'MotorSich' in Zaporizhzhia and automobile manufacturer 'AvtoZaz' obtained the license to contract with Gazprom directly²³².

In 1997 Lazarenko forced the extension of UESU influence in Donets'k. Hence, to implement his intentions the idea of foundation 'Ukrainian Gas-Resource Consortium' (*Ukrains'kyi hazoresursnyi konsortsium, UGRC*) was born. Formally a joint venture of UESU and Ukrhazprom, but in reality vastly controlled by Lazarenko-Tymoshenko tandem (even Lazarenko's economic advisor was appointed as a president of UGC), Ukrainian Gas-Resource Consortium became a bridge for UESU to extend its power in Donets'k, while Itera lost the majority of its shares in Donets'k (See Table 2)²³³.

231 Their partnership could be traced from 1992, when Lazarenko, being the governor of Dnipropetrovs'k, provided her company with the monopoly on gasoline supplies to agro-industrial complexes.

232 Pirani, Simon. (June, 2007). Ukraine's Gas Sector. *The Oxford Institute for Energy Studies*, p. 95, <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG21-UkrainesGasSector-SimonPirani-2007.pdf>, accessed on October 14, 2015.

233 Pirani, Simon. (June, 2007). Ukraine's Gas Sector. *The Oxford Institute for Energy Studies*, p. 20, <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG21-UkrainesGasSector-SimonPirani-2007.pdf>, accessed on October 14, 2015.

Table 2. Regional distributors of the Natural Gas in 1997

<i>Name of Oblast'</i>	<i>Annual amount distributed (bcm) (Industrial consumers / Household Consumers)</i>	<i>Name of the Distributor</i>	<i>Source</i>
Kharkiv, Chernihiv, Crimea, city of Sevastopol, Donets'k, city of Kyiv, Dnipropetrovs'k, Volyn', Chernivtsi, Zakarpattia, Kyiv	30.73 (8.83/21.9)	Ukrhazprom, Ukrnafta, Chornomornaftohaz	Received from Gazprom as transit fee (32.0), domestic production (15.0)
Odesa, Kherson, Vinnytsia, Poltava, Zaporizhzhia, Khmelnyts'k, Kharkiv	8.3 (8.3/0)	Interhaz	Gazprom (10.0)
Luhans'k, Ivank-Frankivs'k, Kyiv (Bila Tserkva), L'viv, Mykolaiv, Sumy, Ternopil, 'Stirol'	11.1. (11.1/0)	Itera-Ukraine	From Central Asia (11.5)
Dnipropetrovs'k	15.5 (5.4/10.1)	United Energy Systems of Ukraine	Gazprom (15.5.)
Cherkasy, Zhytomyr, Rivne	4.0 (4.0/0)	Ukraine Gas Company (Gazpeks)	From Central Asia (4.0)
Kirovohrad, 'Zaporizhstal', Dnipropetrovs'k	3.0 (3.0/0)	Uzbekhazsyntez	From Central Asia (3.0)
Poltava	0.3 (0.3/0)	Poltava Hazonafta Company	N/a
Donets'k	10.0 (8.0/2.0)	Ukrainian Gas-Resource Consortium	N/a
Total	82.93 (48.93/34.0)		

Source. Derzhavnyi komitet naftovoi, hazovoi ta naftopererobnoi promyslovosti Ukrainy. Pro vvedennia v diyu hrupuvannia rehioniv Ukrayiny dlia zabezpechennia yih pryrodnim hazom u 1997 rotsi. Nakaz #1 vid 04.01.1997

The system created by Lazarenko did not last long, he resigned in July 1997. The same time Gazprom suspended the supply of gas to UESU because of the debt equal to 50 million USD as of October 1997. Interhaz, whose debt was 320 million USD got the support from president Leonid Kuchma and regardless its debt was able to continue business. UESU

to compensate its debt gave up its holdings in the Khartsyz Tube Factory. Therefore, UESU was fated to collapse, its shares was taken bu Interhaz, Itera, IUD and Interpipe²³⁴.

Important to mention that in parallel with gas market re-division, Kuchma's government initiated privatization in certain energy sectors: in 1996 of coal mines, in 1998 of electricity distribution companies, and in 1999 of oil refineries. Consequently, four out of six refineries were sold to mostly Russian companies; later it caused the increase of oil processing and Ukraine became a net exporter of oil products. Although privatization of the coal sector attracted new investments, it slowed down by 2001. In electricity sector only six distribution sectors were privatized by 2001, the remaining 21 power distributors remained partially privatized with a mix of free-floating shares and shares owned by the government²³⁵.

First time official energy strategy was developed under Kuchma in 1996, when the National Energy Program of Ukraine to 2010 was adopted by the Parliament. This program included several comprehensive medium-term programs in separate sectors, i.e., Development of Hydrocarbon Resources in the Ukrainian Sector of the Black and Azov Seas (1996); Energy Conservation (1997); Oil and Gas of Ukraine until 2010 (2001); Thermal Power Plant Reconstruction (2002) etc.

Electricity sector reform was introduced by the Wholesale Electricity Market reform back in 2002. Government established a special working commission and five sub-commissions to implement the WEM Concept. The transition to a liberalized market model was challenged by the state agencies and state owned energy companies, who were not interested in such a fast transition. The privatization of power sector was also stalled after the sale of six Oblenergos (power distribution companies) in April 2001.

In 2004 the government introduced the policy of increasing state control over energy sector. The electricity and coal industries were reformed under the control of vertically-integrated companies, namely in the electricity sector – state holding Energy Company of Ukraine (founded in June 2004) and holding company 'Coal of Ukraine' (founded in autumn 2004). Energy Company of Ukraine (ECU) gained equity stakes varying from 25 % to 100 % in joint stock power distribution and generating companies. ECU soon positioned firmly at the market by obtaining the control over four out of five

234 In August 1997 12 bcm of gas belonging to Interhaz was discovered in UGS. See, Negotiations between Gazprom, Ukrhazprom and Interhaz. (1997, Septemder 6), Zerkalo Nedeli.

235 International Energy Agency. *Ukraine Energy Policy Review 2006*. OECD/IEA, p. 40-41.

large thermal power generating companies, all country's hydropower plants and a majority of oblenergos. The idea of ECU as an alternative company to Naftogaz but in the power sector added one more factor to the increase of state control in this field and partially reversed privatization and strengthened state control. The coal sector faced the same reforms of consolidation instead of privatization. Holding company 'Coal of Ukraine' founded in 2004 gained vital assets in the coal sector. The majority of coalmines were left uncompetitive and fully dependent on state support. After electricity and coal sector reform, the Ministry of Fuel and Energy was left with just two strategic enterprises of nuclear power generating company Energoatom and high voltage transmission system operator NEC Ukrenergo²³⁶.

The distribution system created by Lazarenko troubled all the main actors of the energy sector and needed to be revised thoroughly. As previous attempts proved to be insufficient Leonid Kuchma faced a problem of reforming the sector.

IMF vastly criticized Ukraine's vertically integrated energy system. The need for disintegration and privatization of Ukrhazprom was urged to be a priority. Policy of 'no state-guaranteed gas imports' should be implemented without any considerations. As a conclusion IMF stated that 'the role of the state should be reduced to the regulation and licensing of natural monopolies in the gas sector'. Moreover, Lazarenko's system was defined as neither transparent nor predictable in terms of licensing and price setting procedures. Geographic division of the gas supplies restricted competition. And finally the withdrawal of the state from the gas supply was only partial²³⁷. Meanwhile, Gazprom appeared to meet cul-de-sac situation, when UESU together with Interhaz debt increased to 400 million USD and governmental payment guarantees gave no answer to who should take the responsibility for the debt. Moreover, president Kuchma was about to start the preparations for the 1998 parliamentary and 1999 presidential elections. Therefore, Lazarenko's case proved that keeping a control over the market would give undeniable advantage to counterbalance Gazprom's expansion.

As a result in February 1998 Leonid Kuchma dissolved Ukrhazprom and Lazarenko's gas system was dismantled. Instead in May 1998 a holding company Naftogaz

236 Kubrushko, Yu. (January 7, 2005). Orange Revolution to speed up sector reform. *Energy in East Europe*, Platts, Issue 55.

237 Loveu, Laszlo, Skorik, Konstantin. (1997, February 19). Commercializing Ukraine's Energy Sector. In Peter K. Cornelius and Patrick Lenain (Eds.). *Ukraine: Accelerating the Transition to Market*, IMF, p. 206.

Ukrainy that consists of several subsidiaries was created²³⁸. Along with the presidential decree Naftogaz was a national company with 100% of the government shares. Instead of vertically integrated structure of Ukrhazprom, Naftogaz separated these companies²³⁹, but held the majority of their stocks. Moreover, Naftogaz created new companies such as Ukrnafta (oil production) and Druzhba (oil transport). Surprisingly, the first president of the Naftogaz became Ihor Bakai, who already was known in gas sector by bankrupting ‘Respublika’ and ‘Interhaz’²⁴⁰. But being appointed by Kuchma, most probably his political loyalty rather than his business skills was taken into consideration.

Although the creation of Naftogaz to some extent benefitted Gazprom since the government provided import payment guarantees, Gazprom continued insisting on Itera’s further entering the gas sector. Gazprom suspended supplies to the traders, who were not paying properly and consistently replaced them with Itera. By the end of 1998, gas market of Ukraine consisted of two main importers: Naftogaz and Itera. Other gas distributors were left no other choice, but to purchase gas from either Naftogaz or Itera.

In 1999 Ukraine agreed to pay for gas (20 bcm per year) directly to Turkmenistan. But the scheme became even more complicated: Naftogaz was buying gas from Turkmenistan at Turkmenistani border, paying by cash and barter; Itera was paying Gazprom for transportation and received a transportation fee taken in gas from the supplies to Ukraine. By May 1999 Turkmenistan sent 5 bcm of gas that Ukraine did not pay for.

Meanwhile, monetarization and economic recovery of Ukraine in 2000 showed new trend, the barter operations declined, and cash flow increased. This all meant gas mediators were no more needed. From July 2002 Naftogaz and Itera moved to direct relations without the middlemen. But with the Putin coming to power this regime did not last long.

3.3.3. The raise of the independent actors

The mid of the 1990s was characterized by the emergence of the various interest groups, which further strengthened their power through the privatization of different

238 Postanova Kabinetu Ministriv Ukrainy. Pro utvorennia Natsional’noi Aktsionernoi Kompanii ‘Naftogaz Ukrainy’ vid 25 travnia 1998 roku, No. 747. [Laws of Ukraine. Cabinet of Ministers order No. 747. On Foundation of National Joint-stock Company ‘Naftogas of Ukraine’. Passed on May 29, 1998].

239 Among others Naftogaz included Ukrtranshaz, Chornomornaftohaz, Ukrtransnafta, Haz Ukrainy etc.

240 See, Global Witness. (2006). *It’s a Gas: Funny Business in the Turkmen-Ukraine Gas Trade*. Washington, DC, April.

enterprises. These interest groups are defined in the literature as BAGs²⁴¹, financial-industrial groups²⁴², oligarchs²⁴³ and clans²⁴⁴. Although there is slight difference in definition of these terms, I will use these names interchangeably in order to show the relations between the interest groups and president to achieve economic benefits.

The financial welfare of these interest groups was formed as a result of the trade of metals and chemicals (buying at state-regulated prices but reselling at full market prices), the trade of Russian gas, subsidized credits and budget subsidies (among others, in the gas and coal industries). Moreover, the authority of these interest groups was also empowered by their connections with security agencies. As neatly pointed out by Oleksandr Dergachev the only difference between Ukrainian and Russian interest groups was their engagement with security agencies: 'If in Russia the bureaucracy and power ministries play the first violin, then these same structures in Ukraine are employed at the service of the big capital. And, they are relatively strongly controlled'²⁴⁵.

'Red directors', who were important interest articulators of energy issues, after the process of privatization became owners of huge energy-dependent and energy-inefficient Soviet-type factories. Unlike the forecasts that the majority of the factories will be closed or reformed due to change in energy prices, state policy introduced the system of credits, which increased state foreign debt, but provided energy sector with the opportunity to grow. Only under Kuchma these state-owned companies' managers started to connect their interests with economic structures, which further led to the emergence of the clan system. It is remarkable to notice that under Kravchuk 'red directors' did not have at their disposal the resources, which they later obtained under Kuchma. Only second president brought the changes, which led to more coherent formation of the clan system, which combined policy-making and economic resources.

241 BAGs are groups that participated in the president-centered system of 'balancing' and exchange of economic favors for political support. Balmaceda, M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarch's profits and Ukraine's missing energy policy, 1995-2006*. Routledge, p. 38.

242 See, Kryshchanovskaya, Olga. (2002). Business elite and oligarchs: the outcomes of the century. *Mir Rossii*, No. 4, p. 31.

243 *Oligarchs* are defined as powerful economic actors who interact with the political institutions and establish with them a continued relation through which to pursue their own narrow interests. See, Puglisi, R. (2003). The Rise of the Ukrainian Oligarchs. *Democratization*, Vol. 10, No. 3, Autumn, p. 101.

244 *Clans* are 'clusters of businessmen, bureaucrats, and politicians who have certain common interests and an allegiance to one another'. See, Bukkvoll, T. (2004). Private interests, Public Policy. Ukraine and the Common Economic Space Agreement. *Problems of Post-Communism*, Vol. 51, No. 5, September/October, p. 21, note 20.

245 Interview with Dergachev. (2003, November 7-13). *Kompanion*.

As a result by the late 1990s powerful interest groups emerged as important economic players that consequently entered Ukrainian political arena. Each of the Dnipropetrovsk, Donetsk and Kyiv clans²⁴⁶ included a political party, media outlets, and oligarchs. The clans competed for the president's attention and patronage, which provided them with the advantageous access to economic resources. Almost all oligarchs began their careers by active participation in pro-Russian oil and gas sector. Therefore, they earned 'the greatest part of their financial income from close economic relations with Russia' and in certain cases they acted as 'pro-Russian lobbyists'²⁴⁷.

Each of the powerful Ukrainian tycoon had an energy-related interests and relied on the president as an 'arbiter' in interest balancing system. Indeed president's role has been strengthened under the 1996 Constitution and therefore his 'personal rulership' had a cohesive role in a heterogeneous environment of interest groups. Being close to the president or within his 'patronage network' guaranteed access to the administration, redistribution and utilization of state financial or administrative resources. Consequently, being endangered by raising power of Russia, Ukrainian oligarchs sought state's help to purchase strategic enterprises even though Russian bids were higher. President's favoritism enabled the privatization of the Krivoriizhstal steel mill in June 2004 by Viktor Pinchuk (Donetsk clan) and Rinat Akhmetov (Donetsk clan).

With the April 1998 elections 28 % of the parliamentarians were the representatives of the business²⁴⁸. It was the first time when politicians openly announced their wish to influence the decision-making process from the inside. These business actors were in search for political 'roof', which will give them some authority to counterbalance the state. It was the parliament who defined the list of state-owned objects, which would not be made subject to privatization. As a result the sale of 32 large enterprises mostly in energy sector was frozen.

Many of the oligarchs turned to be well-known politicians, which reiterated the ambiguity of the fault lines between the political and economic environments. Serhii Tyhypko of the Dnipropetrovsk clan (Working Ukraine Party), Viktor Yanukovych and Rinat Akhmetov of the Donetsk clan (Party of Regions), Viktor Medvedchuk, Hryhorii

246 For the detailed scrutiny of the newly formed clans, see Bondarenko, K. (2003, July 17). Khto i chym volodiie v Ukraïni. L'viv's'ka Hazeta. (reprinted in Ukrain's'ka Pravda, available at <http://www.pravda.com.ua/news/2003/07/17/2994698/> (accessed December 17, 2011).

247 Bukkvoll, T. (2004). Private interests, Public Policy. Ukraine and the Common Economic Space Agreement. *Problems of Post-Communism*, Vol. 51, No. 5, September/October, p. 17.

248 The energy sector was successfully represented by 15 deputies.

Surkis, and Leonid Kravchuk of the Kyiv clan (Social Democratic Party of Ukraine). This truly tightened the relations between the oligarchs, which entered the political parties and the president, allowing the former to enjoy the economical benefits in exchange for their backing to consolidate president's authority before the elections.

3.3.4. Relations with Russia

In March 1994 Gazprom clearly expressed an intention to cut the gas supplies if no payment would be made or it could negotiate the possibility of taking control over Ukraine's gas transit system. The furious reaction of the opposition not only made the deal impossible, but also passed the resolution in November 1995 on privatization of all 'strategic' enterprises, including in the oil and gas industries²⁴⁹.

In early 1995, after the negotiations between Ukrainian and Russian delegations a new joint company named Haztransit was to be established. In exchange for the debt write-off, transit assets were to be concentrated in this company. However, this proposal was not only dropped off, but also new legislation was adopted by the parliament to prohibit privatization of oil and gas assets. Hence, Russian capital was kept at a distance.

Important intergovernmental agreement was signed between Ukraine and Russia on 18 February 1994. The Agreement on export of Russian Natural Gas to Ukraine and its Transit through the Territory of Ukraine to European Countries established a policy framework, which was valid until 2005. Under this Agreement Gazprom was empowered to export 50-70 bcm of gas to Ukraine and Ukraine at the same time agreed for the transit of 112-144 bcm of gas to European countries. Around 25-35 bcm of Central Asian gas was to be transited through Russian territory to Ukraine. Re-export of Russian gas was prohibited and the export of gas produced in Ukraine was also limited²⁵⁰. Though the agreement on gas supplies and gas transit was reached, the problem with Ukraine's debt was not solved. Therefore, on 3 March 1994 Russia again threatened to halt gas supplies to Ukraine unless the debt is paid.

The Black Sea Fleet Agreement signed on May 28, 1997 included an important energy element. The Agreement outlined that Ukraine and Russia split the BSF on a 50-50

249 Balmaceda, Margarita M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarchs' profits and Ukraine's missing energy policy, 1995 – 2006*. Routledge: London, p. 27.

250 International Energy Agency. (2006). *Ukraine: Energy Policy Review 2006*. Paris: OECD/IEA, pp. 218-219.

percent basis; Russia would lease the ports in and around Sevastopol²⁵¹ for 20 years at 97,75 million USD per year. Ukraine's energy debt would be also credited by Russia in a sum of 526 million USD, and 200 million USD more will be placed for Ukraine's nuclear arsenal transfer to Russia. Accordingly Russia formally recognized Sevastopol as an integral part of Ukraine and agreed to stationing of the Russian fleet in Sevastopol for 20 years until 2017. This was first precedent in the history of Ukraine, when politics and energy were mixed. Former President's Representative on international energy security issues Bogdan Sokolowski noted that, 'In the beginning of 1990s due to the absence of experience state leadership mixed gas and politics by concluding further agreements. Although, the businessmen should have taken over the gas issue the same as other fuel resources issues. This negative legacy, when government concludes gas negotiations, has been passed from one president to another'²⁵².

Later signed in 1997 Russian-Ukrainian Treaty on Friendship, Cooperation, and Partnership established the needed base for cooperation. Consequently in February 1998 Ukraine and Russia signed a more large-scale Treaty on Economic Cooperation for the period of 1998-2007. Though Kuchma and Yeltsin spoke in favor of Russian and Ukrainian businesses having mutual access to each other's markets, in practice it meant Russia's entering so defined areas of energy complex, space sector, nuclear power engineering etc. These agreements officially offered Russian companies an extraordinary opportunity to offset their strategic setback. First of all, because Ukrainian enterprises were at least three times cheaper than Russian ones, while having a similar rate of capital productivity. Second, as Ukraine was in urgent need for external financing to supplement the state budget, Russia used this opportunity to enter the market.

Significantly, Kuchma's visit to Moscow was preceded by talks in Kyiv with a delegation of Russian entrepreneurs, including Vladimir Gusinsky (Media-Most) and Mikhail Khodorkovsky (Yukosi), to discuss the investment opportunities in Ukraine. Among the issues on the table there was the possibility for Russian capital to participate in the privatization of oil and gas enterprises in exchange for a guarantee of energy deliveries to

251 Before the official Agreement Russia two times passed a resolution claiming Sevastopol as a Russian city and as a headquarter of the Russian Black Sea Fleet. See, Bailes, A., Melnik, O., Anthony, I. (2003). *Relics of Cold War: Europe's Challenge, Ukraine's Experience*. SIPRI Policy Paper: Stockholm, No. 6, November, p. 39.

252 Grygoryeva, Iryna. (February 27, 2013). We say gas, but think politics. *Day*, No. 36, <http://www.day.kiev.ua/uk/article/podrobici/mi-kazhemo-gaz-maiemo-na-uvazi-politika>, accessed on March 28, 2013.

Ukraine²⁵³. Renewed opposition by the Verkhovna Rada, which had already blocked a November 1997 presidential decree allowing international tenders for a number of blue-chip enterprises, led skeptical Russian observers to doubt whether the agreement would ever be implemented.

Because of the above-mentioned Russia has chosen another tactics to penetrate Ukrainian market. One of the way was to do business through the affiliated resident companies registered in the West. This practice allowed Russians to bypass Ukrainian regulations, especially in the sphere of gas. Another way was to the expansion of the Russian banks. According to figures published in 1997, out of the 200 commercial banks operating at the time in Ukraine, six were representatives of Russian banks²⁵⁴ and twelve Ukrainian banks were registered with the participation of Russian capital²⁵⁵.

In 2000 the Ukrainian State Property Fund launched the sale of state property and state-owned majority shares in key enterprises. In two years Russian companies consolidated their presence in Ukraine, acquiring substantial blocks of shares in the country's prestigious plants. Sibirskii aluminium, one of the Russian giants in aluminium production, acquired 36% of shares in the Mykolayiv aluminium plant, while a further 33% were granted to a Sibirskii subsidiary, Ukraiinskii Aluminium Company. A number of Russian companies entered oil refinery business, including Tatneft and Tatneftprom, which consolidated their control over the Kremenchuk oil refinery with 57% of the shares²⁵⁶. Tyumen oil company acquired a 67.41% stake in the Lynos refinery, while 52% of the shares in the Odessa refinery went to Lukoil and Syntez Oil²⁵⁷.

It was estimated that in the short span of six months in 2000 Russian companies had taken over 50% of the Ukrainian petroleum market and Russian oil traders came to control the supply of oil to Ukrainian refineries²⁵⁸. In February 2002 Russian United Energy

253 *Kommersant Daily*. (1998, February 28), p. 2.

254 Among others, Onexsimbank, Rossiiskii Kredit, National Reserve Bank, Inkombank, Kreditimpeks and Mezhhkombank. See, Kobzar, V. (1997). *Pervye shagi rossiiskikh bankov v Ukraine. Mirovaya ekonomika i mezhdunarodnye otnosheniya*, 10, pp. 134–138.

255 Among these were Lukoil-Imperial Bank, active in Bank Ukrayna, the agricultural sector authorized bank, and Onexsimbank, which had become a shareholder to save the Ukrainian Yuneks Bank from bankruptcy.

256 Balmaceda, Margarita M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarchs' profits and Ukraine's missing energy policy, 1995 – 2006*. Routledge: London, p. 30.

257 Puglisi, R. (2003). *Clashing Agendas? Economic Interests, Elite Coalitions and prospects for Co-operation between Russia and Ukraine. Europe-Asia Studies*, Vol. 55, No. 6, p. 13.

258 Balmaceda, Margarita M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarchs' profits and Ukraine's missing energy policy, 1995 – 2006*. Routledge: London, p. 60.

Systems' Chairman Anatolii Chubais reached an agreement to buy 14 regional power companies in Ukraine²⁵⁹. It was predicted that by 2005 up to 70% of Ukrainian output would be produced with the participation of Russian capital²⁶⁰.

Putin's coming to power drastically changed energy sector of Russia. In 1997 Vladimir Putin in his Candidate of Science Dissertation entitled 'Mineral Raw Materials in the Strategy for Development of the Russian Economy' clearly pointed out that the Russian government must control Russia's raw resources to both secure its domestic economic prosperity and to rejuvenate its status as a world power²⁶¹. The same statement later reemerged in the Energy Strategy.

For Ukraine the adoption of 'Russian energy strategy till 2020' (2003) was an important document, which directly defined fuel and energy complex of Russia as an 'instrument of internal and external policy'²⁶². The role of the country in world energy markets according to Strategy determines country's geopolitical role. James Sherr concluded that 'Russia's economic imperatives and political goals will combine to ensure that the supply squeeze continues and that spasms between stability and crisis grow shorter and sharper [...] Countries like Ukraine, that have resources of their own, will not escape from this cycle until they become masters of their own energy sectors and confront its ills: opacity, venality and barriers to honesty, urgently needed investment'²⁶³.

After the negotiation with IMF and accepting the 12 years of debt repayment process for Ukraine, Gazprom's president Rem Vyakhirev introduced new element into gas distribution system of Ukraine. A Ukrainian company with Gazprom's strong ties Itera-Ukraine 'should be the only buyer of Russian gas, selling it to Ukrainian companies'²⁶⁴. Although this offer was strongly opposed by Lazarenko as it contravened his personal interests, but the consequent entrance of Russian-lobbied companies inevitably took place.

Both companies Omrania and Itera had been founded by Igor Makarov, former cycling champion, in 1992 and 1994 respectively. Omrania Trading Company was

259 *Russian Oil & Gas Report*. (2000, December 29).

260 Levkin, A. *Ukaina-Rossiya: kak otdelit biznes ot politiki?*, <http://ukr.smi.ru/02/02/12/4329.html>, accessed December 12, 2011.

261 Putin, Vladimir. (January 1999). Mineral Raw Materials in the Strategy for Development of the Russian Economy. *Notes of the Mining Institute*.

262 Sherr, James. (2008). Security in the Black Sea region: back to Realpolitik? *Southeast European and Black Sea Studies*, Vol. 8, No. 2, June, p. 148.

263 Sherr, James. (2008). Security in the Black Sea region: back to Realpolitik? *Southeast European and Black Sea Studies*, Vol. 8, No. 2, June, p. 148.

264 Intel News Weekly Digest. (11 November 1996), p.4

registered in Cyprus, while Itera International Energy LLC in Jacksonville, Florida²⁶⁵. Omrania as a first business experience of Makarov was supplying Turkmenistan with food products in exchange for Turkmen crude oil²⁶⁶. Omrania exported in total 20 bcm of gas to Ukraine at a price of 57 USD per 1000 cubic metres²⁶⁷. His second company Itera Group turned into fourth largest gas company in the world based on its gas reserve base²⁶⁸. The company, which since 1994 supplied gas to Ukraine and since 1998 to Armenia, Azerbaijan, Georgia, Belarus, and Moldova. It should be noted that officially there were no ties between Gazprom and Itera, Gazprom did not possess any shares of this company.

Before Itera became a number one player in gas business between Ukraine and Russia, one more attempt had been made to establish Russian-Turkmenistani joint intermediary. In October 1995, a joint venture TurkmenRosGaz was founded by Gazprom and Turkmenneftegaz with the aim to sell Turkmenistani gas to Ukraine. In this joint venture 51 % belonged to Turkmenneftegaz, 45 % to Gazprom and 4 % to Itera²⁶⁹. Within the period of August 1996 until spring 1997 TurkmenRosGaz exported gas to Ukraine. One of the officials Valery Otchertsov, who was in charge of the TurkmenRosGaz project and the same time vice-minister of the parliament of Turkmenistan, soon became the vice-president of Itera. And therefore TurkmenRosGaz was unilaterally disbanded on 19 June 1997 due to the debts.

Itera meanwhile as noted by Makarov due to ‘boyhood friends’ support, who held key governmental positions, turned into essential player in gas business. Surprising to the analysts, Gazprom let Itera take over the market so vitally important to Gazprom, but the same time frequently unable to pay for the gas. As stated by Makarov Itera and Gazprom set ‘mutually beneficial rules’²⁷⁰. Itera’s know-how included making use of ‘sophisticated and highly developed barter structures’ with the aim to get payments from Ukraine²⁷¹. Hence, everyone appeared to be satisfied: Gazprom because of getting payment in cash and not

265 Global Witness. (2006). *It's a Gas: Funny Business in the Turkmen-Ukraine Gas Trade*. Washington, DC, April, p. 34.

266 Igor Makarov confessed that he entered the business accidentally, as once Turkmenistan offered to reimburse him 30 million USD in gas cargoes, which later he successfully resold in Ukraine.

267 This amount was resold to Ukrainian partner OLhas, which in 1996 resold it to wholesalers in Ukraine.

268 Hermitage Capital Management. (2000, October). Gazprom – the World’s Largest ‘Non-Profit’ Corporation. *Hermitage Capital Management*, Moscow.

269 Fujimori, Shinkichi. (2005). Ukrainian Gas Traders, Domestic Clans and Russian Factors: A Test for Meso-Mega Area Dynamics. In Kimitaka Matsuzato. (Ed.). *Emerging Meso-Areas in the Former Socialist Countries: History Revived or Improvised?* Slavic Research Center, http://src-h.slav.hokudai.ac.jp/coe21/publish/no7_ses/chapter06.pdf, accessed 15 January 2012.

270 Global Witness. (2006). *It's a Gas: Funny Business in the Turkmen-Ukraine Gas Trade*. Washington, DC, April, p. 34.

271 *Ibid*, p. 35.

dealing with barter, and Itera, which planned to extend its activity area. Meanwhile, Itera by selling gas to Gazprom made a significant profit out of it²⁷². All this pointed at well-organized 'siphon system' of illegal profits, which were backed and thoroughly protected by Gazprom²⁷³. Though Makarov acknowledging special non-competitor relations between Itera and Gazprom, Gazprom was losing profits. As stressed by the CEO of Hermitage Capital Management William Browder: 'Gazprom was a poor company only because it was making Itera rich'²⁷⁴.

Itera with different development intensity survived at the market nearly for a decade (1992-2002). But with Putin in power, Itera was first limited in supply, then totally halted²⁷⁵. With appointment of Aleksei Miller, as a chairman of Gazprom, Itera and Gazprom became fierce enemies. According to Itera, from the beginning of 2003, Gazprom demanded 100% prepayment from Itera, while the others were left with old terms²⁷⁶. The final step to squeeze Itera was a more profitable offer to Naftogaz, Gazprom offered 38%, while Itera offered 41% of the value of gas Naftogaz bought from Turkemistan. Gazprom-Naftogaz tandem served the same job as Kuchma used against UESU and Itera was finally removed from the market.

3.3.5. Relations with Western countries and institutions

In 1994 the EU and Ukraine signed a Partnership and Cooperation Agreement, where in Article 61 main priorities in energy sector cooperation were mentioned. The cooperation in further areas were listed: the environmental impact of energy production supply and consumption; the improvement of the quality and security of energy supply; formulation of energy policy; improvement in management and regulation of the energy sector in line with a market economy; introduction of institutional, legal, fiscal and other

272 CEO of Hermitage Capital Management William Browder after a thorough scrutiny of Gazprom's activity listed in his report a number of misdealings. Among others Itera after Gazprom negotiations got a right to buy Turkmen gas at 35.4 USD per 1000 cubic metres and resold it to Gazprom at 45 USD per 1000 cubic metres, making 87 million USD of profit. Though this sum was claimed to be equal to Itera's transportation costs, in reality transportation costs were reimbursed to Itera by separate agreement.

273 See, Hoffman, David. (2000, May 21). Itera: Mystery Player in Russia's Natural Gas Market. *Washington Post*; Report of the Audit Chamber of the Russian Federation. (2003). No. 11 (71); Vlasov, Petr. (2000, March 20). Upolnomozhennye po delam Sodruzhestva. *Ekspert*, No. 11 (224) etc.

274 McGregor, Caroline. (2002, March 18). Gazprom and Itera: A Case Study in Russian Corporate Misgovernance. Washington, DC, Carnegie Endowment for International Peace, <http://www.carnegieendowment.org/2002/03/18/gazprom-and-itera-case-study-in-russian-corporate-misgovernance/nrl>, accessed 16 February 2012.

275 Global Witness. (2006). *It's a Gas: Funny Business in the Turkmen-Ukraine Gas Trade*. Washington, DC, April, p. 36.

276 Itera's press release (2003, January 24).

conditions to encourage energy trade and investment; promotion energy saving and energy effectiveness; modernization, development and diversification of energy infrastructure, improvement of energy technologies; technical training in energy sector²⁷⁷. The delay of four years in ratifying PCA by the EU member states caused first disillusionment of Ukraine with European prospects. The ambiguity of the developments of EU and Ukraine's politics impeded fruitful cooperation in energy sector. Vanishing prospects of EU membership during Kuchma's tenure led to the ups and downs in bilateral relations and contained some distancing from EU-led liberalization of market. Meanwhile, Ukrainian foreign policy was temporary reoriented to Russia.

Relations with Western countries mainly focused on three separate issues. As Chernobyl's damaged reactor continued to be in use, in December 1995 G-7 group signed an agreement on the closing of the Chernobyl nuclear power plant by the end of 1999. Along this agreement financial support²⁷⁸ should have been provided to build sarcophagus to stop the radiation leaking. Regardless tense relations with European countries under Kuchma and his insistence on the possibility to return to a more intensified usage of nuclear energy as an option to decrease dependency on Russian gas and oil²⁷⁹, Chernobyl nuclear plant was finally closed on December 15, 2000.

Second issue draws Ukraine's financial dependence on Western countries, which allowed Ukraine to partially repay its debts to Russia. West was serving as a 'milker', allowing Ukraine to borrow needed sums to manage its external debt. This was the case of Western mediation, which by pressuring Russia for granting a large stand-by credit, allowed Ukraine in 1995 to restructure its debt to Russia.

Third issue of Ukraine's cooperation with Western countries touched upon energy dependency problems. Among programs aiming to diminish energy dependency on Russia one can name TRASECA. The creation of different transportation routes between Caspian and Black Sea countries and Western Europe was one of the program's goals. INOGATE was another instrument of the EU to support the pipeline project in order to facilitate the transport of hydrocarbons within the region and towards the export markets of

277 European Communities. (23 March 1994). *Partnership and Co-operation Agreement Between the European Communities and Their Member States, and Ukraine*. (CE/UKR/en), pp. 51-52.

278 The West was obliged to offer Ukraine 500 million USD in grants and 1.2 billion USD in loans of international financial organizations and the IAEA. See, Ukraine: Kuchma Wants Deeper Contacts With EU Countries. (1996, September 12). *Moscow INTERFAX*, in FBIS-SOV-96-179.

279 In fact, building new nuclear plants in Rivne and Khmelnyts'kyi did replace the capacity of the closed Chernobyl Plant, but did not decrease the dependency on Russia, as nuclear fuel is exported from Russia.

Europe. In the context of these programs Odesa-Brody pipeline project theoretically meant also a solution to oil diversification, though the reality proved the contrary. According to the official version offered by the government after the completion of Odesa-Brody pipeline, there were no sellers of Caspian oil who could offer economically viable prices and no buyers that were ready to sign import contracts committing to buy oil from the pipeline. Finally, in July 2004 Odesa-Brody pipeline was agreed to be used by TNK-BP to pump Russian oil in the reverse direction, and thus transformed from ‘pro-diversification measure’ into ‘anti-diversification measure’. The decision to use Odesa-Brody pipeline in reverse direction provoked negative reaction from the American, German and Polish ambassadors, who in the daily newspaper ‘Den’ warned that this situation will be treated as reorientation of Ukraine’s foreign policy away from Euro-Atlantic structures back to Moscow²⁸⁰. It is notable to mention that position of the German Ambassador symbolized a strong backup of the EU countries for the pipeline to operate in the original direction.

After official announcement of the temporary usage of the Odesa-Brody pipeline in the reverse direction by Yanukovych government, EU made several attempts to dissuade Ukrainian government from this decision. In May 2003, a joint declaration on ‘Support of the Euro-Asian Oil Transport Corridor Project’ was signed establishing a trilateral EU-Poland-Ukraine expert working group to investigate the possible extension of the pipeline to Plock in Poland. This extension was soon given a priority status by the Commission Communication on the Development of Energy Policy for the Enlarged European Union, its Neighbors and Partner Countries²⁸¹ and hence the financing reached about two million euro. Regardless all these attempts reversal of the Odesa-Brody during Kuchma time remained an elusive goal, and the government extended the use of the pipeline by the TNK-BP till 2009²⁸².

The dependency issue of Ukraine was mostly neglected by the EU and therefore improperly addressed due to following reasons. First of all, Ukraine’s dependency (not only in energy) was a part of the Soviet Union’s legacy and there was no easy solution to break it up. Second, Western countries highly dependent on Russia as an exporter of energy resources neglected the opportunity of alternatives diversification routes bypassing Russia

280 Pascual, Carlos, Studemann, Dietmar, Ziolkowski, Marek. (April 8, 2003). Oil and Ukraine’s Euro-Atlantic chance. *The Day Weekly Digest*, <http://www.day.kiev.ua/260444>, accessed March 14, 2012.

281 European Commission. Communication from the Commission to the Council and the European Parliament Wider Europe-Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours. COM (2003) 104 Final, Brussels, March 11, 2003.

282 Minister Boyko delays reversing Odesa-Brody until 2009. (March 16, 2007). *Korrespondent*.

but with Ukrainian participation. And, after all under Kuchma's presidency actual rapprochement with the EU was not observed. As mentioned in the report of Stefan Batory Foundation, 'For Mr. Kuchma 'European ambitions' were a tactical device with which he regulated his multi-vectoral policy of balancing between Russia and the West, lacking the political will to fulfill criteria of EU membership'²⁸³. Pro-European rhetoric was diminished and especially after Georgiy Gongadze's assassination and possible secret sale of 'Kolchuga' radar to Iraq, the West not only lost its interest and patience in Ukraine, but Ukraine partially lost its credibility. Deteriorating domestic dynamics created the conditions under which Ukraine was left with Russia²⁸⁴.

In June 2002 Ukrainian president Leonid Kuchma, Russian President Vladimir Putin and German chancellor Gerhard Schroeder stated their will to start joint management of the Ukrainian gas transportation system (GTS) and trilateral agreement on the foundation of the consortium was signed²⁸⁵. Putin said that Germany's participation in the consortium would enable to attract 2.5 billion USD needed to reconstruct Ukraine's pipeline network²⁸⁶.

Later this year on 7 October the Russian and Ukrainian presidents at the CIS summit held in Chisinau founded the International Consortium for the Control and Development of the Gas Transportation System of Ukraine²⁸⁷. Though Kuchma first insisted on 51% of the shares to be owned by Ukraine, but later he should have accepted parity offer.

The idea of the Consortium was to refurbish one of the main transit pipelines and to build at least one more new one. Foreign investments, especially from the European side (Ruhrgas and Gas de France) were welcomed. Having some disputes concerning capital investments, in 2004 Gazprom and Naftogaz Ukrainy agreed after all to build and operate small additional pipeline from Bohorodchany to Uzhhorod, which would raise the transit capacity by 19 bcm. In April 2006, Naftohazbud was announced by the Consortium as a winner to build the above-mentioned pipeline. Therefore, a grand idea for the Consortium

283 Gromadzki, G., Sushko, O., Vahl, Marius, Wolczuk, K., Wolczuk, R. (2005). *Will the Orange Revolution bear fruit? EU-Ukraine relations in 2005 and the beginning of 2006*. Stefan Batory Foundation: Warsaw, May, p. 23.

284 In the period 2000–2002 Presidents Kuchma and Putin met a record 18 times to discuss the unfolding of the two countries bilateral relations.

285 Ukraine Looks to EBDR for Gas Consortium Project. (2003). *Black Sea Trend Review*, 2:4, Summer, p. 64.

286 Putin, Schroeder, Kuchma sign Energy Accord. (June 11, 2002). *Newsline. RFE/RL*.

287 In Russian Consortium is known as ООО Международный консорциум по управлению и развитию газотранспортной системы Украины.

ended up with a single additional pipeline project and regardless high expectations did not bring efficiency.

3.4. Causal links of energy politics between domestic politics and international relations in the early 2000s

Ukraine inherited energy-intensive and energy-inefficient economy that was previously totally controlled by Moscow. Energy sector was deteriorated by outdated infrastructure, widespread corruption, lack of investment and most importantly so vital gap between policy-making and real actions. This sketched a bigger picture of Ukraine's phenomenon of 'momentocracy', where short-term policies and lack of long-term visions dominated the country's elite²⁸⁸.

First ten years of independence the energy situation in Ukraine turned from integrally dependent part of the former Soviet Union to a country, which imported more than half of the energy it consumed. The prices for gas fluctuated from 15% increase to world market prices level. As a result Ukraine facing regular gas cut offs firmly ran into debt, which further immensely impacted upon the economic crisis in Ukraine. Various estimates that energy prices increase led to a reduction of GDP by more than 10%²⁸⁹.

Kravchuk as a chief negotiator faced sufficient challenges while pursuing harsh break up with Russia. The preferences he had at domestic level covered the urgent issues of management of the economy, more precisely attempts to keep the economy afloat. Initially the coalitions at domestic level provided President with a support for his vision, but as no real alternatives to replace energy resources (so needed for industrial consumers) from Russia were actually brought to the agenda, the withdrawal of the support was observed.

The time for radical reforms in energy sector was wasted, and instead of introduction of real steps for sector modernization, elimination of high energy-inefficiency, vast subsidization etc., as it happened in Baltic states, Kravchuk rather focused on a search for alternatives of Russian gas. Kravchuk's presidency showed a very complicated state of affairs not only in energy domain, but at all levels of state-machinery transformation. Therefore, the most important steps in structural reform of energy sector were not observed,

288 Umbach, Frank. (2011). Ukraine's Energy Security Challenges: Implications for the EU. In T. Kuzio, D. Hamilton (Eds.). *Open Ukraine. Changing Course towards a European Future*. (95). Washington, DC: Center for Transatlantic Relations.

289 Von Hirschhausen, C., Vincentz, V. (2000). Energy policy and structural reform. *Eastern European Economies*. January-February, No. 38 (1), p. 63.

which caused further aggravation of the inefficient, energy-intensive and energy-dependent economy of Ukraine.

The international level indicated another set of preferences. Kravchuk attempted to participate in exploitation of Siberia's energy resources, which at the time was an attractive option, but was not implemented due to the lack of funds. Moreover, this option would have increased dependency on Russia, and one could hardly argue about equal partnership in this project. From the other perspective the failure to implement Ukrainian Tanker Fleet project was among real political miscalculations.

Russia's position in gas issues turned from observer one to active lobbyist one, when the gas issue started to be highly politicized. In negotiations Russia had a strong hand with such cards to play as huge gas debt of Ukraine, favorable conditions of payment (discounts/credits/barter deals) and cut-offs as ultimate tool of pressure. Massandra Agreement that was reached by Russia and Ukraine in September 1993 clearly showed Russia's preferences. Moscow demanded full control of the Black Sea Fleet, handing nuclear weapons and Ukraine's participation in Nuclear Non-Proliferation Treaty, in exchange for gas debt management. Regardless Kravchuk's agreement with the terms offered by Russia, the agreement was vetoed by the parliament. The domestic reaction on this agreement proved that Kravchuk does not hold enough support at home to secure ratification of this deal. This led to involuntary defection, when domestic constituents started to withdraw their support from the president's actions.

Growing state debt for energy resources and gradual transition to market prices narrowed Ukraine's win-set options. Russia was insisting on greater concessions, especially on the participation of Russian enterprises in strategic industrial objects, like refineries and pipe-making plants etc. The negotiations at international level led to a preliminary agreement, namely March Protocol of 1994 on Russian participation in Ukrainian gas-related enterprises. But the ratification of the Agreement was vetoed by the parliament as well as faced harsh resistance from domestic constituents. Therefore an involuntary defection proved the inability of the President to deliver his promises made at international level. One could argue about the nature of this defection, whether Kravchuk was really eager to accept Russia's penetration into Ukrainian market, or that defection was actually of voluntary nature, and was used only as a bargaining chip during negotiations at international level.

The size of the win-set at Kravchuk's disposal appeared to be quite small. Vast dependency of Ukraine on cheap energy resources from Russia left him with only few alternatives for diversification, but no real funds to implement those projects. The state of dependency had not been changed by any radical reforms at the time also due to the lack of political readiness to introduce sharp structural reforms as it would have endangered his chances for re-election. Therefore, Kravchuk's presidency indicated a high level of constraints by domestic politics as well as lack of sufficient support at domestic level in order to secure ratification of the preliminary agreements reached at international level.

The high level of reverberation at domestic level increased international pressures on the decision-making process of the leadership in Ukraine. Though certain agreements that were reached at international level have not faced ratification, the perceptions of Russia's involvement in Ukrainian economy started to be changed. Changes of foreign policy priorities from alienation of Russia to recognition of Ukraine's dependency resulted in Russia's first steps in order to persuade Kravchuk to expand his win-set, barter schemes and side-payments were included as political tools during international negotiations. As a result, Kravchuk ended up with no actual structural reforms, poor state of economy and vastly boosted international pressures. Barter operations led to an increased state debt, and therefore weaker bargaining tools of Ukraine, and as a result Kravchuk eventually lost the support from domestic constituents.

Kuchma's preferences differed from Kravchuk's in various ways. Kuchma did not pursue the policy of alienation with Russia, but rather the one that reiterated close economic cooperation. At domestic level interest groups' support for Kuchma provided him with a necessary impetus to act as an arbiter. Kuchma's system was relying on 'informal institutions of rent-seeking, patronage and coercion'²⁹⁰. Adoption of Constitution in 1996 changed political system into presidential-parliamentary one, where president held substantial power. Kuchma's preferences at domestic level lied in accumulation of power, though without direct involvement in business schemes. Therefore, though with the establishment of Naftogaz the initial purpose was 'to keep the unity of gas transportation system, to prevent buying parts of the system for cheap price by different bidders', Naftogaz turned into political 'feedbox', which was duly used during elections²⁹¹.

290 Kudelia, Serhiy. (2012). The sources of continuity and change of Ukraine's incomplete state. *Communist and Post-Communist Studies*, 45, p. 422.

291 Interview with Alla Yeremenko, Editor of the Department of Economic Security of the newspaper "Dzerkalo tyzhnia" (Mirror of the week), conducted in Kyiv (Ukraine), on 3 June 2013.

The developments at domestic level proved high volatility. The so-called reforms raised various private intermediaries, who in short term made huge profits and attempted to influence political balance. Energy tycoons started to purchase media outlets and parties, therefore their influence increased sufficiently. The energy sector of Ukraine turned into the most opaque one in the world. Shadow corruption networks, non-transparent intermediaries, barter schemes and manually manageable by the president energy sector put Ukraine's economy into the hands of the Russian counterpart. Though vast part of corruption took place in energy sector of Ukraine, Russia's role shouldn't be underestimated here. Domestic developments led to an entrance of Russian business into energy sector. Though not proved directly, but reiterated by investigations of journalists²⁹², Gazprom friendly companies like ITERA were treated as a source of money laundering for high officials in Russia, as well as in Ukraine. Corruption obtained a solid transnational nature and became an important tool in the hands of Russia to keep Ukraine under its sphere of interests.

International level showed now clear tendency of Russia to obtain more concessions from Ukraine. During negotiations with Russia Kuchma's position was significantly weakened because of the pressure from domestic groups to get a favorable gas price. Kuchma's domestic constraints put him into the situation, when new opportunities for an agreement appeared, but they included side payments. Black Sea Fleet Agreement of 1997 for the first time introduced a clear approach to apply 'gas for fleet' formula. It was not just an exchange of gas debt and lower gas price for stationing of Black Sea Fleet in Sevastopol for 20 years, but rather a beginning of a Russian full-scale entrance into Ukraine's economy. With Putin in power Russia got even harsher in its relations with Ukraine, most of the intermediaries were removed, except Itera, a friendly to Gazprom organizations, and gradual transition to gas market prices was announced. An agreement at international level left Russia quite satisfied with the results obtained from negotiations, while Kuchma secured implementation due to the support from energy-dependent interest articulators.

The engagement of European countries at international level remained quite limited. The only energy-related questions negotiated with Ukraine dealt with the outcomes of Chernobyl (mostly covering the issues of financial assistance), re-payment of gas debt to

292 Global Witness. (2006). *It's a Gas: Funny Business in the Turkmen-Ukraine Gas Trade*. Washington, DC, April.

Russia, finalization of the construction of Odesa-Brody pipeline (though initially being a diversification route was further used by Russia). Trilateral negotiations on joint management of Ukrainian GTS failed. All this indicates that at the time neither Ukraine nor European Union did form the main cornerstones of cooperation in energy sector. The negotiations took place spontaneously and were not transformed into a strategic vision of cooperation in energy sector at the time. As neatly pointed by Kataryna Wolczuk: ‘Until 2005, the European Union neither played nor endeavoured to play a role in domestic change in the Soviet successor states. The EU pursued a Russia-first policy in the former Soviet Union, lacking the vision, commitment and effective instruments to affect the domestic political and economic trajectories of the Soviet successor states’²⁹³. It was only after Yushchenko that EU started to empower domestic change in Ukraine. Thus the role of the EU during first decade of Ukrainian independence could be defined as minor.

To sum up, first decade of Ukraine’s independence showed a clear trends of closer cooperation with Russia without paying due attention to implementation of the reforms at domestic level. European vector remained underestimated, and no real steps were made to sketch the basis for closer cooperation. Ukraine as defined by Olga Shumylo-Tapiola was ‘too far away from the EU, too difficult to understand, and too close to Russia’²⁹⁴. The chief executives with high level of domestic constraints followed the easier path of providing Russia with concessions, while the management of the energy sector did not face any sufficient changes.

293 Wolczuk, Kataryna. (2009). Implementation without Coordination: The Impact of EU Conditionality on Ukraine under the European Neighbourhood Policy. *Europe-Asia Studies*, Vol. 61, No. 2, March, p. 187.

294 Shumylo-Tapiola, Olga. (April 16, 2013). Why does Ukraine Matter to the EU? Carnegie Europe, <http://carnegieeurope.eu/2013/04/16/why-does-ukraine-matter-to-eu/fzq3>, accessed on April 18, 2013.

CHAPTER 4

EVOLUTION OF ENERGY POLITICS UNDER YUSHCHENKO'S PRESIDENCY

As a result of massive public protests known as Orange Revolution, Yushchenko became a president and raised the hopes that opaque energy sector would be reformed. Clear Western orientation alienated Yushchenko in the eyes of Russia. Any cooperation with Russia appeared to be highly politicized, which at the end brought poor results in energy sector reform. Inability to form effective government in order to perform needed reforms resulted with decrease in public support and even deeper alienation from Russia. Regardless first steps made in order to reach closer energy cooperation by signing high-level agreements little had been done to implement it in practice.

Relations with Russia ended up with two gas wars in 2006 and 2009. Reliability of Ukraine as a transit country was shaken, so Russia used that opportunity to promote its by-pass pipeline projects. EU's involvement could be rather assessed as cautiously supporting without direct confrontation with Russia. As a result just Odesa-Brody extension project was introduced. Nevertheless, a message of Ukraine's intention to enter energy market of Europe was sent by obtaining a status of an observer in the Energy Community.

4.1. Conflicts of interests in domestic politics and lack of proactive approach

To understand the flow of the reforms conducted by the government I included here a period of reforms that were performed by Tymoshenko under Kuchma's presidency to show the continuity of her policies during her next appointments under Yushchenko. In 2000-2001 Tymoshenko achieved one major reform, which included shift from barter and nonpayment methods to cash payment methods in energy sector. This was important development that indicated elimination of the part of renting opportunities. Her return as prime minister in 2005 indicated even harsher attitude towards wrongdoings in energy sectors. A thorough investigation was opened by Oleksandr Turchynov, SBU chief and her party member, to reveal corruptional activity of RosUkrEnergo. Soon after Tymoshenko was moved from her position, the investigation was frozen. As a result

Yushchenko showed reluctance to break the vicious cycle of energy schemes of corruption, which proved a statement that Kuchma's legacy is being utilized by newly elected president.

Two next prime ministers were either connected to Kuchma, like Yuriy Yekhanurov, or appeared to be former candidate for presidency defeated during Orange Revolution, Viktor Yanukovych. This shift from opposing Kuchma's legacy to its direct accommodation diminished any chances for effective reform. As a result Tymoshenko was again appointed as a prime minister in 2007. Three years of exacerbated political situation and rivalry between president and Tymoshenko brought only one positive result, intermediaries were to be eliminated starting from 2009. Attempts to get political prevalence placed Yushchenko and Tymoshenko into a position of competition, where steps by one side were undermined by the acts of the other side.

4.1.1. Tymoshenko's reforms in the energy sector under Prime Minister Yushchenko (2000-2001)

Yushchenko together with Yuliya Tymoshenko entered political arena under Kuchma as prime minister and vice prime minister for energy issues respectively. Tymoshenko's path to power was especially threatened after Lazarenko's arrest in the United States in 1999, therefore Hromada fraction was dissolved and Bat'kivshchyna (Fatherland) party was created, consequently Tymoshenko left business and started her political career²⁹⁵.

First years in power for Yushchenko and Tymoshenko were implicated by from one side trade wars with Russia that worsened relations, which led to the reduction of the energy supply and in December 1999-January 2000 suspension of oil supplies and from the other side by the reforms they tried to pursue in the energy sector. Due to the pressure of the West newly in power Yushchenko and Tymoshenko announced a three-month 'state of emergency in the energy sector' in January 2000. The main objective of the reforms was to eliminate barter payments (together with gas traders) and non-payments in the energy sector as well as to re-establish state control over gas purchases from Turkmenistan. The first was mainly achieved by establishing auctions and introduction of them as obligatory component for a certain percentage of Ukraine's energy sector. Having vast experience in the gas trade sector, Tymoshenko used her knowledge to clean the system up. She insisted on tax payments in cash rather than through offsets and tried to stop theft of gas from pipelines. Diminishing the opportunities for the dominant energy groups to gain uncontrolled rents

295 Kuzio, Taras (Ed.). (2009). *Democratic Revolution in Ukraine: From Kuchmagate to Orange Revolution*. Routledge, p. 50.

Tymoshenko shook the existing equilibrium of the energy oligarchy, and gained new political rivals. Consequently, she ended up in a vicious conflict with Ihor Bakai, whom she sacked from his post as president of the Naftogas Ukrainy in March 2000.

After gas sector electricity was the next source of rents. Here the scheme was different as third of the market was monopolized by the distributor Hryhorii Surkis. Along with the scheme the distributors extracted payments from the final customers, therefore they paid only 6-7% of the electricity they bought and even less in taxes. As summed up by Tymoshenko she forced distributors to pay 1.8 billion USD for electricity and taxes more in one year²⁹⁶. Moreover adopted as a law this reform became more difficult to be reversed. An attempt to make more transparent the conditions of privatization tenders of oblenerho (regional electricity distribution system) in order to attract investments was treated as another hostile attack at Hryhorii Surkis and Konstantin Grygoryshyn. Nevertheless, favoured purchase of the oblenerhos by foreign investors appeared to be different than Yushchenko expected; only two oblenerho were bought by American AES, the other four by Slovak company Vychodoslovenske Energeticke Zavody, which was known to have ties with Hryhorii Surkis²⁹⁷.

Oil market was more easily reformed as a major oligarch Oleksandr Volkov possessed an exclusive right to import oil at one price and re-sell it two-three times more expensive due to the tax exemption. This oligarch was soon removed from the market and the situation was leveled.

The coal industry appeared to be the most resistant to the reform as it was heavily subsidized by the state. Tymoshenko's intention to arrange open auctions for the sale of coal directly threatened the profits of not only the most important members of Donetsk clan, but also menaced the interests of influential representative of Dnipropetrovsk group Viktor Pinchuk. Therefore, Tymoshenko accused these people to be those who affected her removal from the position, so the reform of the coal industry was postponed.

The most controversial and the same time challenging reform was performed in the gas sphere. Tymoshenko as an initiator of this reform had both objective and subjective reasons to make it harsh. As defined by Balmaceda the objective reasons included the vital need to impose payment discipline in the Ukrainian energy market, to

296 Aslund, Anders. (2009). How Ukraine became a market economy and democracy. Peterson Institute for International Economy, p. 138.

297 Guzhva, I., Aksenov, Yu. (2004, October 11). *Deti gaza i stali*. *Ekspert*, No. 38 (438), http://expert.ru/expert/2004/38/38ex-fpg_28421/?n=87778, accessed March 12, 2012.

eliminate non-payments and existing obstacles in the system. The subjective reasons comprised from Tymoshenko's intention to seek vengeance upon Hryhorii Surkis and Ihor Bakai. As her opponents they had a direct connection to the dissolution of the IESU as well as to state's refusal to take over some of IESU's debts toward the Russian Ministry of Defence²⁹⁸. The basis of the gas sector reform touched upon the breaking of the monopoly status of Naftogaz Ukrainy in purchase, transport and distribution of gas. Naftogaz Ukrainy as mentioned before was a creation of Kuchma, who before the elections needed to get additional sources of income to organize electoral campaign accordingly. Therefore Naftogaz was not only a source of rents for Ihor Bakai, but also for the president himself²⁹⁹.

For years Gazprom and Naftogaz argued about the sum of debt Ukraine owed. Two sides named different numbers, which year by year were gradually growing. In 1999 when this question was again raised, Naftogaz insisted on 1 billion USD, while Gazprom used a figure of 2 billion USD. After Tymoshenko's visit to Moscow in January 2000 the debt was determined even more than 2 billion USD³⁰⁰. This announcement resulted from the unclear gas amounts that were supplied by Russia as well as blurred barter schemes payments. Tymoshenko used this situation to accuse Naftogaz of stealing gas, which threatened the image of the company and the future rents of the officials. Moreover this announcement caused negative public reaction, which tarnished company's reputation. Tymoshenko the same as Bakai used her ties with Gazprom, and even more importantly with ITERA (who by the time was a major supplier of gas to Ukraine) to counterbalance her confrontation with Bakai. Though for Gazprom it seemed beneficial to acknowledge the biggest debt of Ukraine, but one should remember that all non-transparent gas business was done with the knowledge of top management of Gazprom.

In 2000 Tymoshenko offered new plan of gas market restructuring, which foresaw the creation of a joint venture of ITERA and NAK Naftogaz Ukrainy. The plan allowed Russian companies to participate in regional gas distribution on competitive basis. Later that year Tymoshenko insisted on the division of the market, so ITERA would get industrial consumers, while Naftogaz Ukrainy would get the households. This resembled the reform introduced by Lazarenko earlier, as it meant that designated gas traders would hold

298 Balmaceda, M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarch's profits and Ukraine's missing energy policy, 1995-2006*. Routledge, p. 55.

299 Pirani, Simon. (June, 2007). Ukraine's Gas Sector. *The Oxford Institute for Energy Studies*, p. 23, <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG21-UkrainesGasSector-SimonPirani-2007.pdf>, accessed on October 14, 2015.

300 Balmaceda, M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarch's profits and Ukraine's missing energy policy, 1995-2006*. Routledge, p. 56.

deals with more profitable industrial customers, while the ones in less favor to the government would deal with households. Notably, while offering all these harsh schemes of reform, Tymoshenko maintained the power regardless firm opposition from Naftogaz as she neatly used the confrontation between Russian and Ukrainian oligarchs. The entrance of the Russian oligarchs into Ukrainian oil refining sector concluded with Russians owning four out of six oil refining factories. Even after Boiko resigned from the head of Naftogaz (March 2000), dominant energy groups continued to battle Tymoshenko's reforms, among others was Minister of Fuel and Energy Serhii Tulub³⁰¹. Not only the energy tycoons opposed the reforms, but also some parliamentarians, who directly or indirectly were connected to the business³⁰². Consequently, due to vast opposition in the parliament and presidential administration, also lack of judiciary unveiling of corruption cases the reforms were fated to be frozen and backed. In July 2000 President Kuchma signed a decree stipulating state's taking over the debts, i.e. if budget organizations owed money to energy companies, the state took the responsibility to compensate them through the debts these companies had vis-à-vis the state. Next blow to Tymoshenko was the appointment of Ihor Didenko³⁰³ as temporary head of NAK Naftogaz Ukrainy, who accused her in false allegations against Naftogaz. The conflict between Tymoshenko and Didenko resumed in Tymoshenko's dismissing Didenko from his position and Didenko's being reinstated due to the court decision in September 2000, which was a clear blow to Tymoshenko's authority.

Tymoshenko maintained her position till January 2001 and Yushchenko till April 2001. It is remarkable to note that Kuchma did not fire her before due to at least two reasons. First, Tymoshenko's party support was essential to conduct constitutional reform, therefore Kuchma managed to close his eyes to her harsh political reforms. Second, if being dismissed the position of vice prime minister would be a titbit for the representatives of either Kyiv or Donetsk clan, which was not favorable according to Kuchma's considerations³⁰⁴. Oleh Dubin, a representative of metallurgical lobby, who replaced Tymoshenko, promised to continue the path to reduce gas debt of Ukraine. But in reality

301 Serhii Tulub being appointed by Kuchma was originally meant to counterbalance Tymoshenko's radical actions. But on June 15, 2000 citing an 'aggressive atmosphere' in the Cabinet and the ignorance of Ministry's advices on energy reform Tulub resigned. See, *Nefteynok*. (June 25, 2002), accessed via ISI.

302 Van Zon, H. (2003). Reform of Ukraine's energy complex as precondition for eliminating its energy dependence. *Mining Technology*, April, Vol. 112, p. 19.

303 Balmaceda, M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarch's profits and Ukraine's missing energy policy, 1995-2006*. Routledge, p. 57.

304 Burkovskii, P. (2004, April 16). *Rozhdennaia evoluciei*. *Kompanion*, No. 14 (374), p. 47, <http://www.companion.ua/Articles/Content?Id=942>, accessed March 16, 2012.

new laws and decrees, which were adopted by the parliament, diluted the value of the reforms. After Yushchenko's dismissal Kuchma declared a moratorium on oblenhero privatization³⁰⁵. Moreover, with Prime Minister Kinakh in power, Kuchma continued to protect favored energy monopolies and the reforms were stalled.

Tymoshenko soon faced the power of her rivals as she was not only fired, but also her husband was arrested and accused of embezzlement. Later Russian prosecutor opened a case against Tymoshenko accusing her in bribes giving to Russian officials in the late 1996. In February 2001 Tymoshenko was jailed, but soon released. After all she changed her political orientation and headed anti-Kuchma platform.

One year of reforms resulted in greater transparency, state controlled import of gas from Turkmenistan. Tymoshenko amounted about 4 billion USD gained from energy reforms, which were equal to 13% of official GDP³⁰⁶. The main outcome of the reforms was the shift to cash payment methods and vast elimination of renting opportunities. The move away from barter schemes indicated promising and efficient developments in the energy sector. In electricity sector itself the level of cash payments increased from 15,8% in 1999 to 87% in 2001³⁰⁷. Foreign companies entered oil and electricity sector. Though the negative outcome meant that enterprises were obliged to pay real money, which led to the decrease of the energy import and consumption. But the same time new reforms provided Kuchma with greater power as 'balancer' to control the growing power of the oligarchs and to get an access to their financial rents.

But the reform in gas sector was not finished. In accordance with 2001 agreement between Naftogaz and Gazprom the debt was converted into Naftogaz bonds with a condition that if Naftogaz bankrupts or is liquidated, state would cover the debt fully. The debt ever since should have been paid in cash. Unclearness with debt remained as Gazprom did not accept Naftogaz bonds as guarantee for debt. Further the situation resulted in the last days of Kuchma's presidency, agreement reached in 2004 stipulated that Naftogaz is obliged to pay Gazprom in gas, namely 5 bcm of gas annually³⁰⁸.

305 Just two exceptions were made; Donbasenergo at the final stage was purchased by Rinat Akhmetov, and Lugansk oblenhero became a part of 'Lugansk energy alliance' belonged to Viktor Pinchuk. See, Guzhva, I., Aksenov, Yu. (2004, October 11). Deti gaza i stali. Ekspert, No. 38 (438), http://expert.ru/expert/2004/38/38ex-fpg_28421/?n=87778, accessed March 12, 2012.

306 4 billion USD included 2 billion USD of gas rents, 1.8 billion USD of electricity rents and 0.2 billion USD of oil rents.

307 World Bank. (September 2003). Ukraine: Challenges Facing the Gas Sector, pp. 10, 16, <http://siteresources.worldbank.org/INTECAREGTOPENENERGY/34004325-1112025344408/20772948/ukrainegassector.pdf>, accessed March 16, 2012.

308 Interview with Yuliya Tymoshenko. Eto monopolnaya vlast v rukah treh-chetyreh chelovek. (2005, August 10). Kommersant Ukraina, No. 18 (18), <http://kommersant.ua/doc/600038>, accessed March 16, 2012.

4.1.2. Radical energy reforms of Tymoshenko under president Yushchenko (2005)

The beginning of Yushchenko presidency together with Yuliya Tymoshenko as prime minister could be characterized as rather complicated period, where both sides declared high goals of reforms, but due to conflict of interest (further developed into political crisis), reached minor results. It is remarkable that building new pipeline from Turkmenistan bypassing Russia and Naftogaz investment activity abroad should have enabled Ukraine with new perspectives of diversification and shift of energy priorities. Minor part of the declarations, which was fated to come true included adoption of the energy strategy of Ukraine (2006), agreement on the extension of Odesa-Brody pipeline, and the increase of the energy prices.

Yushchenko according to the Concept for the Development of the Coal Industry, adopted in July 2005, continued Kuchma's legacy to corporatize state-owned mines and then privatize them through competitive bids. He also supported the idea of a vertically integrated oil company. Founded by Kuchma Energy Company in Ukraine consolidated electricity sector and further privatization did not take place.

First challenge to Tymoshenko-Yushchenko tandem was observed during the oil crisis in May 2005. They both showed different methods of tackling the problem. First of all, Tymoshenko accused Russian oil traders in 'cartel conspiracy' against the new government and 'sabotage of oil market operators'³⁰⁹. Not waiting for president's directions, she preferred to use manual control methods, which were exercised in removing import duties on oil products³¹⁰. Though it had rather devastating effect on the work of two Ukrainian refineries in Odesa and Kherson, which remained largely idle for the next 13 months, but in general this method handled the oil crisis situation. President Yushchenko vastly criticized Tymoshenko for non-market methods of tackling the problem and therefore on 18 of May issued a decree 'On measures for stabilization of the situation in oil and oil products market', according to which prohibited the administrative methods of oil price regulation in Ukraine (previously applied by Tymoshenko). Moreover, he apologized to Russian oil companies' management for Tymoshenko's hostile comments³¹¹. Different

309 Yeremenko, A. Ariya svetlyh nefteproduktov: 'Ne govornite mne proshchai'... (2005, May 21). Zerkalo Nedeli, No. 19, http://zn.ua/ARCHIVE/ariya_svetlyh_nefteproduktov_ne_govornite_mne_proschay-43451.html, accessed March 20, 2012.

310 To balance the situation by state-owned oil refineries appeared to be impossible as four out of six refineries belonged to foreign investors, mainly Russian.

311 President not only named Tymoshenko's government as 'the worst in Europe', but also highly recommended Tymoshenko to resign. See, Mostovaya, Yu. Igra so spich'kami vokrug benzina. (2005, May 21). Zerkalo Nedeli, No. 19, http://zn.ua/ARCHIVE/igra_so_spichkami_vokrug_benzina-43450.html, accessed March 20, 2012.

approaches of managing the economy of Ukraine, in case of Tymoshenko – regulatory, and in case of Yushchenko liberal market approaches, resulted in confusing situation of ‘family quarrel’. This marked a first serious misunderstanding and led to further escalating of the confrontation between Yushchenko and Tymoshenko.

Another point of misunderstanding between Tymoshenko and Yushchenko was the role of the gas intermediaries, among others RosUkrEnergo. Tymoshenko insisted not only on eliminating third party in the gas deals, but also on investigating the corruption schemes of RosUkrEnergo and Eural Trans Gas. Supported by Tymoshenko SBU chief Oleksandr Turchynov launched an investigation into the activities of Swiss-registered gas intermediary RosUkrEnergo. A company that on 50/50 stakes basis belonged to Gazprom and Austria’s Raiffeisen Investment AG according to Turchynov’s view ‘could not have been created without the approval of the most influential people in Russia and Ukraine’³¹². Severe infringements investigated in company’s dealings among others involved siphoning of funds into private hands. The predecessor of RosUkrEnergo Hungarian-registered firm Eural Trans Gas was also under suspicions of wrongdoing even before Tymoshenko. Offices of Naftogaz Ukrainy were searched for the possible links with RosUkrEnergo. But before Turchynov reported about the investigation’s results, Yushchenko warned him to ‘leave my boys in peace’ and ‘do not quarrel me with Putin’³¹³. As it appeared later unwillingness of Yushchenko to eliminate Firtash was due to the reason that Firtash was ‘Yushchenko’s close supporter’³¹⁴ and not surprisingly appeared to be a major beneficiary of 2006 Agreement with Russia. After Tymoshenko was dismissed by Yushchenko on September 8, 2005, soon after Turchynov resigned and investigation was frozen.

Tymoshenko’s dismissal and Yushchenko’s resistance toward energy corruption schemes investigation provided with a hint that new president succeeded in accommodation with old well-designed energy scheme. To support the argument one should mention that despite Tymoshenko’s statement that the next head of NAK Naftogaz would be appointed through an open competition, Yushchenko appointed Oleksii Ivchenko in March 2005³¹⁵. At first glance a member of ‘Our Ukraine’ Party, Ivchenko had a vast

312 Former US Ambassador to Ukraine Carlos Pascual in 2004 urged Ukraine to modify its Turkmen gas supply arrangement as Ukrainian-born reputed mobster Semion Mogilevich had ties to Eural Trans Gas, which threatened Ukraine’s energy security. See, SBU launches criminal investigation in regard to RosUkrEnergo. (2005, June 20). Kyivpost, http://www.kyivpost.com/news/business/bus_general/detail/22839/, accessed on March 20, 2012.

313 Mostovaya, Yu. O butonah, cvetochkah i yagodkah. (2006, January 21). Zerkalo Nedeli, No. 2, http://zn.ua/ARCHIVE/o_butonah_tsvetochkah_i_yagodkah-45715.html, accessed on March 20, 2012.

314 Korduban, Pavel. (December 8, 2010). WikiLeaks confirms role played by Firtash in Ukrainian politics. *Eurasia Daily Monitor*, Vol. 7, Issue 219, http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=37257&tx_ttnews%5BbackPid%5D=484&no_cache=1#UrhYn6VXtNE

315 Ivchenko was recommended to the president by Petro Poroshenko and Oleksandr Tretyakov.

experience in gas business, i.e., during 1994-1998 he was a representative of ITERA in Kyiv, which definitely indicated direct connection to Kuchma's energy schemes. Therefore, by appointing Ivchenko Yushchenko not only found 'his own man' in so lucrative sphere, but also prevented other political groups in gaining control over Naftogaz³¹⁶. Moreover, other Naftogaz workers such as Serhii Pereloma, close associate of Yurii Boyko, and Boyko's assistant Voronin remained in the system, that confirmed a trend of continuity with the old regime. And Boyko himself returned to power in August 2006 as a Minister of Fuel and Energy under Prime Minister Yanukovych.

Serhiy Kudelia differentiates two periods of Yushchenko's presidency. During first one Yushchenko 'could still influence the position of rents through his appointment powers', while in 2006 after the constitutional changes 'the president could decide on rent-distribution mainly with cooperation from the government'³¹⁷. A bright example of cooperation with government was Vanco's case. A tender on the exploration of oil and gas reserves in the Black Sea was won by American company Vanco Energy, however the license was awarded to another company Vanco Prykerchenska³¹⁸. Interestingly to mention that Vanco Prykerchenska appeared to be owned by Akhmetov, a close ally of Yanukovych. In the words of the President of Vanco Prykerchenska Jim Bown winning the tender was just the beginning and after Tymoshenko became the prime minister 'she started to block the project for no legal law or commercial reasons, but pure her own political selfish reasons'³¹⁹. Jim Bown though did not mention that Yushchenko by all means tried to keep Vanco in business, but due to Tymoshenko's harsh position the compromise was not found and government finally withdrew from the Production Sharing Agreement. Therefore, Yushchenko's attempt to cooperate with the companies associated with Akhmetov turned unsuccessful as Tymoshenko fiercely resisted it.

On September 15, 2005 now ex-head of SBU Turchynov on press conference stated that 'transnational criminal system' in energy sector, patroned by Kuchma was still flourishing in Ukraine. According to Turchynov non-Russian shares of RosUkrEnergo were controlled personally by former president Leonid Kuchma and former Prime Minister Viktor Yanukovych, while the managers of the shares were Pinchuk and

316 Kachanov, V. Tochki nad I. (2006, May 15). *Energobiznes*, No. 20 (451).

317 Kudelia, Serhiy. (2012). The sources of continuity and change of Ukraine's incomplete state. *Communist and Post-Communist Studies*, 45, p. 424.

318 Yeremenko, Alla. (May 17, 2008). Chernomorskii shelf na predyavitelia. *Zerkalo Nedeli*.

319 He is a President, Head of Representation of 'Vanco Prykerchenska Ltd'. The interview was conducted during a Round Table on 'The ways of efficient utilization of Ukrainian Gas Transportation System: reverse, transit and the creation of Eastern-European gas hub' held by the Expert Council on the development of the gas industry and natural gas market' in cooperation with Kyiv International Energy Club 'Q-Club' in Kyiv, on 3 June 2013.

Akhmetov³²⁰. Change in the leadership of Ukraine from Kuchma to Yushchenko did not change the structure and the system. According to Turchynov the actors of the energy schemes were of the closest environment of Kuchma, and many of them were still working in Naftogaz. Even more Turchynov named Tretyakov, now close advisor to Yushchenko, as the one in charge of the energy corruption schemes³²¹.

4.1.3. Energy Strategy of Ukraine to 2030 and further energy reforms (2006-2007)

Two years after Tymoshenko's dismissal, the position of prime minister was occupied by the old associates of the previous regime, namely Yuriy Yekhanurov³²² and not long ago political rival Viktor Yanukovych. The reprivatization started by Tymoshenko found its logical end in reselling Kryvorizhstal to Mittal Steel. Therefore important industrial factory once sold to Akhmetov and Pinchuk found its own owners for the price six times higher. After this great success Yekhanurov stopped further reprivatization, planned before by Tymoshenko, and the anxiety in the society decreased.

Meanwhile, reversal tendency of energy reforms was observed as well as more unfavorable development for Ukraine in energy business with Russia. January 2006 Agreement presented very tough conditions for Ukraine's energy market.

In March 2006 the Energy Strategy of Ukraine to 2030 was approved by the Cabinet of Ministers of Ukraine³²³. Energy Strategy was presented in line with the government program 'Towards the People'. The main objectives of the refined Strategy included the creation of favorable conditions for meeting energy supply; stable functioning and efficient development of the energy system; increase of domestic energy security; reduction of the impact on the environment; introduction of energy efficiency, energy-saving technologies to reduce the cost of energy production; integration of Ukraine's energy system into the European energy system.

The main document in energy sector though outlined comprehensive overview of the energy market in Ukraine, possessed certain shortcomings. The chapter on

320 Serafin, T. Ukrainian Billionaires May Be Behind Murky Gas Deal. (January 13, 2006). Forbes, http://www.forbes.com/2006/01/13/ukraine-gazprom-billionaires-cz_ts_0113autofacescan09.html, accessed on March 20, 2012.

321 Sensatsiini zayavy Turchynova: Shemy Kuchmy pochav patronuvaty Tretyakov. Fakt otruyennia Yushchenka dosi ne vstanovleno. (2005, September 15). Ukrains'ka Pravda, <http://www.pravda.com.ua/rus/articles/2005/09/15/4391976/>, accessed on March 20, 2012.

322 Yekhanurov 'was unassuming and usually described as technocrat, but he had carried out Ukraine's mass privatization from 1994 to 1997 without any stains on his reputation, which was political mastery'. See, Aslund, Anders. (2009). How Ukraine became a market economy and democracy. Peterson Institute for International Economy, p. 209.

323 Cabinet of Ministers of Ukraine. (March 15, 2006) *Energy Strategy of Ukraine for the Period until 2030*. No. 145-p, <http://mpe.kmu.gov.ua/fuel/control/uk/doccatalog/list?currDir=50358>, accessed December 19, 2011.

energy trends was written mainly based on political considerations, rather than economic analysis and statistical data. Therefore, the estimate of demand seemed to be inflated. General misconception of the Energy Strategy was its focus on energy supply than energy demand and energy efficiency, which to the point of view of International Energy Agency was more vital for Ukraine³²⁴. Moreover an important link between energy sector and other sectors of national economy is missing.

Taking into consideration Ukraine's dependence on energy imports, the key concern for the government was energy security. Three main sets of measures were foreseen to enhance energy security. First, reducing energy intensity appeared to be among the priorities as Ukraine's energy intensity was three times higher than the EU average. In order to develop Ukraine's potential in energy efficiency in December 2005 the National Agency on Efficient Energy Use was created, which should develop and introduce more consistent energy efficient policy. Second set of measures was dedicated to diversification, attempts of which took place in the past, but did not produce vivid results and dependence on Russia remained unchanged. Third, government planned to reduce dependence on import by increasing domestic energy production, namely of coal and nuclear, which should led to a decrease on import dependence from actual 55% to 12.4% in 2030³²⁵. Though this estimation was based on government presumption of 'rather stable prices for coal and nuclear fuel' rather than constantly raising prices for oil and gas in international market, it did not guarantee that domestic production of coal and nuclear would be cheaper due to the lack of investments and huge reliance on subsidies.

Another important aspect was the vital need of prices increase in the energy sector as most tariffs and prices did not cover not only long-term costs, but also current costs and were explicitly subsidized by the state. A foundation of the National Electricity Regulatory Commission in 1994 initially was aimed to regulate the prices for electricity sector, but further in 2005 its authority was widened and NERC ensured tariff regulations for heat generated from cogeneration, nuclear energy, renewable and non-conventional sources. Certain shortcoming limited effectiveness of NERC activity, among others approval and registration of NERC's decisions by the Ministry of Justice, dependence on the state budget. Therefore, greater administrative and budgetary independence would enable NERC to be unbiased in its tariffs regulation.

324 International Energy Agency. *Ukraine Energy Policy Review 2006*, p. 52.

325 Ibid, p. 54.

Energy Strategy was vastly criticized by the experts, who concluded that instead of a roadmap for the energy sector, the adoption of the Strategy was named as ‘inadequate in terms of resource opportunities and potential (energy) needs of the Ukrainian society; as both were not defined correctly and lacked systemic approach’³²⁶. As noted by Razumkov Centre all the governments that ruled after the adoption of the Strategy were little interested at the implementation of its provisions: ‘Over that period, no regular report of attainment/non-attainment of its goals and priorities has been made; none of the state programmes passed in pursuance of its objectives was implemented; the issue of the Strategy revision, elaboration and/or update in line with changes in the domestic and outside situation was not officially raised; both national and international documents were drawn up and signed (approved) without due regard to and coordination with the Strategy provisions’³²⁷.

In 2008 Energy Strategy of Ukraine was supplemented, though the content was not changed sufficiently. Meanwhile by providing a comprehensive overview of the energy sector, it remained vastly supply-oriented lacking thorough scrutiny of demand trends and mostly oriented on the decrease of import dependency and improvement of efficiency. A list of issues mentioned in the Strategy are unlikely to be practically implemented, and will remain very ambitious declarations. And finally, as determined by experts: ‘The Energy Strategy actually does not contain provisions on specific actions of the government and the responsible government authorities aimed at creating favorable conditions for attracting investments in the most problematic energy sectors; improvement of payment discipline; enhancement of tariff and pricing; promoting energy saving technologies, etc.’³²⁸.

UkrHazEnerho as established in February 2006 was responsible for buying all gas from RosUkrEnergo and reselling it to Naftogaz and other customers. While Naftogaz was selling gas to domestic customers, it voluntarily handed its business with industrial users to RosUkrEnergo. The introduction of UkrHazEnergo³²⁹ into energy market

326 Yermilov, S. Enerhetychna stratehiia Ukrainy na period do 2030 roku: problemni pytannia zmistu ta realizatsii. (2006, May 27). *Zerkalo Nedeli*, No. 20, http://dt.ua/ECONOMICS/energetichna_strategiya_ukrayini_na_period_do_2030_roku_problemni_pytannia_zmistu_ta_realizatsiyi-46810.html, accessed on March 29, 2012.

327 *Ukraine-Russia Relations in the Energy Sector: status, recent development trends, and prospects*. (2010). National Security and Defence Journal, Razumkov Centre, No. 6 (117), p. 4.

328 *Energy Sector Transparency Index – pilot research*, DiXi Group, a Project of the German Marshall Fund, p. 36, http://ua-energy.org/upload/files/ESTI_pilot_final.pdf, accessed May 9, 2012.

329 Peculiar detail, while UkrHazEnerho entered Ukrainian gas market and became a competitor to Naftogaz, Mr. Voronin, who served as vice-chair of the board ‘Naftogaz’, was simultaneously chairman of the board of ‘UkrHazEnerho’, which draws a question was it really a competition.

decreased the volumes supplied by Gaz Ukrainy, a subsidiary of Naftogaz. Hence, the revenues of Gaz Ukrainy from industrial customers in 2005 amounted 64%, but in 2006 this share decreased to just 40%³³⁰. Nevertheless some of the large industrial enterprises obtained a license for gas supplies directly from UkrHazEnerho or even Gazprom (i.e., SCM holding company, owned by Rinat Akhmetov).

In July 2006 new government of Viktor Yanukovych was appointed, which removed all restrictions on gas volumes supplied by UkrHazEnerho. The position of UkrHazEnerho was even more strengthened with the appointment of Yuriy Boyko as Minister of Fuel and Energy, who declared that UkrHazEnerho plans to access gas extraction in Russia and gain shares in Ukrainian oblgazes. Moreover, Naftogaz announced that UkrHazEnerho would participate in developing offshore gas field in the vicinity of Odesa³³¹. Although finally in November 2006 the Antimonopoly Committee of Ukraine initiated an investigation and recognized UkrHazEnerho as monopolist, it did not affect the company's activity. Indeed, as rightfully noted by the former director of the Ukrainian Service of Radio Free Europe/Radio Liberty Roman Kupchinsky UkrHazEnerho 'allowed Gazprom to get its first toehold in the Ukrainian gas distribution market, something that Gazprom CEO Miller and Putin had dreamed of doing for years'³³².

The agreement between RosUkrEnergo and UkrHazEnerho on gas supplies was signed on October 25, 2006. Being not an intergovernmental agreement, but an agreement between two business entities, it stipulated the supply of 55 billion cm of gas at the price of 130 USD only from Uzbekistan, Kazakhstan and Turkmenistan³³³. Hence, in 2007 Ukraine was no more obtaining Russian gas.

From 1 February, 2007 Yanukovych introduced energy reform. According to it 'clearing accounts' were created for the district heating companies. The money paid by customers for heating were transferred to the clearing accounts, and therefore district heating companies lost an ability to have access to these accounts. These measures were

330 Tsarenko, A. (2007). Overview of Gas Market in Ukraine. CASE Ukraine, WP 2/2007, Kyiv, p. 11.

331 On August 14, 2007 Naftogaz's board approved the foundation a joint venture with UkrHazEnerho. Later on August 21, the chairman of Naftogaz Yavheniy Bakulin announced that UkrHazEnerho was ready to invest 400-500 million USD in the Odesa and Bezimyany sea deposits. See, Gazprom, affiliates stretch strategic stronghold over Ukraine's energy sector. (2007, August 22). *KyivPost*, <http://www.kyivpost.com/news/nation/detail/27271/>, accessed on March 23, 2012.

332 Kupchinsky, R. The gas labyrinth of mirrors in Ukraine. (2007, August 23). *KyivPost*, http://www.kyivpost.com/news/opinion/op_ed/detail/27272/, accessed March 23, 2012.

333 Tsarenko, A. (2007). Overview of Gas Market in Ukraine. CASE Ukraine, WP 2/2007, Kyiv, p. 12.

initiated due to the lowest level of payment 68.2% in 2006 and great debt accumulated about 1.2 billion UAH³³⁴.

Second, according to the Decree of Cabinet of Ministers as of 16 January, 2007 the structure of the cash flows between wholesalers, distribution and supply companies, and final consumers has been changed. The new payment method stipulated final customers paying directly to Naftogaz and UkrHazEnerho, which in turn would pay to oblgazes for the delivery. This new mechanism provided the elimination of the different agreements, which final customer concluded, one with the wholesaler for the gas, the other for the gas distribution with oblgazes.

Moreover, Gaz Ukrainy, subsidiary of Naftogaz, initiated the review of agreements with oblgazes, which appeared to be debtors. In 2007 Gaz Ukrainy created a company Ukgazmerezha with the aim to take gas distribution networks from oblgazes-debtors to hand them in the newly created company's ownership. The list of the oblgazes, who committed embezzlements included Lviv, Ivano-Frankivsk, Chernivtsi, Volyn etc.

In July 2007 Viktor Yushchenko by declaring the need to eliminate the gas intermediary 'UkrHazEnerho' faced a furious comments from Minister of Fuel and Energy Yuriy Boyko and head of Naftogaz Yevhen Bakulin, who insisted that it would lead to Ukraine paying European prices for gas, and therefore would destroy the economy of Ukraine. The January Agreement already not only eliminated the right of Ukraine to negotiate prices directly with Turkmenistan, but also allowed an obscure middleman to make huge revenues out of this business. Russia's approval of RosUkrEnergo was mainly based on huge compensation Ukraine paid to RosUkrEnergo, about 13 billion cm of the Central gas it purchased at 135 USD per 1000 cm. Later this gas was sold to European countries at a price 250 USD³³⁵.

On October 15, 2007 the chairman of Gazprom's Board of Directors Dmitry Medvedev told the German ARD television channel: 'We will probably revise the scheme of our relations and give up any intermediary structures that are not clearly understandable, at least those structures whose existence is not quite clear to us and which were proposed by our partners in a certain historical context'. This statement was supported

334 Ibid, p. 13.

335 Kupchinsky, R. The gas labyrinth of mirrors in Ukraine. (2007, August 2007). KyivPost, http://www.kyivpost.com/news/opinion/op_ed/detail/27272/, accessed March 23, 2012.

by Tymoshenko, who claimed that intermediaries acted as ‘parasites, feeding on state-owned enterprises and fueling corruption at the highest echelons’³³⁶.

4.1.4. The effect of Tymoshenko-Yushchenko confrontation on energy sector (2007-2010)

The come back of Tymoshenko as a prime minister on December 18, 2007 meant the revival of the tough energy reforms. The state of the energy sector by the time was characterized by almost bankruptcy of Naftogaz due to extended role of UkrHazEnerho in Ukrainian market, small profits from the households (as the prices for domestic customers are regulated by the government) and rising tax burden (up to 30% in 2009). The main aim was defined as removal of RosUkrEnergo as ‘a super metastasis’ and the revision of the signed agreements with RosUkrEnergo, where the boosted prices were defined. Under Tymoshenko the share of UkrHazEnerho was decreased by the National Electricity Regulatory Commission of Ukraine (NCRE) from 30 billion cm to 5.04 billion cm³³⁷. But the same regulation did not allow Naftogaz to take over the ‘released’ market share.

Soon after Tymoshenko’s appointment and her declaration to eliminate the intermediary system, Russia raised a question of the gas debt. Instead of Tymoshenko, Ukrainian President Yushchenko flew to Moscow on 12 February, 2008 an agreement concerning the repayment of outstanding debts for gas was reached. A working group was founded to develop solution to gas cooperation between two countries. But the RosUkrEnergo was expected to continue its activity till the end of the year. As a result of Putin-Yushchenko negotiations, the consensus was reached that starting from 2009 intermediary would be eliminated, while the share of Gazprom will remain of 50% (for industrial customers even raised from 25% to 50%)³³⁸. This could be treated as a defeat for Yuliya Tymoshenko, who just started dismantling the existing system and was backed off by the President. Different approaches in tackling the gas problems worsened the possibility of introduction of energy reforms. For Yushchenko primary objective was to hold the stability of supplies and price, while Tymoshenko was aimed at dismantling the existing

336 Gazprom might eject middlemen. (2007, October 17). KyivPost, <http://www.kyivpost.com/news/nation/detail/27602/>, accessed on March 23, 2012.

337 Gorska, A. (January 22, 2008). Yulia Tymoshenko is striving to change the rules of the Ukrainian gas market. *EastWeek*, No. 3 (112), Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2008-01-23/yulia-tymoshenko-striving-to-change-rules-ukrainian-gas-market>, accessed March 23, 2012.

338 Gorska, A. (February 12, 2008). The Russian-Ukrainian gas agreement temporarily averts the crisis without solving the core problem. *EastWeek*, No. 6 (115), Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2008-02-13/russian-ukrainian-gas-agreement-temporarily-averts-crisis-without-sol>, accessed March 23, 2012.

system, which undoubtedly would affect the financial revenues of her political rivals, Party of Regions.

Yuliya Tymoshenko boycotting the February talks of Ukrainian and Russian presidents worked on the new agreement, which was finally signed on 13 March 2008. This agreement enabled to eliminate UkrHazEnerho and to transfer its shares to Naftogaz. The share for industrial customers changed, so as RosUkrEnergo lost 25 %, Naftogaz obtained 75 % of it for 2008. The main accomplishment of Tymoshenko was to get back the control over the gas market of Ukraine, which appeared to be not only successful reform in energy sector, but also viable political card in contrast to the defeat of Yushchenko's defending the old system.

On 2 October 2008 Prime Minister Yuliya Tymoshenko visited Vladimir Putin and signed an intergovernmental memorandum on gas cooperation. This document being not legally binding remained a very important symbol, reiterating Ukrainian political crisis and Russia's own way to make use of this situation. The memorandum declared that Ukraine would switch to direct gas supplies from Gazprom (namely from GazpromZbyr) eliminating intermediaries starting from 1 January 2009. Ukrainian inevitable transition to market prices would be conducted within three-year period. And both Naftogaz and Gazprom could jointly sell gas surpluses stored in Ukraine's underground depots to European customers. Though a memorandum did not have any direct economic outcomes, it was more important as Putin's political gesture of Tymoshenko's support. In the press conference Putin accused Yushchenko in selling weapons to Georgia, while praised Tymoshenko in staying neutral. Also taking into considerations that Tymoshenko went to Moscow not only without prior consulting with the president, but also declaring her rival attitude toward Yushchenko during ongoing political crisis in Ukraine, one could presume she would have got support in the forthcoming elections.

The problems of buying gas to fill underground storage facilities in order to meet gas demand in winter times appeared under threat. Though Russian government during February and April talks was positive about providing Ukraine with a loan to purchase gas, on 22 May 2009 in Astana Prime Minister Putin withdrew from preliminary promises. And insisted on joint EU-Russia loan to support Ukraine, which was not accepted by the EU. Consequently, Ukraine was left with about-to-be bankrupt Naftogaz and empty underground depots before the forthcoming January 2010 presidential elections. During telephone conversation with Putin Tymoshenko on 30 October accused Yushchenko of obstructing Ukraine's gas settlements with Russia. Tymoshenko fully used Ukraine's internal energy

dispute on international level to gain more political dividends in the forthcoming elections. Despite all the efforts Tymoshenko failed to get loans from the European financial institutions and therefore insisted on National Bank of Ukraine to redeem the state treasury bonds issued for Naftogaz.

4.2. Gas crises with Russia and disruption of bilateral relations

To analyze energy relations between two neighbors, Ukraine and Russia, one should fully take into consideration what kind of strategic documents Moscow adopted during that period. Among the most important ones one can name ‘Energy Strategy till 2020’ adopted in 2003 and further replaced with ‘Energy Strategy up to 2030’ (2009). At the same time in 2009 Russia introduced its own approach to international energy cooperation, undervaluing existing European Energy Charter. The logical sequence of the events continued by Russia’s attempt to create a Gas OPEC and removing in August 2009 signature of Russian Federation from the Energy Charter Treaty, which symbolized Russia’s detachment from 51 member countries of ECT³³⁹. Further Russia’s aggressive and decisive role in European affairs can be found in the Programme on efficient use of foreign policy (2010) as a tool to support long-term development of Russia. Hence, these important documents deserve to be scrutinized as they show one main tendency to bypass transit countries like Ukraine and to use energy tool in its own political interests.

4.2.1. Energy Strategy of Russia up to 2030 and other official documents: impact on energy relations with Ukraine

Energy Strategy of Russia up to 2030 developed a clear understanding of Russia as a pivotal country, which will strengthen its influence over the resource centers: ‘Russia will augment efforts for main regional gas producing centers (countries of the Central Asia, Iran) consolidation on the basis of its gas transport infrastructure. Russia will seek to establish the Eurasian integrated gas transportation system for provision of export and transit cross-flows between Europe and Asia’³⁴⁰.

Separately in the Energy Strategy Russia defined the role of Ukraine and its gas transportation system: ‘Russia’s participation in the operation of the gas transport

339 Stern, Jonathan. (February, 2007). Gas-OPEC: A Distraction from Important Issues of Russian Gas Supply to Europe, *Oxford Energy Comment*, <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/01/Feb2007-GasOPEC-JonathanStern.pdf>, accessed May 13, 2012; Fachinotti, M. (April 3, 2007). Will Russia Create a Gas Cartel? *Russian Analytical Digest*, No. 18, pp. 14-16; Wagbara, O.N. (2007). How Would the Gas Exporting Countries Forum Influence Gas Trade? *Energy Policy*, Issue 35, no. 2, pp. 1224-1237.

340 *Energy Strategy of Russia for the period up to 2030*, p.82-83, [http://www.energystrategy.ru/projects/docs/ES-2030_\(Eng\).pdf](http://www.energystrategy.ru/projects/docs/ES-2030_(Eng).pdf), accessed May 6, 2012.

system of Ukraine should be regarded as a strategic goal³⁴¹. As neatly pointed out Russia will not be fully-fledged bridge of gas flows from East to West without Ukrainian gas transport system. The attempts to apply this provision and for Russia to gain a control over Ukrainian GTS by means of merging Naftogaz and Gazprom were observed several times, and instead of joint consortium with the EU, Moscow always preferred to get overwhelming control over Ukrainian GTS, which usually ended in negotiations cul de sac.

Moreover, if to scrutinize Energy Strategies of both countries, one could clearly state that they reveal opposite goals and objectives. While Ukraine tries to increase transit of Russian hydrocarbons through its territory, Russia, on the contrary, relies on minimization of the dependence on its neighbors. Ukraine in its Strategy plans to increase oil refining, including Russian oil; while Russia, fully realizing exhaustion of its own oil fields till 2020, takes a responsibility to supply oil to Russian companies rather than Ukrainian refineries. Ukraine declares its wish to introduce energy-efficient technologies to decrease dependency on Russia; while Moscow insists on Ukraine staying on the list of the largest consumers of hydrocarbons. And the last but not the least, while Ukraine declares plans to extract energy resources abroad (e.g., Energy Strategy foreseen the extraction of 3.6 million tons of oil and 2.5 cm of gas in 2010³⁴²), it does not fully envisage how it will happen, especially taking into consideration Ukraine's poor experience in that field. Russian companies not only successfully developed its international projects, but also drew new plans on expanding international dialogue with producers and consumers (ignoring transit countries). The above-mentioned provisions of the Energy Strategy of Russia objectively pose risks for Ukraine's position as a transit country. Revised Energy Strategy of Russia demands adjustment of the main tasks of Ukraine's Energy Strategy at least due to its non-attainment.

Moscow acting in harmony with the provisions of its Energy Strategy adopts its own rules for energy cooperation: 'A Conceptual Approach to a New Legal Framework for International Energy Cooperation: Goals and Principles'³⁴³. This document was proposed as Russian view of new set of rules in energy sector and was presented to the EU, CIS, G8 and G20. In some way this document could be treated as a response to the

341 Op. cit., Gonchar, M., Duleba, A., Malynovskiy, O. *Ukraine and Slovakia in a post-crisis architecture of European energy security. Prospects for transport of hydrocarbons and bilateral cooperation*. Bratislava-Kyiv, 2011, p. 26

342 Cabinet of Ministers of Ukraine. (March 15, 2006) *Energy Strategy of Ukraine for the Period until 2030*. No. 145-p, <http://mpe.kmu.gov.ua/fuel/control/uk/doccatalog/list?currDir=50358>, accessed December 19, 2011.

343 President of Russia. (April 21, 2009). *Kontseptualnii podhod k novoi pravovoi baze mezhdunarodnogo sotrudnichestva v sfere energetiki (tseli i printsipy)*, <http://archive.kremlin.ru/text/docs/2009/04/215303.shtml>, accessed on March 29, 2012.

Energy Charter Treaty. Though the document reiterated some of the articles of the Charter, it differed in two major aspects. First, by guaranteeing ‘unhindered energy supply to international markets, including through transit systems’³⁴⁴, Moscow ignored the rights of the transit countries. To the contrary, it insisted on the responsibility of the transit countries for not fulfilling their transmission obligations and for the occurred losses to be born by the transit countries. Second major difference was about the operation of the energy market itself. Russia demanded predictability and guarantees of sales, investments and ‘non-discriminatory access to international energy markets’ (which contradicted EU’s intention to separate supplies and distribution in the EU market). This document could be treated as ‘a propaganda demonstration of Russia’s activity in its dialogue with the European Union’³⁴⁵. EU’s indirect response was fulfilling the provisions of the Energy Charter, which was reaffirmed by the adoption on 22 April 2009 of the third package of regulations liberalizing the energy market.

During Russia-EU summit in Khabarovsk on 21-22 May 2009, Russia again tried to impose its rules for energy cooperation on the European Union. Firm position of Moscow, which would not apply the rules of the Energy Charter Treaty, as it foresaw access to Russia’s transport infrastructure to all market participants, but would rather stick to previously declared rules played a contradictory role during the summit. An attempt to convince EU that Kyiv is not reliable partner and joint offer of EU and Russia to grant Ukraine with a loan to purchase gas would de facto mean the subordination of Ukraine’s gas pipeline system to Russia. EU’s reaction was to consider all the offers but only with the concurrence of the Energy Charter Treaty. Consequently, Russian President removed RF signature from the Energy Charter in August 2009.

Another step was to create a Gas OPEC, the Gas Exporting Countries Forum (GECF), which from Russian initiative transformed into intergovernmental organization and on December 23, 2008 in Moscow the charter was adopted. Most analysts were skeptical about the future of the GECF³⁴⁶, however gradual institutionalization of the Forum and transformation of the gas market casted doubts on their assumptions. A Forum

344 Paszyc, E. (April 29, 2009). Moscow’s response to the Energy Charter Treaty. *EastWeek*, No. 16 (166), Centre For Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2009-04-29/moscows-response-to-energy-charter-treaty>, accessed on March 25, 2012.

345 Ibid.

346 See, Stern, Jonathan. (February, 2007). Gas-OPEC: A Distraction from Important Issues of Russian Gas Supply to Europe, *Oxford Energy Comment*, <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/01/Feb2007-GasOPEC-JonathanStern.pdf>, accessed May 13, 2012; Fachinotti, M. (April 3, 2007). Will Russia Create a Gas Cartel? *Russian Analytical Digest*, No. 18, pp. 14-16; Wagbara, O.N. (2007). How Would the Gas Exporting Countries Forum Influence Gas Trade? *Energy Policy*, Issue 35, no. 2, pp. 1224-1237.

originally created to increase the level of coordination and strengthen the collaboration between gas producers and gas consumers³⁴⁷, including 11 members and 3 observers, intentionally left the transit countries apart from this development. GECF gradually evolved and deserved a greater attention as it started to resemble a gas cartel. Robert W. Ortung and Indra Overland suggested that GECF already obtains some features that can be disposed to form fully-fledged cartel. Among others, in contrast to oil market gas market possessed fewer key players that represented the majority of the gas market, e.g. Russia, Iran, and Qatar control 53 % of global gas reserves³⁴⁸. Second, the creation of cartel could be a preemptive attempt to hold the prices from downfall in 2015 as predicted by IEA. Third, gradual institutionalization of GECF and experience of many members of cooperation with OPEC gives ground to further development. And the last, but not the least Russia's engagement and will would be critical to organization's success. Russia's role in supporting the initiative of Gas OPEC confirmed its intention to strengthen positions in gas market by ignoring transit countries like Ukraine. If Russia continues to invest in GECF, it could get dividends of its raising energy power; the organization would act as a group and therefore could undoubtedly increase the gas prices.

All these events confirmed that Moscow pursued its own interests to reformat international energy sector and precisely determine exclusive zones of its influence. With its new Energy Strategy, Conceptual Approach to Energy Cooperation and GECF, Russia clearly declared its intention to oppose EU in energy sector by adopting own rules and goals. For Ukraine it meant greater pressure from Russia, who by pursuing own foreign policy goals, by all means tried to undermine Ukraine's rights as a transit country to act independently and to increase Ukraine's dependence on a big neighbor.

4.2.2. 2006 gas cut off and January Agreement

Despite the expectations that dismissal of radical Tymoshenko and introduction of Russian-friendly prime minister should bring more fruitful results in energy sector, the January 2006 Agreement proved the opposite. Gazprom proposed the threefold increase in gas prices in summer 2005. The negotiations started on December led to no solution, and were heated up by January 1, 2006 as all supplies were stopped. Three days of no gas supplies resulted in signing the agreement between Ukraine, Naftogaz and

347 See, www.gecforum.com.qa

348 BP. *Statistical Review of World Energy*. (June, 2010), p. 20.

Rosukrenergo³⁴⁹. Appreciating Yushchenko's statement: 'If Ukraine really wants to become economically independent, sooner or later we have to move to market relations in the energy sector', Gazprom offered a price 230 USD per 1000 cm (while in 2005 Ukraine paid just 50 USD)³⁵⁰.

Though defined by the head of Naftogaz Ivchenko as a 'victory of Ukrainian side' January agreement stipulated further important conditions. First of all, the price for gas would be 95 USD, but as clarified later only for the first half of 1996, and this price was a mixture of more cheaper Central Asian gas³⁵¹ and more expensive Russian one, which meant that Russia was actually selling Russian gas for the price of 230 USD (See, **Table. 3**). Second, the barter schemes would be abandoned and all the payments should be made in cash. Third, RosUkrEnergo³⁵² remained the only legal importer of gas to Ukraine and had a right to transit gas to Europe through Ukraine (re-export of gas was forbidden³⁵³). Therefore, Naftogaz and RosUkrEnergo set up a joint venture of UkrHazEnerho. Fifth, transit rates were determined as 1.6 USD per 1000 cm for 100 km and were to be constant during 5 years, which meant that first time transit rates were separated from the gas price³⁵⁴. As neatly evaluated by Edward Chow and Jonathan Elkind 'the agreement was as incomprehensible in its logic as it was unprofessional in its form'³⁵⁵

349 Tekst soglasheniia mezhdou 'Naftogazom' i 'Gazpromom'. (2005, January 5). *Ukrainska Pravda*, <http://www.pravda.com.ua/rus/articles/4b1aeb82d0ef/>, accessed March 22, 2012.

350 Yushchenko obeshchaet ne ustraivat' shokovoi terapii. (2005, December 17). *Ukrainska Pravda*, <http://www.pravda.com.ua/news/2005/12/17/3035079/>, accessed March 21, 2012.

351 Before signing January 2006 Agreement, Russian reached a deal with Turkmenistan and Uzbekistan, along which all the gas was now sold to Russia, and then Russian was reselling it to further customers. Ukraine was left face-to-face with gas monopolist with much more higher prices.

352 Later that year the truth about the owners of RosUkrEnergo and Eural Trans Gas was unveiled. Dmytro Firtash owned 45% of RosUkrEnergo and was directly connected with its predecessor Eural Trans Gas. See, Warner, T. Ukrainian billionaire that nobody knows. (2006, April 27). *Financial Times*.

353 This is important change as revenues from re-export Naftogaz used to cover losses from non-payment of households.

354 The break of the chain 'transit rates - gas price' meant transit would remain stable, while the gas price could change. Moreover, if along 2000 agreement transit rates were 1.093 USD and the gas price was 50 USD, Ukraine in exchange for gas transportation received about 29 billions cm of gas. Now with gas price of 95 USD and transit rate 1.6 USD, Ukraine would get only 22 billions cm of gas. The lost revenues would amount 7 billions cm of gas.

355 Chow, Edward; Elkind, Jonathan. (January 2009). Where East Meets West: European Gas and Ukrainian Reality. *The Washington Quarterly*, No. 32:1, p. 82.

Table 3. Sources of natural gas for Ukraine according to January 2006 Agreement

Country Source	Amount bcm/year	Acquired by	Price
Turkmenistan	41	Gazexport, Naftogaz	65.0
Uzbekistan	7	Gazexport	65.0
Kazakhstan	8	Gazexport	65.0
Russia	17	Gazexport	230.0
Total	73		103.4 ³⁵⁶

Source: Energy Information Administration (USA), www.eia.doe.gov

The Russian-Ukrainian gas issue that drew a wide response all around the world found its culmination in January Agreement. Demonstrative confidence of Ukrainian authorities poured oil on the flames. Rough declarations from both counterparts aggravated the possibility of mutually beneficial consensus. It became obvious that both parts will lose in this balancing game. For Ukraine those losses included monopolized sales of gas through RosUkrEnergo, monopolized export of Central Asian gas by Gazprom and one more artificial creation of Naftogaz and RosukrEnergo – UkrHazEnerho. Negotiations, which were conducted in high secrecy, reiterate a great lack of transparency. The President Yushchenko not only failed to organize fruitful negotiations, but also ‘is personally responsible... he openly showed incompetence and acted against the interests of the Ukrainian people’³⁵⁷ and agreed to put the interests of the separately designated RosUkrEnergo above the state interests. This agreement was fairly named by deputy minister of foreign affairs Oleksandr Chalyi as ‘Pearl Harbor for Ukrainian diplomatic service’³⁵⁸. Moreover, the absence of the exact formula of the gas price left Ukraine in annual struggle for the discount. As further determined by the Head of the Council of National Security and Defence Vitalii Hayduk the transfer to gas market prices is inevitable as ‘cheap gas means drug-addiction of the economic body’³⁵⁹. For Russia the undersupply

356 In the January agreement formula of the gas price is not mentioned. Therefore, the price 95 USD was offered basing on the considerations, further mentioned by Alla Yeremenko. If to count an average price of Central Asian gas and Russian one, the price should be 103 USD. Gazprom could give a discount, as all re-export for Naftogaz was forbidden; hence the revenues from the re-export of gas to European countries by RosUkrEnergo covered the difference (103 USD – 95 USD = 8 USD). See, Yeremenko, A. Shalom gazavat, slavianie! (2006, January 14). Zerkalo Nedeli, http://zn.ua/ARCHIVE/shalom_gazavat_slavyane-45646.html, accessed March 21, 2012.

357 New joint venture created to supply Ukraine with gas through 2010. (2006, February 3). KyivPost, http://www.kyivpost.com/news/business/bus_general/detail/23821/, accessed March 23, 2012.

358 Yeremenko, A. Shalom gazavat, slavianie! (2006, January 14). Zerkalo Nedeli, http://zn.ua/ARCHIVE/shalom_gazavat_slavyane-45646.html, accessed March 21, 2012.

359 Mostova, Yu. Vitalii Hayduk: ‘a vam chto, horosho zhivets’a?’ (2006, October 28). Zerkalo Nedeli, http://zn.ua/ARCHIVE/vitaliy_gayduk_a_vam_chno_horosho_zhivetsya-48254.html, accessed March 22, 2012.

of European countries shook the image of Russia as reliable supplier, though the guilt was shifted to Ukraine as unreliable transit country. Nevertheless, this, from the first point of view, disastrous situation was used by Russia to initiate new pipeline projects to bypass Ukraine, which decreased Russia's dependency on Ukraine, but increased EU's dependency on monopolist Russia.

Table 4. Changes in the gas structure after signing January 4, 2006 Agreement.

		2005	2006
Supply	Gas transit compensation	35% of gas balance was received from Gazprom as payment for transportation services	No compensation
	Central Asia gas	40% of gas balance was delivered from Central Asia at a price 65 USD	Central Asian gas is sold by RosUkrEnergo together with Russian gas at price 95 USD. Ukraine has no more direct supplies with Central Asian countries.
Wholesalers		Direct supplies	UkrHazEnerho, founded by Naftogaz and RosUkrEnergo
Re-export		Until 2005 Naftogaz re-exported gas to European countries, the profit from re-export covered the losses from non-payments of households.	Re-export is forbidden for Naftogaz, but allowed to RosUkrEnergo

Source: Tsarenko, A. (2007). Overview of Gas Market in Ukraine. CASE Ukraine, WP 2/2007, Kyiv, p. 8.

4.2.3. 2009 gas cut off

Second gas crisis in Russian-Ukrainian relations took place in January 2009 and differed radically from the previous one that took place in 2006, which lasted only for three days. The reasons to cut off Ukraine included Ukraine's gas debt, the absence of new agreement and more directly Gazprom's application of energy cut off as a political instrument. Suspended supplies were accompanied by effective mass media campaign to discredit Ukraine in the eyes of Europe. President Medvedev publicly claimed that there is no effective government to work with. The hidden intentions of the Gazprom included driving Naftogaz into bankruptcy, which would enable Russia to gain at least control over the gas distribution system.

The gas cut off lasted until 19 January Agreement was signed. Under these force majeure circumstances Russia demanded higher gas prices and lower transit fees. On 16-17 January Prime Minister Putin visited Germany ‘to pressure Ukraine to accept Russia’s terms in resolving the gas conflict’, but instead of the offer of international consortium, he stated that ‘the EU’s position in fact meant support for Ukraine’³⁶⁰. As a result both sides signed five documents, two of which were long-term agreements. The main goal of these agreements was to define more transparent rules of Ukrainian-Russian gas cooperation. In contrast to 2006 Agreement the formula of the gas price and transit tariffs had been settled for the next 10 years (in reality the price appeared to be 20% lower than the European one). Second important improvement was the elimination of the murky intermediary RosUkrEnergo³⁶¹, though GazpromSbyt guaranteed Gazprom’s presence in Ukrainian gas market. GazpromSbyt obtained the right to sell gas directly to Ukrainian industry; the amount for 2009 was defined as 10 billion cm (25% of all imports and 50% of industry needs). Third, the change of the price will not be felt immediately, as apart from 40 billion cm of gas planned to be purchased for 2009, Ukraine would buy technical gas at the price 153.9 USD, 11 billion cm of gas from RosUkrEnergo’s depots at a price 167 USD; in addition Ukraine still possessed about 16 billion cm of gas purchased in 2008 at the price 179.50 USD³⁶². It is important to mention that EU entered this conflict from Russian initiative. During 2009 Russian-Ukrainian gas crisis that affected the whole Europe, European Union served as a mediator. On 12 January 2009 Russia, Ukraine and the EU signed a protocol on establishing an international mission to monitor the gas transit system and gas underground storage facilities.

2009 gas cut off was used not only with the aim to undermine the role of Ukraine as a reliable transit country, it was also used for the support of the alternative pipeline projects. Baltic states being quite reluctant to support the Nord Stream were forced to revise their position. Vladimir Putin together with the head of the Nord Stream Gerhard Schröder appeared timely on television and pertinently advocated the advantages of the

360 Gorska, A., Kononczuk, W. (January 20, 2009). End of the Russian-Ukrainian gas conflict. *EastWeek*, No. 153, Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2009-01-21/end-russian-ukrainian-gas-conflict>, accessed March 23, 2012.

361 The role of RosUkrEnergo was unveiled by Putin on January 9, 2009 as in its ties with Ukrainian political leadership: ‘What they are fighting for today is not the gas price, but a chance to keep their middlemen, in order to use the dividends obtained for personal ends and personal enrichment, and in order to receive financial resources needed for their future political campaign’. *Washington Post* (January 9, 2009), as cited in Global Witness letter to the European Commission President regarding corruption and energy security. (May 27, 2009), <http://www.globalwitness.org/library/global-witness-letter-european-commission-president-regarding-corruption-and-energy-security>, accessed May 5, 2012.

362 Gorska, A., Kononczuk, W. (January 20, 2009). End of the Russian-Ukrainian gas conflict. *EastWeek*, No. 153, Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2009-01-21/end-russian-ukrainian-gas-conflict>, accessed March 23, 2012.

pipeline project. As Putin concluded, ‘I think that our European partners have now finally realized that this project is necessary and has to be carried out promptly’³⁶³, it finally changed the reluctance of Europeans to Nord Stream. Sweden and Finland approved the project and as a result the pipeline was constructed.

To conclude, I would like to cite the words of George Friedman, who in his book ‘The Next 100 Years. A Forecast for the 21st Century’ precisely defined the role of Russia in the coming years: ‘Russia, constructing pipelines to feed natural gas to Europe, takes care of Europe’s energy needs and its own economic problems, and puts Europe in a position of dependency on Russia. In an energy-hungry world, Russia’s energy exports are like heroin. It addicts countries once they start using it. Russia has already used its natural gas resources to force neighboring countries to bend to its will. That power reaches into the heart of Europe, where the Germans and the former Soviet satellites of Eastern Europe all depend on Russian natural gas. Add to this its other resources, and Russia can apply significant pressure on Europe’³⁶⁴.

4.3. EU as a mediator and first steps of energy cooperation

Relations with the European Union under Yushchenko’s presidency despite loud EU-inspired declarations faced certain stagnation. At the beginning of 2005 declarations on energy cooperation were made, which were followed by signing of framework documents on deeper energy integration with the EU. Due to political instability and growing confrontation between political leaders of the Orange Revolution, little was implemented in the following years. The position of the European Union was critical, but it lacked effective solutions for the energy crisis management. EU’s involvement in the opaque intermediary RosUkrEnergo also proved that vast financial flows passed through chain of corporate ownership in the jurisdiction of the EU.

Energy cooperation was intensified after signing Brussels Declaration in 2009 and further energy and environmental initiatives were introduced. An important development reached during Yushchenko’s tenure was finalizing the negotiations on Energy Community Accession. This symbolized a turning point for Ukraine’s energy sector reform. To sum up, if political situation was more stable, Yushchenko could have reached greater results in structural reform.

363 Op. cit., Smith Stegen, Karen. (2011). Deconstructing the ‘energy weapon’: Russia’s threat to Europe as case study. *Energy Policy*, No. 39, p. 6509.

364 Friedman, G. *The Next 100 Years. A Forecast for the 21st Century*. Doubleday, 2009, p. 105.

4.3.1. Normative basis of EU-Ukraine energy cooperation

The position of the EU Member states towards Ukraine can be characterized as contingent upon internal developments in Ukraine, therefore ‘if Ukraine were to introduce significant reforms, a change in sentiment towards Ukraine could be expected’³⁶⁵. The time to implement vast reforms appeared to be quite limited by 2006 parliamentary elections and internal political confrontation between Yushchenko and Tymoshenko. Thus, closer cooperation leading to membership prospects seemed quite unlikely and EU-Ukraine cooperation remained focused on technical issues.

Ukrainian aspirations for harmonization of the energy sector of Ukraine with the EU standards found the grounds, when official Law on an All-National Programme for Adaptation of Ukrainian Legislation to European Union Legislation was adopted in March 2004³⁶⁶. This was the time when key principles of energy sector government were introduced.

Table 5. Key principles of energy sector in Ukraine and the EU.

Current principle in Ukraine	EU principle
Monopoly	Competition
State management	State regulation
Central planning	Liberalization
State ownership	Opportunities for the private sector

Source: International Energy Agency. Ukraine Energy Policy Review 2006.

The adoption of this Law was a cornerstone of the long awaited reform process. It established the key principles for the development and implementation of the liberalization process.

Although previous period of cooperation between Ukraine and EU in energy sector, which mostly was fulfilled through TACIS programme and foresaw technical assistance, Yushchenko’s election symbolized introduction of new instruments, among others, the European Neighbourhood Policy. General Affairs and External Relations Council on 21 February 2005 stated that EU was committed to supporting Ukraine and

365 Gromadzki, G., Sushko, O., Vahl, Marius, Wolczuk, K., Wolczuk, R. (2005). *Will the Orange Revolution bear fruit? EU-Ukraine relations in 2005 and the beginning of 2006*. Stefan Batory Foundation: Warsaw, May, p. 32.

366 International Energy Agency. (2006). *Ukraine Energy Policy Review*. OECD/IEA, p. 56.

decided to enhance cooperation in energy sector. February 2005 appeared to be the time, when two parties agreed on EU-Ukraine neighborhood action plan to cooperate in the gas transit, reforming coal and gas industry, promoting energy efficiency, renewables and nuclear safety. Two parties agreed to hold annual ministerial meetings to review progress. Starting from 2006 annual progress reports were presented during EU-Ukraine summits. Each report traced not only main developments in reforming, but also the achievements of five working groups on nuclear safety, electricity and gas markets, security of energy supplies and the transit hydrocarbons, coal sector, energy efficiency and renewable energies.

EU energy commissioner Andris Piebalgs on 28 April 2005 declared that boosting energy cooperation is a priority between the EU and Ukraine³⁶⁷. Brussels Declaration signed on 23 March 2009 was a cornerstone of energy cooperation between the EU and Ukraine. It enabled the financing of modernization program for Ukraine's gas pipelines by international institutions in return for reforms in gas sector. Not surprisingly, Russia's reaction to this declaration was rather hostile and treated as a threat to Moscow's strategic interests. The parties of the declaration were the Prime Minister of Ukraine, the EU's commissioner for external relations and the neighborhood policy, the EU's energy commissioner and the representatives of the World Bank, EBDR and the European Investment Bank. Along the declaration a Technical Coordination Unit (TCU) within Naftogaz was to be founded, which would be in charge of developing business plans and overall coordination of the modernization of the gas pipelines. Moreover, Kyiv presented at the conference first initiatives of the reforms in the energy sector, namely replacement of pumping stations, expansion of the two largest depots, installation of gas meters in Ukraine, which would cost about 2.5 billion USD. Another Ukrainian offer was about the increase of the pipelines' capacity to 60 billion cm per year, which would demand around 5.5 billion USD investment. Undoubtedly, the conference in Brussels was a positive sign in EU-Ukraine energy cooperation. The implementation of these plans would make the energy market of Ukraine more transparent, and therefore Ukraine's chances to join the European Energy Community would increase immensely. Further it would create a basis for the revival of the idea of international gas consortium. In July 2009 the European Commission and the four international financial institutions (EIB, EBRD, the World Bank and the IMF) issued a 'Joint Statement of Intent regarding support to gas sector reform in Ukraine and the

367 European Commission. (28 April, 2005) The Commission and Ukraine strengthen energy cooperation in the framework of the EU-Ukraine Neighbourhood Action Plan. Brussels. IP/05/504, accessed on December 15, 2015, http://europa.eu/rapid/press-release_IP-05-504_en.htm

purchase of gas from Russia', which could trigger significant additional assistance for the energy sector reform to be undertaken³⁶⁸.

Notable that Russia's reaction to this declaration was a grotesque protest, when Russian delegation including Gazprom representatives and Ministry of Energy officials left the conference before the signature, which meant the failure of Russia's interests. Russian energy minister Sergei Shmatko urged that EU-Russia relations could be revised, and even Russia could find another buyers of gas. Official negative comments from Russian side resulted in cancelling April consultation between the prime ministers of Ukraine and Russia. This harsh reaction was positioned as the ignorance of the gas provider Russia in EU-Ukraine gas cooperation. Russian officials warned EU not to take control over Ukraine gas network and threatened to suspend purchases of EU-manufactured equipment for the gas sector (worth about 26 billion USD per year³⁶⁹). Regardless the level of harmonization in EU-Ukraine gas cooperation, Russia treated it as direct harm to its own interests. The absence of Russia as a party of these negotiations was perceived by Russia as EU's self-declared right to interfere in Russia's vital sphere of interests in CIS. Moreover, the expansion of Ukraine's transmission system would undervalue the viability of the Nord and South Stream pipeline projects. Ukraine being more transparent in energy sector as well as more reformed meant for Russia loss of control over Ukraine's vital energy sector. Therefore, further measures to hinder objectives of the declaration were to be expected from Russia's side.

In October 2009 Ukraine and European Commission concluded negotiations on the country's accession to the Energy Community Treaty. The same time a draft law on the principles of the electricity market was submitted to the Parliament and Ukraine continued to study the conditions under which it could join together with Moldova, the interconnected electricity networks of continental Europe (ENTSO-e, European Network of Transmission System Operators for Electricity). The end of the year also showed a promising tendency when Ukraine intensified cooperation with EU in all energy sectors. With EU assistance Kyiv started to work on a Master Plan for the Development of the Ukrainian coal-mining sector. The Cabinet of Ministers tasked National Agency of

368 *European Commission*. Implementation of the European Neighbourhood Policy in 2009. Progress Report Ukraine. (May 12, 2010). SEC (2010) 524, Brussels, p. 17.

369 Gorska, A. (March 24, 2009). Russia objects to EU-Ukrainian gas co-operation. *EastWeek*, No. 12 (162), Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2009-03-25/russia-objects-eu-ukrainian-gas-co-operation>, accessed March 23, 2012.

Gorska, A., Kononczuk, W. (January 20, 2009). End of the Russian-Ukrainian gas conflict. *EastWeek*, No. 153, Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2009-01-21/end-russian-ukrainian-gas-conflict>, accessed March 23, 2012.

Ukraine for the Efficient Use of Energy Resources to prepare proposals for the participation in the EU Intelligent Energy Europe Programme. In November 2009 the EU, Ukraine and other countries launched Eastern Europe Energy Efficiency and Environment Partnership (E5P) in Stockholm. This fund with initial focus on Ukraine was to be created with funding of about 90 million EUR. Moreover, active nuclear cooperation with EU continued in implementation of Comprehensive Programme on Nuclear Safety Improvements, according to which Euroatom loans enabled the modernization of nuclear reactors³⁷⁰.

Therefore, the end of Yushchenko's presidency proved a tendency of active cooperation with the EU in every energy sector. The reforms of energy sector were initialized and the work on the basic legislation started. Moreover, the majority of the disputable questions on Ukraine's accession to the EEC were solved and EU officials highlighted the clear perspective of Ukraine's membership in the nearest future.

4.3.2. EU's involvement in the gas crises between Ukraine and Russia

Two gas crises that took place in 2006 and 2009 acquired pan-European nature, as adversely affected most of the European countries. These crises though having trilateral format (including EU as consuming party, Ukraine as transit country and Russia as supplying party) failed to be prevented by either of the parties. Moreover, the resolution of the crises had an ad hoc nature and did not foresee a complex solution.

EU's role as a mediator in both gas conflicts should not be underestimated, as EU facilitated negotiations among the parties and acted instrumental on creating an international monitoring mission. Moreover, a Mechanism of an Early Warning between the European Commission and the Government of Russia was developed in order to notify in advance possible supply disruptions. Hence, the implementation of EU-Ukraine energy Memorandum of Understanding, in accordance to which one of the working groups was to address the issue of enhancing the security of energy supplies, and deeper cooperation on Ukraine's gas transit system modernization showed EU's engagement with the neighbors to address the issue. But these instrumental steps appeared to be not enough as more holistic approach to the problem was missing.

In an official report of the EU on the January 2009 gas supply disruption, EU stated the main problem was lacking an objective information, which was mentioned in the report of the Commission: 'At the EU level, a major difficulty in assessing how best to

370 *European Commission*. Implementation of the European Neighbourhood Policy in 2009. Progress Report Ukraine. (May 12, 2010). SEC (2010) 524, Brussels, p. 18.

respond to the crisis was the limited access to important technical information with respect to the gas system and gas flows at a national and an EU level. There was not enough reliable information about gas flows, how much gas was in the system, and demand patterns³⁷¹.

Another problem was that though the EU-Russia Early Warning Mechanism had warned about the possibility of the crisis in the late 2008 (a letter of Viktor Zubkov to President Barroso as of December 18, 2008), but it did not notify full cut off, which occurred in January and EU possessed no contingency plan how to react to force majeure cut off. Therefore, Early Warning Mechanism and crisis prevention mechanisms were defined as weak and not sufficient. Nevertheless, after 2009 gas cut off EU required all member states to adopt and regularly update preventive action plans. The other suggested measures listed in Annex II to the EU Regulation Concerning Measures to Safeguard Security of Gas Supply and Repealing Council Directive are diversification of gas suppliers and gas routes; investment into network infrastructure; increase of the share of renewable gas; increase in energy efficiency³⁷². As noted by Smith Stegen, ‘Diversification away from gas supplied directly from Russia, however, may not necessarily lead to diversification away from Russian, or partly Russian-owned, gas’³⁷³. Indeed, Russia is vastly investing abroad, and the countries, from which EU hopes to procure non-Russian gas, could possibly appear to be influenced by Russia.

Another perspective should also be duly scrutinized unlike EU’s definition of its position during the crisis as a ‘victim of a commercial dispute between two non-EU companies’³⁷⁴, EU’s indirect involvement in the gas dispute in practice facilitated the developing of the crisis. Raiffeisen Investment AG, a bank based in EU, namely in Austria, enabled the shareholders of gas mediator RosUkrEnergo to hold their shares in trust and refused to disclose their identities to the public. The same bank also acted as banker to RosUkrEnergo predecessor Eural Trans Gas. It is reasonable to judge that income of Ukrainian shareholders passed a chain of corporate ownership in the jurisdiction of EU.

371 Commission of the European Communities. Commission Staff Working Document. Accompanying document to the Proposal for a Regulation of the European Parliament and of the Council concerning Measures to Safeguard security of Gas Supply and Repealing Directive 2004/67/EC. *The January 2009 Gas Supply Disruption to the EU: an Assessment*. COM (2009) 363, p. 5.

372 European Union. (2010). Regulation No 994/210 of the European Parliament and the Council of 20 October 2010 Concerning Measures to Safeguard Security of Gas Supply and Repealing Council Directive 2004/67/EC, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:295:0001:0022:EN:PDF>, accessed on February 19, 2013.

373 Smith Stegen, Karen. (2011). Deconstructing the ‘energy weapon’: Russia’s threat to Europe as case study. *Energy Policy*, No. 39, p. 6511.

374 Commission of the European Communities. Commission Staff Working Document. Accompanying document to the Proposal for a Regulation of the European Parliament and of the Council concerning Measures to Safeguard security of Gas Supply and Repealing Directive 2004/67/EC. *The January 2009 Gas Supply Disruption to the EU: an Assessment*. COM (2009) 363, p. 6.

Unlike the hardships of the gas conflict, the above-mentioned EU-based companies preferred maintaining the opacity of the gas trade. Lacking disclosure of full information about the volumes of gas and incomes from it as well as the identities of the beneficiaries regardless where they have registered their offshore companies will make it impossible to make gas trade more transparent. EU member states learned the lessons and faced the need to require in an obligatory way all energy-related companies in their jurisdiction to disclose their ultimate beneficial ownership and all revenue payments. As energy companies usually seek access to Europe's banking system, EU is obliged to create international standards of transparency for the energy-supply countries and energy-transit countries. The laws and regulations against money laundering and prevention of offshore tax havens for criminal funds of the gas-related companies should be also adopted. Moreover, as pointed out by Global Witness: 'The European Union should build on its support of the Extractive Industries Transparency Initiative by requiring all resource-rich countries that receive EU development aid and technical assistance to implement the EITI [...] Transparency has little meaning without public debate'³⁷⁵.

As a conclusion, the EU appeared not ready to face Russian-Ukrainian energy disputes and its role as a mediator lacked information to thoroughly analyze situation. Hence, gas disputes proved inefficiency and incoherence of the applied tools to tackle the problem and demanded direct EU's engagement in transparency of all involved parties.

4.3.3. Odesa-Brody extension project

Under Kuchma Odesa-Brody pipeline regardless EU intentions to make it pro-diversification tool was officially announced to be used in reversal direction and Plock extension project was left without any attention. But with the pro-Western president Yushchenko in power EU again turned back to the idea of reviving of the Odesa-Brody project. In March 2005 European Commission signed a contract with consortium of companies including SWECO PIC of Finland, ILF GmbH of Germany, and Kantor of Greece. The companies were intended to prepare technical documentation of the planned extension to Plock, which would further lead to Gdansk³⁷⁶. The work of the SWECO PIC-ILF-Kantor consortium was finished by December 2006.

³⁷⁵ Global Witness letter to the European Commission President regarding corruption and energy security. (May 27, 2009), <http://www.globalwitness.org/library/global-witness-letter-european-commission-president-regarding-corruption-and-energy-security>, accessed May 5, 2012.

³⁷⁶ EC Delegation in Kiev. (March 11, 2005). The EU gives new momentum to the extension of the Odesa-Brody pipeline to Plock, Kiev.

Later that year framework agreement signed between European Investment Bank (EIB) and Ukraine offered a unique opportunity of this extension project to be included into the list of the Trans-European Network projects funded by EIB³⁷⁷. Moreover, the project was included into Baku Initiative (2004) and afterwards reiterated its importance within Black Sea Regional Cooperation strategy as an instrument of integration of energy and transport markets of the Black Sea littoral states into the EU³⁷⁸. Four energy summits in Krakow, Vilnius, Kyiv and Baku recognized the significance of involvement of Odesa-Brody oil pipeline in the system of Euro-Asian Oil Transportation Corridor. All these initiatives proved EU's firm will to use Odesa-Brody in averse direction as a diversification tool and in fact led to the inclusion of Ukraine into trans-European energy networks, but unfortunately did not bring any viable results toward the real extension of the pipe to Plock.

It is also important to mention that Yushchenko made several attempts to raise the importance and need of decrease in energy dependency from Russia. One of the platform that was vastly used by him was GUAM³⁷⁹. Most of the members of this organization alike Ukraine vastly relied on Russia as gas supplier. Though organization was reflecting the vision of that group of CIS countries, which did not bear Soviet nostalgia and preferred Trans-Atlantic cooperation, the instruments to implement major energy projects without participation of major powers were quite limited. Moreover, security concerns (frozen conflicts) within the territories of those countries were as well limiting political manoeuvring of GUAM. As a result energy cooperation, being of vital importance for all member states, did not lead to real projects during Yushchenko's presidency. As mentioned by Balmaceda regardless strong potential of this organization to develop non-Russian energy resources connecting Black Sea and Baltic Sea, Ukraine's rapprochement with Russia became the main reason these projects were not implemented³⁸⁰. Thus, Odesa-Brody pipeline's extension, though initially mentioned within the discussions of constructing

377 European Investment Bank. (June 15, 2005). EIB and Ukraine sign Framework Agreement, 2005-042-EN.

378 European Commission. (November 30, 2006). The EU and the countries of the Black Sea and Caspian Sea regions agree on a common energy strategy, Brussels, IP/06/1657.

379 GUAM is a regional organization that consists of Georgia, Ukraine, Azerbaijan and Moldova, and was established in 1997. Uzbekistan joined organization in 1999, but in 2005 withdrew from it. The name of the organization was changed for the Organization for Democratic and Economic Development in 2006. See, <http://guam-organization.org>

380 Balmaceda, M. (2008). *The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarch's profits and Ukraine's missing energy policy, 1995-2006*. Routledge, p. 30.

Azerbaijani-Georgian oil supply line through Ukraine to Europe, was later succumbed due to political pressure³⁸¹.

4.4. Causal links between domestic politics and international relations under Yushchenko

Domestic level under Yushchenko was depicted by high level of politicization. Conflict of interests between Viktor Yushchenko and Yuliya Tymoshenko reflected different approaches toward energy sector management, as seen during oil crisis in May 2005 and issues on elimination of RosUkrEnergo. But position of Yushchenko on appointing people connected to Kuchma and energy corruption proved his success in accommodation of previous rules of the old state machinery. Major strategic document ‘Energy Strategy of Ukraine to 2030’ was rather a political document focusing merely on energy security, while the need for actual reforms at domestic level was not prioritized. Moreover, the governments that frequently changed during Yushchenko’s presidency were not interested in actual adoption of this Strategy.

After 2006 Yushchenko’s authority faced alterations as political system turned into parliamentary-presidential, thus his impact on rent-distribution was seen only under the terms of close cooperation with the government. Even though Yushchenko in 2007 declared the need to eliminate UkrHazEnerho, one more lucrative intermediary, he faced furious resistance from his own entourage. Interestingly that as only Tymoshenko was raising the question of the elimination of RosUkrEnergo, Russia in response was immediately raising the question of gas debt.

Interestingly to mention Orange Revolution that brought Yushchenko to power turned to be a ‘revolution of millionaires against billionaires’³⁸², which kept Yushchenko in close tie with the oligarchs. The vicious cycle of corruption was not broken, and old oligarchs found new political patrons under parliamentary-presidential system. Unlike Kuchma, Yushchenko also failed to mediate corruption as his political standing was blurred with frequently changing prime ministers and enduring conflict of interest.

Therefore, for the period of Yushchenko’s tenure it is clear that political preference for him was to hold stability of gas prices and supplies, rather than introduction of reforms and diversification efforts. Tymoshenko by having high political ambitions attempted to get

381 Kuzio, Taras. (March 28, 2008). GUAM as a Regional and Security Organisation. *National Security and Foreign Policy of Azerbaijan Conference*, St. Michael’s College, University of Toronto, http://www.taraskuzio.net/conferences2_files/GUAM_Azerbaijan.pdf, accessed on May 28, 2016.

382 Anders Åslund. (2009). *How Ukraine became a market economy and democracy*. Washington, DC: Peterson Institute for International Economics, p.175.

in direct contact with Putin (October 2008 visit to Moscow) as she was attempting to get support as a future candidate for presidency. All this led to a duality at domestic level.

Russia's preferences in this situation lied in full transition to market gas prices for Ukraine and eventual elimination of intermediaries³⁸³ (leaving GazpromZbyt as sole exporter). Therefore, political crisis between Tymoshenko and Yushchenko was rightfully used by Putin, who by negotiating with two chief executives at the time, reached the intended results.

Major strategic document 'Energy Strategy of Russia to 2030' posted targets that were exactly the opposites for Ukraine. This indicated a sharp clash in approaches between two countries. Moreover, Moscow tried to set up the set of rules, an alternative to Energy Charter Treaty, by diminishing the role of the transit countries and putting the responsibility for energy supply losses on them, as well as a demand for predictability and guarantees of sales for gas exporters. Not surprisingly this political stand of Moscow led to the withdrawal from Energy Charter Treaty. As a result, Moscow's preferences focused on reaching market gas prices for Ukraine, securing the rights of gas producers and exporters, and as a result opposing Europe-led market liberalization in Ukraine.

Due to high political hostility between Russia and Ukraine, the win-set of Ukraine was quite small. Yushchenko was just trying to keep the gas supplies flowing as Europe was already revisiting the notion of stability of Ukraine as a transit country. Furthermore, in connection with Russia's promotion of the North Stream and South Stream pipeline projects, Ukraine faced the threat of its diminishing role as leading gas transit country in Europe, while remaining one of the biggest importers of Russian gas.

The nature of Ukraine-Russia relations in the oil and gas sector during Yushchenko's term could be characterized by: on the part of Ukraine – inconsistency, lack of a systemic approach, prevalence of short-term interests over long-term goals, spread of non-transparent schemes and inability of the state leadership to get rid of the influence of interest groups competing for economic benefits from Ukraine-Russia commercial contracts; on the part of Russia – aggressiveness, consistency, coordination of efforts of the state and business structures in order to impose on the Ukrainian counterpart a favorable for

383 As this issue also got a vast criticism all around the world. At the end Moscow was forced to agree on intermediaries' elimination. Though the presence of intermediaries in Ukrainian market for Russia meant an important source of 'cash flow'. As noted by energy expert Alla Yeremenko: 'What they are not allowed to steal in Russia, they steal in Ukraine by means of manipulating prices, barter, trade contracts, inclusion of traders. There are at least 10 legal ways how to make illegal money from gas trade'. Interview with Alla Yeremenko, Editor of the Department of Economic Security of the newspaper "Dzerkalo tyzhnia" (Mirror of the week), conducted in Kyiv (Ukraine), on 3 June 2013.

Russia format of relations. As a result, Ukraine's dependence on Russian hydrocarbons critically increased, objectives set by the Energy Strategy of Ukraine, including diversification, were not met in 2006-2010.

But as neatly underlined by James Sherr: 'Had the Orange team eliminated subsidy and multi-tier pricing in energy and other commodities after 2005, Ukraine would still, in all likelihood, be outside the EU in 2010. But the preconditions would have been set for the elimination of intermediaries from the internal gas market, a transformed investment climate, the attraction of external finance for new energy sources, industrial restructuring and the unchaining of private entrepreneurship'³⁸⁴. The negotiations during the gas crises indicated Russia's success in elimination of the terms that were not in line with its preferences (namely barter schemes, elimination of intermediaries in 2009) and implementation of its own preferences (introduction of stable for 5 years transit fees etc.).

Regardless numerous declarations of Yushchenko to boost cooperation with the EU in energy and even actual allocation of funds under Brussels Declaration, few real steps were made in that direction. The preferences of the European Union lied in modernization of Ukrainian GTS and reform of Ukraine's energy sector. These preferences caused a great resistance from Russian side, it was perceived as interference into Russia's sphere of interests. Moreover, negotiations between Ukraine and the EU on Energy Community Treaty accession were treated as last warning for Russia, as it would lead to energy market transformation, where Ukraine would appear on the other part of the equation. As a result two gas crises intended to show unreliability of Ukraine as a transit country. The European Union was dragged into a conflict between Russia and Ukraine as a mediator, but it lacked objective information. Early Warning Mechanism proved to be only an ad hoc solution, but no real strategy or understanding how to prevent alike gas disruptions was developed at the time. Moreover, registration of RosUkrEnergo in the jurisdiction of the EU pointed at the gaps in the EU's legislation and indicated strong transnational nature of corruption ties in energy sector.

As a result, pro-European vision of Yushchenko did not bring any viable results of European liberalization of the market as the basis of energy business remained the same as during Kuchma's tenure. The strong tendency of Ukraine's dependence on oil and gas deliveries from Russia preserved the state of Ukraine's energy-inefficient, energy-intensive and highly energy-consuming economy.

384 Sherr, James. (August 2010). *The Mortgaging of Ukraine's Independence. Briefing Paper*. (11) Chatham House, REP BP 2010/01.

CHAPTER 5

CONTINUITY IN ENERGY POLITICS UNDER YANUKOVYCH

Yanukovych's come back to power paved the beginning of the new era in energy sector. His first steps in political domain proved an attempt to accommodate Kuchma's legacy: so called 'third way' in foreign policy to balance cooperation with the EU and Russia, appointment of the Kuchma's closest associates as ministers, reintroduction of 1996 Constitution, according to which he gained much more power than any of the previous presidents in Ukraine before. All this created a basis for the establishment of a strong presidency with the elements of authoritarianism, which enabled him to alter the system by adopting laws and pursuing reforms in the way the president considered to be the most efficient.

Energy sector was listed at top priorities for the reform and not surprisingly appeared to be a tidbit for the interest groups. The chosen representatives of various interest groups created a very sharp competition at ministerial positions in order to pursue political and business benefits from energy reform. Successful ones (e.g., Dmytro Firtash in gas sector, Rinat Akhmetov in electricity sector etc.) obtained more dominant position in desired sector of energy business. The President himself did not neglect the possibility of entering the energy market, which led to the creation of his own clan headed by his son Oleksandr.

The process of liberalization of the energy market started with the assistance of IMF and the European Union. The IMF loans initiated the start-up of the energy reform, but they were suspended due to the lack of eagerness from government's side to increase energy tariffs. Further EU's active engagement in the revision of the Energy Strategy and sectoral assistance through Twinning Programs to reform the legislative base resulted in the adoption of great range of legislative acts.

The main aim of the Energy Strategy was reduction of gas dependency. Yanukovych's government is proceeding with this aim by means of diversification and development of alternative energy resources. First accomplishments could have already been observed in the decreased amount of gas imported from Russia, therefore under implementing alternative resource development scheme, Ukraine tends to reduce Russian gas dependency to minimum.

As a result though Ukraine accomplished the revision of the Energy Strategy, adopted new basic laws regulating energy market operation among others in gas sector and showed partial progress in harmonization of Ukraine's gas legislation according to the Energy Community's requirements, with Yanukovich fleeing the country energy reform remained unfinished and political system again facing a reset.

5.1. Accommodation of old regime approach and ostensible energy reforms

First steps of Yanukovich after the elections, when on 25th of February 2010 he was inaugurated as a new president of Ukraine, showed a quite clear tendency of consequent accommodation of Kuchma's legacy. First of all, it is needed to mention that Yanukovich the same as Kuchma was born near Donetsk and he is a natural easterner in style, management and language. As Dr. John Besemeres neatly pointed out about Yanukovich: 'He will be more at home in Moscow than Brussels or Washington, and probably feels more comfortable in his native Donetsk than in Kiev, where Western sentiment and the Ukrainian language have made inroads since Soviet times, when Russian was dominant'³⁸⁵.

Second, Yanukovich is 'often presented as being the creature of his patrons and handlers'³⁸⁶. Therefore the choice of his personnel and team was essential to predict the direction of future foreign policy. During first days in power Yanukovich renamed the presidential secretariat into the presidential administration, as it was known under Kuchma. More interesting was the appointment of the former Kuchma's secretary and his official first assistant Serhiy Lyovochkin. Lyovochkin was widely known as a middleman with links to some intermediary companies in the gas trade triangle of Russia-Ukraine-EU, including murky corruption schemes. Hence, the statement that he would prefer to return to the old arrangements, which Tymoshenko successfully dismantled, was one more sign of continuity of Kuchma's policy. This tendency was confirmed by the appointment of Azarov as a prime minister, therefore one more Soviet-style statist in his approach to financial management joined the team. Dmytro Firtash, a Gazprom-friendly figure in gas sector, was appointed as a Co-Chairman of the National Tripartite Social and Economic Council. In total thirteen out of twenty-nine ministers appeared to be from Eastern provinces (namely, Donetsk and

385 Besemeres, J. (2010, April). Ukraine: a sharp turn eastwards? *Inside Story*, <http://inside.org.au/ukraine-a-sharp-turn-eastwards/>, accessed September 25, 2012.

386 Besemeres, J. (2010, April). Ukraine: a sharp turn eastwards? *Inside Story*, <http://inside.org.au/ukraine-a-sharp-turn-eastwards/>, accessed September 25, 2012.

Luhansk³⁸⁷). To sum up, all those appointments proved a tendency of the sharp turn to the East, rather than ruling from the centre.

Third, in accordance with his promises on foreign policy to pledge neutrality and to seek the best possible relationships with Russia, the European Union and the United States, hence ‘to become a bridge between the East and the West’³⁸⁸, which he stated during his Inauguration speech, he resumed Kuchma’s multi-vector foreign policy³⁸⁹. The essence of the policy the same as during Kuchma’s time indicated the declarations about equally important partnerships with key actors, while in reality Russian counterpart was indeed welcomed with much greater favoritism (at last in the beginning of Yanukovych’s presidency). It should be clearly understood that unlike Kuchma’s time USA presence in the region was limited, while Russia has intensified its efforts to push Ukraine into integration projects. Thus not surprisingly, though officially his first foreign trip was scheduled to Brussels and second to Russia, in reality the head of the Russian Presidential Administration and Putin’s man in Medvedev’s entourage, Sergei Naryshkin visited Yanukovych half a month before Yanukovych’s visit to the EU. Following Kuchma’s multi-vector approach in foreign policy, Yanukovych gave close ties with Russia the preference in order to gain more concessions when trying to achieve some progress especially in energy sector³⁹⁰.

Tymoshenko’s arrest perceived by the West as politically motivated watered the ground for Association Agreement with the EU. Due to Yanukovych’s reluctance to get involved into the issue, the chances for Association agreement to be signed were diminished and after EU-Ukraine Summit in December 2011 it became obvious that this question is out of agenda until Tymoshenko’s release. Final warning was given by the State Secretary Hillary Clinton at the Munich Security Conference in February 2012 on human rights infringement, which was disregarded and the arrest of Lutsenko followed. Yanukovych’s reaction resembled the way of thinking of neo-Soviet administration, when he confessed that he never expected that Tymoshenko’s imprisonment would make such ‘noise from any European country or the USA’. As former US Ambassador to Ukraine Steven Pifer assessed

387 The phenomenon of *nepotism* flourished under Yanukovych’s presidency. It was foreseeing the promotion of close friends and business associates to top governmental positions.

388 Channel 5, February 25, 2010.

389 In fact multi-vector policy appeared to be bidirectional with main poles of Russia and the EU.

390 Solovyov, Vladimir. Konfeta po-kievski. *Kommersant Vlast*, №7 (861), February 22, 2010, <http://www.kommersant.ru/doc/1323691?isSearch=True>, accessed September 26, 2012.

that Yanukovich and the MFA believed Ukraine was as strategically important to the West as Russia and that human rights infringements could not be ignored³⁹¹.

Hence, Serhiy Kudelia compares Yanukovich's steps with Kuchma's by stating, 'Like Kuchma in the early 2000s, Yanukovich clearly prioritizes his political survival over any gains from enhanced access to the European market, as he made repeatedly clear by rejecting any compromise offers on Tymoshenko's case'³⁹². At this point, Yanukovich's government concentrated on rather economic cooperation, where free-trade deal, visa-free travel regime and energy sector reform appeared to be at the top of the agenda while ignoring the effect of domestic political implications.

Some kind of progress was observed in April 2013, when Yanukovich pardoned two of ex-ministers, namely Yuriy Lutsenko and Heorhiy Filipchuk, who faced 'selective prosecutions'. From cost and benefit analysis, Viktor Yanukovich being aware of tangible rewards from cooperation with the EU should have sided long ago EU demands on selective prosecution. As opposite situation with the absence of any progress would ultimately lead to negotiations deadlock. But in authoritarian states 'if a ruler views a contentious issue as indivisible and critical to his long-term political survival, he is likely to be rigid in setting his preferences and willing to accept the costs of noncompliance as long as they pose no immediate threat to his continued rule'³⁹³. Therefore, release of Yuriy Lutsenko, not Yuliya Tymoshenko, is a minor concession, which Yanukovich made not to lose the EU trump card and not to release his number one political opponent.

'Third way' in Ukraine's foreign policy was reiterated also by foreign minister Konstantyn Hryshchenko in his article on the objectives and tasks of Ukraine's foreign policy. He introduced the notion of a 'new Ukrainian pragmatism', which would not mean indifference or separation, but to the contrary would mean that Ukraine is open to all new forms of cooperation with the rest of the world in order to modernize its own country. Hillary Clinton defined the foreign policy of Viktor Yanukovich as 'strategic balancing'³⁹⁴. Strategic balancing included equal partnership with main actors, the EU and Russia. In the opinion of Hryshchenko the most realistic acts of cooperation with EU in the near future

391 Op. cit., Kuzio, Taras. (March 6, 2012). Ukraine Prepares for Elections with Putinization of Security Forces and Repression of Opposition. *Eurasia Daily Monitor*, Vol. 9, Issue 46.

392 Kudelia, Serhiy. When External Leverage Fails. The Case of Yuliya Tymoshenko's Trial. *Problems of Post-communism*, Vol. 60, No. 1, January-February 2013, p. 39.

393 Kudelia, Serhiy. When External Leverage Fails. The Case of Yuliya Tymoshenko's Trial. *Problems of Post-communism*, Vol. 60, No. 1, January-February 2013, p. 30.

394 Ibid, p. 34.

should include Association Agreement, visa waivers and Deep and Comprehensive Free Trade Agreement, while strengthening cooperation with Russia should not face decline³⁹⁵. To sum up, the concept of ‘healthy pragmatism’ during Kuchma’s presidency could be treated as resurrected within Hryshchenko’s pragmatism.

Forth, the beginning of Yanukovich presidency showed one more very common with Kuchma tendency in gas area. In Brussels Viktor Yanukovich also said about willingness of Ukraine to develop the internal gas market. ‘We believe that it is necessary to develop gas market, and we are ready to adopt a law on domestic gas market ... It also will strengthen the confidence in us in the East and in the West’³⁹⁶. In terms of gas relations with Russia Yanukovich insisted on the need of renegotiating gas contract with Russia, which could also mean reintroducing murky middleman. The one who was most probable candidate among Yanukovich’s backers was Dmytro Firtash.

One should not forget that International Consortium, which was created in 2002 as Ukraine-Russia-Germany initiative, turned into single pipeline project and then lost its efficiency, therefore the idea of the creation of EU-Russia-Ukraine consortium to run gas transit system, which was declared by Yanukovich at the high meeting in Brussels, lacked novelty and more importantly political will from the participants. Russian reaction was reiterated by the statement to see Ukraine as a part of Custom’s Union, and therefore only under these terms Russia would reduce the prices.

Fifth, Yanukovich’s coming to power introduced the rolling back tendency, as we observed the reintroduction of the president-parliamentary constitution of 1996. The president-parliamentary system, which blossomed during Kuchma’s presidency was suspended by Yushchenko’s reforms, but with Yanukovich in power found its revival. Under the restored Constitution of 1996 prime minister is clearly subordinated to the president, and therefore president dominates the executive power. Yanukovich in his turn ended the split in power between president and prime minister, which existed during Yushchenko times by revoking the 2004 amendments to the Constitution. Moreover, by rewriting the rules in a questionable way, President also achieved parliamentary majority, which strengthened his position as leader who accumulated wider political competences at his disposal.

395 Hryshchenko, Konstantyn. Poza mezhamy shakhivnytsi: prahmatychnyi poriadok denniy ukrainskoi zovnishnoi polityky. (July 17, 2010). *Dzerkalo tyzhnia*, No. 27, http://dt.ua/POLITICS/poza_mezhami_shahivnytsi_pragmatichniy_poryadok_denniy_ukrayinskoyi_zovnishnoyi_politiki-60748.html, accessed October 17, 2012.

396 President: For Ukraine European integration is key priority of foreign policy, and the strategy of systematic socio-economic reforms. Official website of the President of Ukraine, March 1, 2010, <http://president.gov.ua/en/news/16625.html>, accessed September 27, 2012.

I should mention that Yanukovich's roll back to the president-parliamentary system resembled the times of the Kuchma's presidency. Kuchma's prerogative of presidential primacy provided him an opportunity to distance himself politically from economic and social policies of the government; therefore he used his exclusive right to dismiss government members in order to avoid public disenchantment with the ineffective reforms. Therefore, prime ministers were used as shields against popular critique while at the same time demonstrating action and responsibility. Not surprisingly, Kuchma changed seven prime ministers during his presidency³⁹⁷. This tactics provided Kuchma with the ability to be re-elected and to hold the presidency for about ten years, while prime minister position was much more disadvantageous and squeezed between parliament and president.

Political groupings, which formed the government coalition, were subjugated to the President. Serhiy Tyhipko, whose party received the third highest support in the presidential elections, was nominated deputy prime minister and his Party 'Strong Ukraine' was dissolved by joining the Party of Regions in March 2012. Two other influential parties represented by Lytvyn Bloc and Communist Party consequently turned into satellites of the ruling Party. The most influential opposition leader Yulia Tymoshenko was erased from the competition list by being imprisoned. This balance of power turned to be quite durable and effective³⁹⁸.

Yanukovich guided by the rollback strategy, undoubtedly had so far been much more successful than Yushchenko in his attempts at building institute of strong presidency. With strong president-parliamentary system he possessed control over prime minister and the policy-making process in general. Yanukovich so far consolidated much greater power than Kuchma had ever had.

The same time one more observation should be revealed. President Yanukovich neatly managed to accommodate and show the continuity of key policies of Kuchma, while the same time introducing new elements. One of these elements was his attitude towards NATO. Concerning NATO President Yanukovich was definitely less enthusiastic than Kuchma was. He clearly envisaged continuation of existing cooperation without NATO membership. Moreover the existing structures of NATO-Ukraine cooperation were

397 Sedelius, Thomas, Berglund, Sten. (2012, May). Towards Presidential Rule in Ukraine: Hybrid Regime Dynamics Under Semi-presidentialism. *Baltic Journal of Law and Politics*, Vol. 5, No. 1, p. 32.

398 Matuszak, Slawomir. The Oligarchic Democracy. The influence of Business Groups on Ukrainian Politics. *OSW Studies*, No. 42, September 2012, p. 39, http://www.osw.waw.pl/sites/default/files/Prace_42_EN.pdf, accessed on November 1, 2012.

dissolved and servants dismissed³⁹⁹. Yanukovych stated: ‘Speaking of the question of NATO, today they are at the level reached by my predecessors. As for the future - it is the question of future’⁴⁰⁰. Moreover this position was further strengthened by Ukraine’s acquirement of non-block status. On June 8, 2012 Viktor Yanukovych approved new National Security Strategy ‘Ukraine in a Changing World’⁴⁰¹ and the Military Doctrine. In these documents abandoned aspirations to NATO membership were not replaced with any other pro-active agenda in the area of security. But among key threats to state security ‘Increasing competition over the access to natural resources and control of their delivery routes to the consumption markets, use of economic competitive advantages to achieve political goals’ was mentioned in Article 9⁴⁰².

Yanukovych while successfully accommodating Kuchma’s legacy at the same time altered it and introduced some new elements in decision-making and foreign policy priorities. Newly elected president confirmed one stance that he though being Russian-friendly candidate⁴⁰³ would not follow purely Russian-dominated line in foreign policy, but would rather try to sketch a multi-vector approach. His policy would be undoubtedly affected by his entourage, which also did not prefer to be overtaken by their Russian colleagues. But President Yanukovych’s position would rather follow the statement ‘to remain the independent leader of a sovereign nation, not a governor of a Russia province’⁴⁰⁴.

Nevertheless the biggest difference between Yanukovych and Kuchma was in the way that his foreign policy doctrine did not intend to bring Ukraine actually to the West, as Ukraine with its non-block status erased NATO membership from its priorities. As later concluded by James Sherr: ‘The greatest difference between policies of Yanukovych and Kuchma is that the former has jettisoned the counterweights that made partnership with

399 Six specialized structures coordinating NATO-Ukraine integration were dissolved, among them: Coordination Bureau for European and Euro-Atlantic Integration of the Cabinet of Ministers, the National Center for Euro-Atlantic Integration of the Presidential Administration, the Interagency Commission on Preparation for NATO Membership (led by the Ministry of Foreign Affairs), the National Institute for International Security Problems and the Institute for National Security Problems.

400 Viktor Yanukovych: Ukraine does not seek expansion of cooperation programs with NATO. Official website of the President of Ukraine, March 1, 2010, <http://president.gov.ua/en/news/16624.html>, accessed September 27, 2012.

401 President of Ukraine. National Security Strategy of Ukraine ‘Ukraine in a Changing World’. (June 8, 2012). Unofficial translation, <http://www.mfa.gov.ua/missionnato/en/publication/content/61647.htm>, accessed on November 1, 2012.

402 President of Ukraine. The Military Doctrine of Ukraine. (June 8, 2012). Unofficial translation, <http://www.mfa.gov.ua/missionnato/en/publication/content/61645.htm>, accessed on November 1, 2012.

403 Such moves as extended lease of the Black Sea Fleet till 2047, withdrawal of NATO membership pursuit, reversing Yushchenko’s position on 1933 Famine (Holodomor) by denouncing Holodomor as Ukrainian ‘genocide’ listed him as any other previous Ukrainian presidents as the most pro-Russian.

404 Shumylo-Tapiola, Olga. Ukraine and Russia: Ever Closer Neighbors? (June 8, 2011). Policy Outlook. (2) Washington, D.C.: Carnegie Endowment for International Peace.

Russia feasible and safe'⁴⁰⁵. Once an important counterweight in the hands of Kuchma, NATO transformed into forfeited foreign policy instrument under Yanukovich presidency. And as evaluated by Taras Kuzio by downgrading cooperation with NATO and greater economic and defense industry collaboration with Russia Yanukovich's multi-vectorism is defined as more pro-Russian in contrast to the pro-Western multi-vectorism pursued by Leonid Kuchma⁴⁰⁶.

5.1.1. The role of the interest groups in energy politics

Interest groups under the terms of restricted time limitations and little constraint from the state act in order to extract maximum resources for their personal benefit. According to Grzymala-Busse this creates the foundation for 'predation' strategy, when extracted resources are neither redistributed nor invested into the state⁴⁰⁷. Under this scenario predation would inevitably lead to the collapse of the state unless state utilizes these rent-seeking groups, which would provide state with temporary advantage. From the other perspective, the role of the interest groups was diminishing when it came to the absence of the natural resource base to buy off the key supporters⁴⁰⁸, that's why after two years of his presidency he replaced representatives of the interest groups with his personal loyalists, which ended with the creation of so called 'Yanukovich's family'.

Energy-related business groups vested their interests deeply into the energy sector and obtained majority control over stakes in state-owned energy-related enterprises by means of non-transparent mechanisms. These groups by neglecting state interest are pursuing their own private short-term interests, frequently freezing energy reforms or supporting them in case of direct benefit. As neatly defined by Patronym and Zhovkva: 'The key players in energy security in Ukraine, those who form or influence the formation of energy policy, include: the government, international partners, business, and consumers. None of these players defend the country's national interests, nor have any of them guaranteed its energy security'⁴⁰⁹.

So let me draw a line connecting governmental officials and parliamentarians with

405 Sherr, James. (August 2010). *The Mortgaging of Ukraine's Independence. Briefing Paper*. (12). Chatham House, REP BP 2010/01.

406 Kuzio, Taras. (March 15, 2012). Growing Ukrainian-Russian Arms Export Cooperation. *Eurasian Daily Monitor*, Vol. 9, Issue 92.

407 Grzymala-Busse, A. (2008). Beyond Clientism: incumbent state capture and state formation. *Comparative Political Studies*, 41, 4/5, p. 644.

408 Bueno de Mesquita, B., Smith, A. (June 6, 2011). How tyrants endure. *The New York Times*, http://www.nytimes.com/2011/06/10/opinion/10DeMesquita.html?_r=0

409 Patronym, I., Zhovkva, I. (2010). *Energy Security Challenges in Ukraine. A Snapshot – 2010. Policy Paper*. Kyiv: International Centre for Policy Studies, p.7.

energy-related groups. The top-down hierarchy confirmed the connection of high officials with energy business groups, which distorted the equation according to which state officials should represent national interests in energy sector, but in any case private ones.

Under new Constitution the President started immediately to form the government and secured a coalition with a working majority in parliament⁴¹⁰. The government was heavily dominated by the Party of Regions, while also influenced by the representatives of the interest groups close to the Party's leader.

Influential interest groups surrounding Yanukovich vastly shaped his approach to the formation of domestic energy policy. The unprecedented process, when executive was dominated by the representatives of one party and oligarchic groups connected to it, took place. The group of Sergiy Lyovochkin and Dmytro Firtash was closely associated with gas trade and chemical industry, and was most interested in reducing price of the gas, and therefore satisfying Russia's interests. As an attempt to counterbalance interest groups in the government Iryna Akimova, who was representing the interests of Akhmetov's group, was appointed as first deputy of chief of the presidential administration Sergiy Lyovochkin. Despite this, Lyovochkin had been successful at dominating the flow of information, which reached the president⁴¹¹.

Final distribution of power in Ukraine was dependent on the appointment of the government, which would indicate the interests of which group were going to prevail. Therefore, out of the seven deputy prime ministers three were associated with Yanukovich's group, three with Rinat Akhmetov's group, and one was independent⁴¹². A tendency to follow the legacy of Leonid Kuchma as an arbiter of the clans was clearly observed in the way how Yanukovich appointed the representatives of different clans to work in the same ministry or sector. Energy sector was a tidbit for two main clans of Firtash and Akhmetov. For example, Yuriy Boyko, who belonged to Dmytro Firtash group, was appointed as minister of energy, while Andriy Kluyev, a representative of Akhmetov's group, became first deputy of the Prime minister in charge of the energy policy (See, *Figure*

410 On 11 March 2010 new government was formed by a coalition of the Party of Regions, the Communist Party of Ukraine and the Lytvyn Bloc. After long period under Yushchenko, where Ukraine was paralyzed by the lack of coalition, Yanukovich neatly used legal trick, namely an amendment to the parliament's rules of procedure, which allowed individual deputies to enter the coalition. As a result coalition finally got 235 deputies and Yanukovich formed his cabinet. According to the revised Constitution Yanukovich gained control over all key ministries, but a composition of the cabinet, which was reached was an outcome of the rivalry among interest groups, and was far from being coherent.

411 Khara: Lyovochkin i kompaniia ogranichivayut Yanukovicha v informatsii. (October 31, 2011). Zerkalo Nedeli, http://news.zn.ua/POLITICS/hara_levochkin_i_kompaniya_ogranichivayut_yanukovicha_v_informatsii-90610.html, accessed November 1, 2012.

412 Sergiy Tigipko at that time did not belong to any group, but in the past was associated with Dnipropetrovsk clan. See, Bukkvoll, Tor. (2004). Private interests, Public Policy. Ukraine and the Common Economic Space Agreement. *Problems of Post-Communism*, Vol. 51, No. 5, September-October, p. 15.

3. Energy hierarchy and interest group representation under Yanukovych). Therefore, until the end of 2011 most members of the government were linked to Donetsk clan.

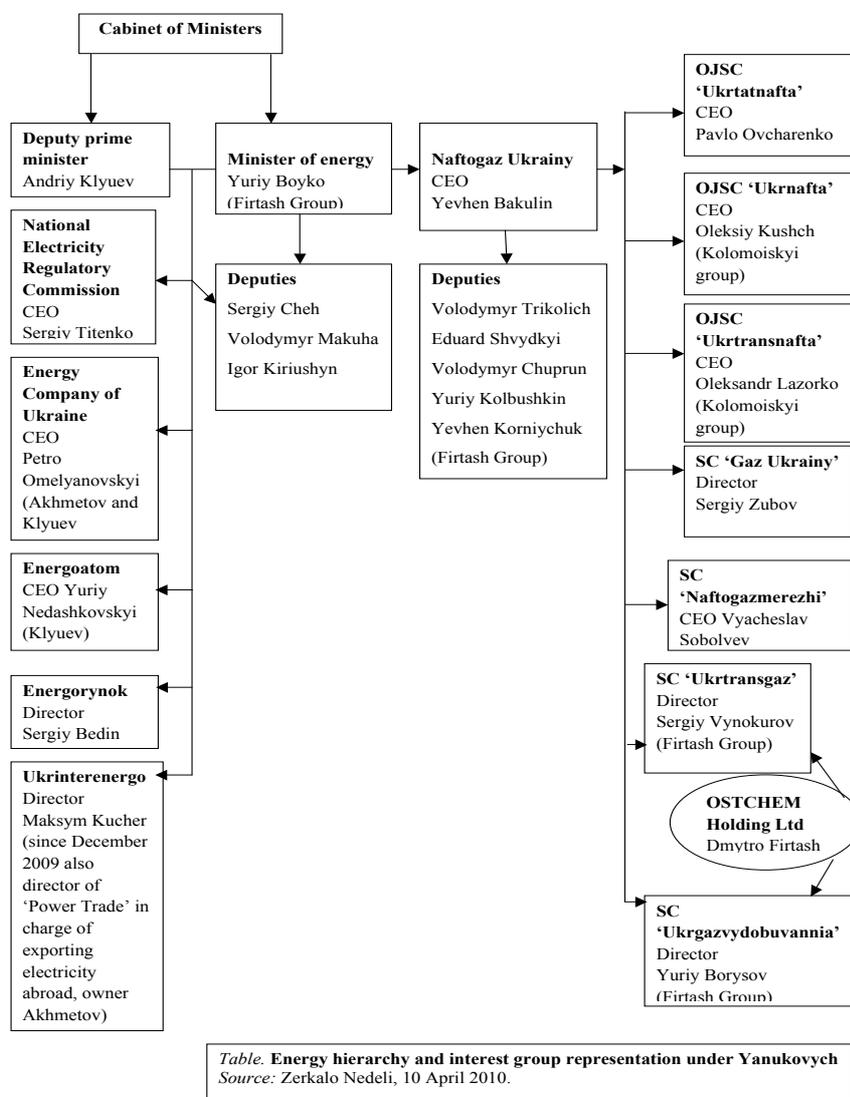


Figure 3. Energy hierarchy and interest groups represented under Yanukovych.
Source: Zerkalo Nedeli, 10 April 2010.

I would like to take a more precise look at the representation share of the interest groups, hence their impact on energy policy would become clearer. The group of Rinat Akhmetov tended to be one of the most influential entrepreneur groups in Ukraine responsible for metallurgical industry of Donetsk region. Being a member of the Party of Regions, his representatives in the cabinet could be listed as follows: Borys Kolesnikov, deputy Prime Minister in charge of preparations to the EURO 2012 football championships; Andriy Kluyev, who aspired to control the electricity sector of Ukraine and counterbalance

energy ministry Yuriy Boyko; and Iryna Akimova as a key representative at the Presidential Administration. As further mentioned Akhmetov obtained a great share in district electricity companies (oblenerho), as well as DTEK was granted a 49-year lease of two companies, which control a share of over 50% in the production of energy coal. Therefore, Akhmetov became an owner of integration production chain: from coal mining and enrichment to the production and distribution of electricity.

Another important figure in energy sector was Group of Dmytro Firtash⁴¹³. His co-ownership of RosUkrEnergo and engagement in corruption barter schemes in gas sector with Russian counterpart formed the basis of the energy history and politics of Ukraine till 2009. His inspiration to regain former power could find support in the appointment of his former business partner Yuriy Boyko. The other representative of Firtash group was close associate of Kuchma and is now heading the Presidential Administration. Third and the last representative of Firtash group was Valeriy Khoroshkovsky, who was a head of the Security Service between 2010 and 2011 and in February 2012 he was nominated first deputy prime minister⁴¹⁴. Apart from governmental positions Firtash associates also took key positions in gas business, including: Yevgeniy Bakulin, who became CEO of Naftogaz Ukrainy; Volodymyr Trikolich, deputy CEO, working on domestic distribution; and other deputies like Eduard Shvydkiy and Volodymyr Chuprun, Yuriy Kolbushkin and Yevgeniy Korniychuk. Former Firtash employees, who worked with him at OSTCHEM Holding Ltd had been appointed to head Naftogaz's subsidiaries: Yuriy Borysov at Ukrkazvydobuvannya, the E&P division, and Sergiy Vynokurov at Ukrtransgaz, the transit company (See, *Figure 3. Energy hierarchy and interest groups representation under Yanukovych*)⁴¹⁵.

Yanukovych, by introducing an opportunity for Firtash to strengthen his position, was mediating the balance of power of the other interest groups to reach his own political and business concessions. Firtash's group gained much more influence than it could have been expected if to compare with Party of Regions. The reason why Yanukovych offered great number of senior state positions to Firtash's associates was his attempt to distance

413 Group of Dmytro Firtash (GDF) is a private international group of companies whose interests and assets range from energy and chemicals through to energy infrastructure and real estate. Main entities of GDF include: Centragas (owned 50 % in RosUkrEnergo), Emfesz (energy trading and service provider), Zangas (pipeline construction company), OSTCHEM Holding AG (chemicals). See, www.groupdf.com/about.asp, accessed November 18, 2012.

414 In Kuzio's opinion the appointment of Khoroshkovsky 'cemented the gas lobby's control of the Ukrainian president's domestic and foreign policies'. Khoroshkovsky and Firtash are business partners, as they own Ukraine's most viewed television channel 'Inter'. Op.cit., Kuzio, Taras. (March 18, 2010). Gas Lobby Takes Control of Ukraine's Security Service. *Eurasia Daily Monitor*, Vol. 7, Issue 53.

415 Liuta, Ganna. Dengi liubiat tishinu ... kabinetov. (2010, April 10). *Zerkalo nedeli*, http://zn.ua/ECONOMICS/dengi_lyubiat_tishinu_kabinetov-59787.html, accessed October 6, 2012.

himself from Donetsk group, and especially from the influence of Rinat Akhmetov. The other reason was to counterbalance Firtash to grand coalition idea of BYuT and Party of Regions, which as a result would restrict Yanukovich's presidential power.

The business of Dmytro Firtash under Tymoshenko was on the verge of collapse, but with Yanukovich in power returned to flourish again. An example of this could be given his growing influence in gas sector via privatization of gas district companies. The Decree of October 3, 2012 provided Firtash not like in the past with only one company of RosUkrEnergo, but with 25 regional companies, which guaranteed his monopolistic control over the market and eliminated his competitor Naftogaz. Moreover, possessing such trumps in one hand as Contract between OSTCHEM and Gazprom Germany, network of regional gas enterprises in Ukraine and immense influence in the government, Firtash seemed to turn in again a number one gas trader in Ukraine⁴¹⁶ (See, *Figure 4*. Map. Who owns regional gas enterprises in Ukraine?). Among other assets newly obtained by Firtash one can mention Kharkiv Heat Electropower Station, which was one of the oldest and biggest in Ukraine⁴¹⁷. Though Kharkiv HES was supposed to be restructured from utilizing gas to utilizing coal, as a measure to decrease gas dependence, after being purchased by Firtash Group this HES appeared to continue consuming gas.

416 Ibid.

417 Kharkiv HES was bought for 339.9 million UAH by JSC 'Ukrigaz'. The connection of JSC 'Ukrigaz' with Emfesz Kft, which belongs to Dmytro Firtash, was unveiled by one of the journalist investigation by Ukrainska Pravda. For more see, Shcherbyna, Serhii. Teplo dlia Firtasha. (November 7, 2012). *Ekonomichna Pravda*, <http://www.epravda.com.ua/publications/2012/11/7/342983/>, accessed on November 9, 2012.

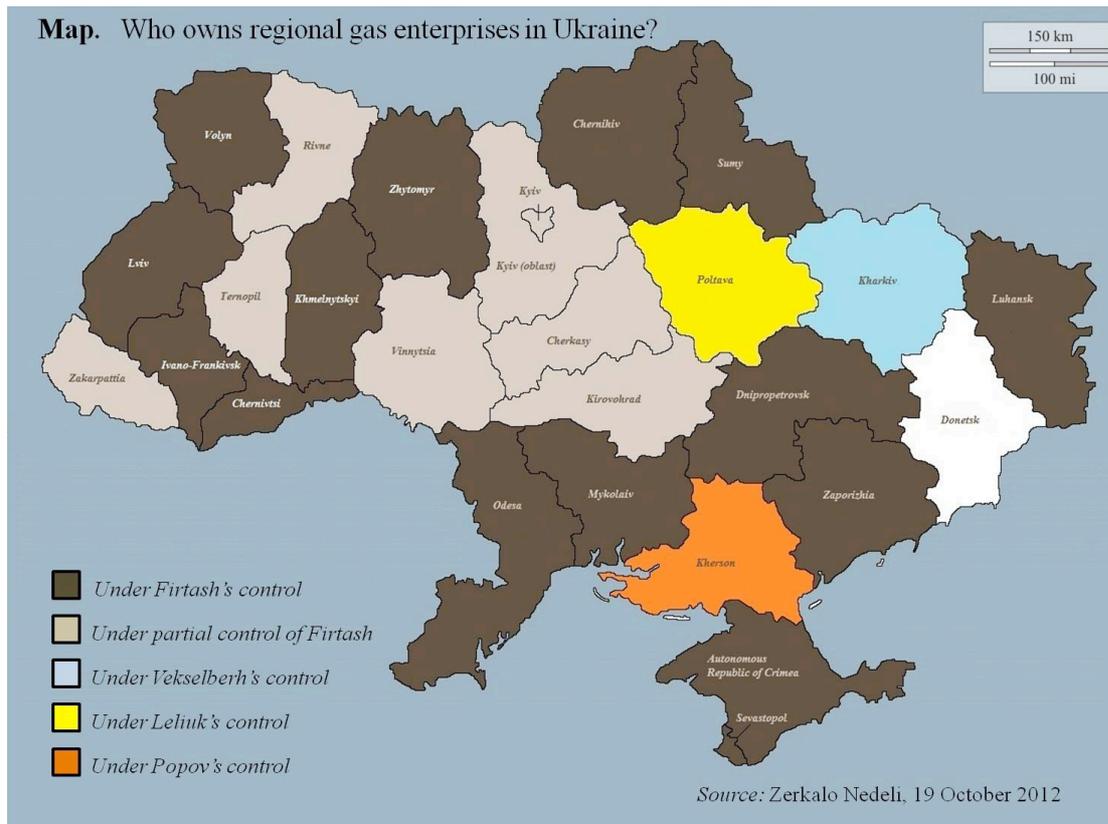


Figure 4. Map. Who owns regional gas enterprises in Ukraine?

Source: Zerkalo Nedeli, 19 October 2012.

Moreover, it should be mentioned that Firtash got a positive result from Stockholm Arbitration Court along the case RosUkrEnergo against Naftogaz. According to which Naftogaz was to return the disputed 11 billion cm of gas to Firtash's RosUkrEnergo as well as another 1.1 billion cm of gas as a compensation for lost profits. Moreover, RosUkrEnergo asked to be paid cash equivalent of 12.1 billion cm of gas and according to Firtash's calculations the sum to be paid would amount about 5.4 billion USD⁴¹⁸. It is interesting to mention that position of Naftogaz in this gas case reversed its legal position by 180 degrees after Yanukovich in power and Naftogaz suddenly admitted that this gas 'belongs to and has always belonged to RUE'⁴¹⁹.

A relative innovation, which was represented during Yanukovich presidency was the formation and development of Yanukovich's own interest group. After the Constitution

418 Matuszak, Slawomir. The Oligarchic Democracy. The influence of Business Groups on Ukrainian Politics. *OSW Studies*, No. 42, September 2012, p. 51, http://www.osw.waw.pl/sites/default/files/Prace_42_EN.pdf, accessed on November 1, 2012.

419 This farce as concluded by Spiegel could mean the following: 'Viktor Yanukovich, the president of Ukraine, served the commercial interests of an oligarch with whom he has close ties – at the expense of his own country', See, Neef, Christian. A Stockholm Conspiracy. The Underbelly of Ukrainian Gas Dealings. (December 30, 2010). *Spiegel*, <http://www.spiegel.de/international/europe/a-stockholm-conspiracy-the-underbelly-of-ukrainian-gas-dealings-a-736745-3.html>, accessed November 2, 2012.

was amended and President gained extensive competences, and not surprisingly he tried to shape his own interest group under the title ‘Family’ (Simia). This interest group was based on the business of people whom he trusted the most – his sons and little-known but loyal to him politicians⁴²⁰.

The capital, which Viktor Yanukovich gained before his presidency though was not that enormous still included stakes in fuel and property development companies, the majority of which was based in Donetsk and was controlled by MP Anton Pryhodskii and metallurgy magnate Rinat Akhmetov. Moreover, the capital of Yanukovich’s older son was estimated at 100 million USD, and his corporation ‘MAKO’ has share in construction business and coal energy sector⁴²¹. Another company which was the constituent part of the ‘MAKO’ corporation OJSC ‘Interregional Gas Company’ already obtained licenses to develop oil and gas fields in Luhansk and Kharkiv regions. In coal sector, Oleksandr Yanukovich successfully became an owner of five biggest coal-cleaning factories in Donetsk oblast after Viktor Yanukovich approved amendments to the Law by revoking obligatory 50% state share for any tentative owner of coal factories⁴²².

These developments coincided with Family clan’s decision to enter also oil refinery industrial sector by the means of purchase of Lysychansk Oil Refinery Plant, which was announced by TNK-BP Group⁴²³. The information about potential buyer listed the company ‘Gas Ukraine-2009’, whose director was Stanislav Levchenko, while the real chief of the company was Sergiy Kurchenko⁴²⁴, Kharkiv businessman. Sergiy Kurchenko was known as being close associate of the older son of Viktor Yanukovich – Oleksandr⁴²⁵. In the official

420 An attempt to form his own interest group was made by President Kuchma, when his son-in-law Pinchuk was favored in an extensive way (with the minor difference that Pinchuk even before marrying Kuchma’s daughter Olena Franchuk had already become quite powerful businessman). Yushchenko also made an attempt to build his clan with his brother Petro, but this attempt ended at Petro Yushchenko’s very limited influence in business.

421 There is also information confirming that business career of his sons started long before his presidency, when in 2006 Oleksandr was the deputy general of Donbassnefteprodukt, while Viktor junior was the deputy general director of BK-Engineering, responsible for property construction in Donetsk. See, Garmash, Sergei. Tainy semejnogo biznesa Yanukovicha. (March 21, 2007). Ostrov, <http://www.ostro.org/articles/article-1030/>, accessed on November 1, 2012.

422 Kapliuk, Ekaterina. Rassledovanie: obogashchenie Aleksandra Yanukovicha. (October 23, 2012). *Forbes.ua*, <http://forbes.ua/business/1340389-rassledovanie-obogashchenie-aleksandra-yanukovicha>, accessed October 30, 2012.

423 Officially this plant suspended its activity in March 2012 and total loses reached 68 million USD in 2010. In October 2012 TNK-BP was bought by Rosneft, which is controlled by Russian government.

424 According to the Ukrainian secret service Kurchenko is viewed as ‘chief financial officer’ of Family clan. If one wanted to pay off Yanukovich Kurchenko was acting as a broker. Former executive of Lidergaz described Kurchenko as master of opaque commodity deals. By charging VAT on his deals, he never paid it to the government, this created notorious violations of the tax system.

425 Pogorilov, Stanislav. Chuzhoi kush. Firtash mozhet proigrat Lisichanskiy zavod novoj FPG. (October 22, 2012). LIGABiznesInform, <http://biz.liga.net/all/tek/stati/2335673-chuzhoy-kush-firtash-mozhet-proigrat-lisichanskiy-zavod-novoy-fpg.htm#>, accessed October 22, 2012; Kuznetsov, Andrii. (October 25, 2012). Komu distanetsia Lysychanskiy naftererobnyi zavod? Radio Svoboda, <http://www.radiosvoboda.org/content/article/24750218.html#>, accessed October 26, 2012.

website it was mentioned that the future priority of the company was the processing of 50 000 ton of crude oil on the basis of Lysychansk Oil Refinery Plant⁴²⁶. Deputy director of Scientific-Technical Center ‘Psychea’ Hennadii Riabtsev was convinced that factory had already been sold to ‘Gas Ukraine-2009’, which was associated with Oleksandr Yanukovych⁴²⁷.

An interesting development took place after parliamentary elections, when new government got no members linked to oligarchs⁴²⁸. People loyal to Yanukovych because of Yanukovych’s increased influence in state administration have got promotion and president got more influence in key law enforcement agencies⁴²⁹. Especially the appointment of the second government after 2012 Parliamentary elections proved the tendency of ‘Ukraine’s evolution from an oligarchy to a cronyist state’, where even greater amount of Yanukovych’s relatives and loyal associates had been promoted⁴³⁰. Serhii Arbuzov, who was reputed as a Yanukovych’s family accountant, was appointed as the president of the National Bank of Ukraine in late 2010, though in 2013 replaced by Ihor Sorkin, who closely cooperated with him⁴³¹. The changes in the appointment of a key figures in energy sector did take place and shifted the power from the gas lobby, which appeared to be unable to secure many parliamentary seats during 2012 elections. Leonid Kozhara replaced foreign minister Konstantyn Gryshchenko, who was aligned with oligarch Rinat Akhmetov’s group. This move was interpreted as an attempt to eliminate the power of the ‘pro-Russian gas lobby’, which was accused in derailing Ukraine’s European integration⁴³².

Even after 2012 changes in governmental positions, Akhmetov continues to control transportation, economy, social and regional policy through the Minister of Economic

426 See, Gas Ukraine-2009, <http://www.gaz-ukraine.com.ua/directions>.

427 Kuznetsov, Andrii. (October 25, 2012). Komu distanetsia Lysychanskyi naftererobnyi zavod? Radio Svoboda, <http://www.radiosvoboda.org/content/article/24750218.html#>, accessed October 26, 2012.

428 Jarabik, Balazs and Kobzova, Jana. (March 14, 2013). The EU’s relationship with Ukraine: fling or partnership? *European Council on Foreign Relations*, http://ecfr.eu/content/entry/commentary_the_eus_relationship_with_ukraine_fling_or_partnership, accessed on April 17, 2013.

429 About Yanukovych’s usage of law enforcement agencies as a tool to enter the business. See, Yanukovich i Ivaniushchenko ispolzuyut UBOP dlia reiderstva – Tomenko. (October 22, 2011). *Gazeta.ua*, http://gazeta.ua/ru/articles/politics/_yanukovich-i-ivanyuschenko-ispolzuyut-ubop-dlya-rejderstva-tomenko/406043, accessed November 1, 2012.

430 Kuzio, Taras. (January 16, 2013). Ukraine Sliding From Oligarchy to Cronyism. *Eurasia Daily Monitor*, Vol. 10, Issue 8.

431 Among other people, who are linked to the ‘Family’ and got their promotion one can name Oleksandr Yanukovych Oleksandr Klimenko (since December 2011 – the head of the State Tax Service), Vitalii Zakharchenko (since November 2011 – minister of internal affairs), Hennadii Reznikov (since December 2011 – State Special Communications Service), Ihor Kalinin (head of Security Service of Ukraine), Dmytro Salamatin (since February 2012 - minister of defence). See, Matuszak, Slawomir. The Oligarchic Democracy. The influence of Business Groups on Ukrainian Politics. *OSW Studies*, No. 42, September 2012, p. 41-42, http://www.osw.waw.pl/sites/default/files/Prace_42_EN.pdf, accessed on November 1, 2012.

432 Kuzio, Taras. (January 16, 2013). Ukraine Sliding From Oligarchy to Cronyism. *Eurasia Daily Monitor*, Vol. 10, Issue 8.

Development Ihor Prasolov and First Deputy Prime Minister Borys Kolesnykov. Firtash Group faced marginalization with Yuriy Boyko being moved from the position of Minister of Energy and the Coal industry to First Deputy Prime Minister. Promotion of president's associates and demotion of unfavored ones consolidated power of Yanukovich and showed increasing distrust of outsiders. 'He agrees to entrust his future exclusively to the people with whom he has profited within the past years in power'⁴³³. This new approach proved firm ambitions of Yanukovich to consolidate power at the expense of even oligarchs, who supported him at the beginning of his political career. Therefore, 'to remain in power without provoking a backlash from disaffected oligarchs, the family may adopt more Putin-style measures or at least keep open the option of introducing such measures'⁴³⁴.

Though the above-mentioned developments prove that Yanukovich was firmly gaining influence in energy sector, this evidence was not enough to provide the grounds to state that his control was overwhelming. As defined by Slawomir Matuszak 'The family' was at the time the most aggressively operating group in Ukraine'. But Family's actions rather proved the tendency that Yanukovich was using the opportunities when they appeared rather than acting accordingly to the well-planned strategy. Moreover, as energy sector was already divided among the interest groups, any attempt of the 'Family' to enter these segments would certainly provoke a conflict of interests. The possessions of Yanukovich's group in energy sector in comparison with other oligarchs (like Firtash and Akhmetov) were miserable and of marginal significance⁴³⁵. Other oligarchs though did not have an essential share in energy sector, nevertheless tried to get one. An example could be listed one of the widely publicized cases of the purchase of an oil rig at a price inflated by 150 million USD by the Ministry led by Yuriy Boyko⁴³⁶.

Ukrainian energy sector strongly relied on three pillars of the current structure of business and political influence in the country. One was Firtash group's business structures, second was Rinat Akhmetov's group and third is 'Family' group, which is mainly linked to the president's son, Oleksandr Yanukovich. Therefore, these developments in the sector proved the firm will of the Yanukovich's family to strengthen its stake in energy sector,

433 Op. cit., Riabchuk, Mykola. 'Family' on the March. Current Politics in Ukraine. (January 20, 2013). Current Politics in Ukraine, <http://ukraineanalysis.wordpress.com/2013/01/>, accessed on January 21, 2013.

434 Jarabik, Balazs and Kobzova, Jana. (March 14, 2013). The EU's relationship with Ukraine: fling or partnership? *European Council on Foreign Relations*, http://ecfr.eu/content/entry/commentary_the_eus_relationship_with_ukraine_fling_or_partnership, accessed on April 17, 2013.

435 Matuszak, Slawomir. The Oligarchic Democracy. The influence of Business Groups on Ukrainian Politics. *OSW Studies*, No. 42, September 2012, p. 42, http://www.osw.waw.pl/sites/default/files/Prace_42_EN.pdf, accessed on November 1, 2012.

436 Nikolov, Yu., Shalaiskii, A. Vyshka dlia Boyko. (May 27, 2011). Zerkalo nedeli, No. 19, http://zn.ua/POLITICS/vyshka_dlia_boyko-81790.html, accessed on November 2, 2012.

which would mean re-division of the influences and counterbalancing of other interest groups. Former head of the State property Fund of Ukraine Oleksandr Bondar summarized that ‘All, what is connected with coal will be possessed by Akhmetov, and all, what is connected with gas by Firtash’⁴³⁷.

Meanwhile Firtash group was considered to be the most pro-Russian of all the major interest groups in Ukraine. As the success of Firtash business largely depended on gas prices, hence Gazprom policy and Russian banks, which were providing Firtash with loans, there was a view that ‘ultimate beneficiary of the ongoing distribution of the gas market in Ukraine may be Gazprom, which has not formally been admitted to the process of privatizing the regional and local gas enterprises in Ukraine’⁴³⁸.

In the analytical report of Razumkov Centre it was mentioned that current state of affairs in gas sector proved ‘market monopolization of gas supply and distribution by Group DF, spread of ‘shady’ schemes and abuse of huge amount of public funds to financially support corrupt Naftogaz Ukrayiny NJSC’⁴³⁹. Already established oligarchic groups in energy sector raised monopoly rent and spread corrupt revenues by blending business with government. These practices suspended real reforms and used European integration as a cover for achieving other purposes.

5.1.2. The beginning of domestic energy reforms: IMF factor

Yanukovich won the elections in February 2010 and after 100 days Program of economic reforms was introduced. The Program under the title ‘Prosperous Society, Competitive Economy, Effective Government’ was a joint effort of Ukrainian and foreign experts⁴⁴⁰ and therefore consisted of four main blocks of reforms. Fourth chapter of this Program under the title ‘Modernization of Infrastructure and Basic Sectors’ was dedicated to energy reform, namely in electricity, gas, oil and coal sectors. The main two aims of the energy sector reforms included ensuring competitively priced quantities of reliable power supply required for the economy’s development as well as improvement of specific energy efficiency. In gas and oil industry the main accent was made on systemic reform, which

437 Translation mine. See, Shcherbyna, Serhii. Teplo dlia Firtasha. (November 7, 2012). *Ekonomichna Pravda*, <http://www.epravda.com.ua/publications/2012/11/7/342983/>, accessed on November 9, 2012.

438 Sarna, Arkadiusz. (October 24, 2012). Dmytro Firtash’s companies are monopolizing the retail gas market in Ukraine. *EastWeek*, No. 35 (311), Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2012-10-24/dmytro-firtash-s-companies-are-monopolising-retail-gas-market-ukraine>, accessed on October 27, 2012.

439 Razumkov Centre. (2014). *Ukraine’s Gas Sector Development in the Context of European Integration*. Kyiv, p. 23

440 Foreign experts included McKinsey & Company, economist Anders Aslund and Oleksandr Pashkaver.

should reduce dependency from import, ensure the stable gas supply, and continuous transit of gas and oil through Ukraine to European consumers, liberalization of gas market (including extraction and distribution) and implementation of energy-saving technologies. Further necessary steps included restructuring of Naftogaz by spinning off bulk transportation network into separate company; creating favorable conditions for private investments in gas and oil extraction; increase of tariffs by establishing uniform prices for natural gas; determination of the prices for transportation, storage, distribution and delivery of the natural gas separately; enhancing the quality of petroleum products according to EU standards⁴⁴¹.

IMF among other international organizations and experts positively assessed Yanukovich's reform program and hence approved 29-month loan in the amount of 15.1 billion USD. Moreover, IMF First Deputy Managing Director John Lipsky in his statement pointed out that 'The authorities are committed to addressing existing imbalances and putting the economy on a path of durable growth through important fiscal, energy, and financial sector reforms. Sustained implementation of these reforms will help Ukraine entrench macroeconomic stability, boost confidence, facilitate access to capital markets, and emerge with more balanced and robust growth'⁴⁴².

When it came to the implementation of the scheduled steps to reform Ukraine's energy sector, Yanukovich faced several obstacles that altered the process of implementation.

The need of the gas prices increase was at the top of the agenda and IMF requested that the prices of gas for households should be increased so that the initial cost would be at least covered⁴⁴³. Though the government received two tranches from IMF, this measure was implemented partially. To meet the demand of IMF in order to get next tranche of the stand-by loan the prices for the public and heating sector starting from August 1, 2010 were increased by 50 %, and prices on electricity increased by 30 % in January 2011. These rises would not guarantee profitability⁴⁴⁴ and would still limit market competitiveness of the gas prices. Further gas prices increase, which was planned to take place in June 2011 was

441 Committee on Economic Reforms under the President of Ukraine. (July 7, 2010). *Prosperous Society, Competitive Economy, Effective State*. Program of Economic Reforms 2010-2014. Unofficial translation, pp. 56, 63-65, http://www.usubc.org/site/files/Ukraine_Program_of_Economic_Reforms_2010-2014.pdf, accessed October 1, 2012.

442 Roudet, Stephane. (August, 2010). IMF Approves \$ 15.1 Billion Loan for Ukraine. *IMF Survey Magazine: Countries & Regions*, <http://www.imf.org/external/pubs/ft/survey/so/2010/car081110a.htm>, accessed October 2, 2012.

443 As the population that time was paying one-fifth of the price of gas.

444 It is estimated that prices for heating sector are currently 70 % lower than the price of imported gas, and prices for the general public are 1.5 times lower.

suspended. An excuse government used to explain the inability or lack of eagerness to introduce price increase was confidence of Ukrainian government to secure cheaper gas.

According to Myers Jaffe and Soligo gas prices in former Soviet republics differed significantly. So if to take the year of 2007 when average European price for gas was at the level of 260 USD, Belarus was paying only 46 USD, Ukraine despite political confrontation was paying 135 USD, while Georgia with more pro-Western government was charged 235 USD. They conclude that ‘the prices of Russian gas are negatively correlated with the degree of pro-Western orientation of the government reinforces the belief that Russia is using its energy resources as an instrument of its foreign policy’⁴⁴⁵. With successful implementation of the foreign policy objectives, for instance in Belarus, where the control of Gas Transmission System shifted to Russia, the gas price developed into quite important tool to either win significantly due to price increase or to gain the ownership in strategic sectors abroad⁴⁴⁶.

The price increase policy did not bring the intended result and the control over Gas Transmission System of Ukraine remained in the state hands. As Ukraine did not sell any pipeline assets to Russian counterpart, the price negotiations failed miserably and brought no results. Ukrainian government even used a tactics of blackmailing, declaring that Russia leaves Ukraine only one choice of reducing Gazprom’s high gas prices via arbitration, ‘You are driving us into a corner, from which we have only one exit: contract termination’⁴⁴⁷.

Nevertheless, when the hope of getting cheaper gas disappeared, Yanukovich still remained reluctant to increase of the price for the population: ‘The demand of the International Monetary Fund to raise by 50 percent the price of the gas for the population is unacceptable, and we have not agreed and will never agree with that’⁴⁴⁸. Yanukovich was not eager to introduce measures that would decrease his political dividends to drive policymaking. According to President’s opinion in current economic situation tariff increases would lead to increased non-payment. Therefore well-designed subsidization formula should be applied simultaneously.

Nevertheless government denied the possibility of prices increase, and therefore in

445 Myers Jaffe, Amy; Soligo, Ronald. (May, 2008). *Militarization of Energy: Geopolitical Threats to the Global Energy System*. Working Paper Series: The Global Energy Market: Comprehensive Strategies to Meet Geopolitical and Financial Risks. Rice University: James A. Baker III Institute for Public Policy, p. 33.

446 Ibid.

447 Olearchyk, Roman, Buckley, Neil. (August 31, 2011). Ukraine Poised to Mount Gazprom Challenge. *Financial Times*, <http://www.ft.com/intl/cms/s/0/ed837292-d3e2-11e0-b7eb-00144feab49a.html#axzz2DQgz3aN5>, accessed on November 27, 2012.

448 President: Ukraine will not raise gas price for its citizens. Official website of the President of Ukraine, March 6, 2012, <http://www.president.gov.ua/en/news/23256.html>, accessed October 3, 2012.

spring 2011 the IMF decided to suspend the program. It was important to specify unwillingness of the government to implement these reforms as they were unpopular and deferred to the medium-term. But IMF experts Pritha Mitra and Ruben Atoyan targeted the necessity of ‘gradual but immediate tariff increases, supplemented by social assistance reforms targeting the most vulnerable members of society’⁴⁴⁹. Moreover, they argued that low tariffs despite supporting households disproportionately favored wealthy households. They concluded that 20 % of tariff increase would affect 1.5 times more wealthy households than lower income ones. Government’s excuse of postponement of price increase, which would end with higher level of non-payment among households was contrasted by the argument that social programs could fully defray the cost to poorer households⁴⁵⁰.

In order to achieve short-term political dividends Yanukovich postponed gas price increase, which led to Naftogaz’s growing debt. In 2010 the amount of gas utilized by population grew rapidly, therefore Naftogaz was forced by NERC to sell imported gas by the price of domestic one. Due to the difference Naftogaz sold 5 billion cm of imported gas for the price 92 USD instead of 340 USD, therefore accumulated debt reached 4.6 billion UAH. Not surprisingly on November 5, 2012 Naftogaz brought an action against NERC in order to identify Naftogaz with losses⁴⁵¹.

Cheaper gas price was theoretically reached by getting virtual gas discount in the amount of 100 USD after signing the Kharkiv Accords. But this situation neither changed the formula of gas price nor prevented from future increases. Yanukovich administration after numerous attempts failed to revise the gas price and in the time of consequent increase of the oil prices faced proportional increase of the gas prices for Ukraine⁴⁵². According to the energy experts of the Oxford Institute for Energy Studies one of the reasons of failed negotiations were Russian efforts over the last five years to end discounts as well as the effects of the economic crisis⁴⁵³. The prospects of Ukraine getting a fair gas price⁴⁵⁴ vanished.

449 Mitra, Pritha, Atoyan, Ruben. (October 2012). Ukraine Gas Pricing Policy: Distributional Consequences of Tariff Increases. *IMF Working Paper*, WP/12/247, p. 3-4.

450 Ibid.

451 Gavrysh, Oleg. V vozduhe zapahlo dengami. (November 23, 2012). *Kommersant Ukraina*, No. 191 (1681), <http://www.kommersant.ua/doc-rss/2073554>, accessed on November 23, 2012.

452 As according to the formula introduced by Tymoshenko-Putin deal in 2009 gas price was tied to oil price.

453 Pirani, S., Stern, J., Yafimava, K. (June, 2010). The April 2010 Russo-Ukrainian gas agreement and its implications for Europe. *The Oxford Institute for Energy Studies*, p. 8, http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/05/NG_42.pdf, accessed October 6, 2012.

454 ‘Fair gas price’ according to Prime Minister Azarov’s calculations would conclude the price for gas Germany is paying minus payment for gas transit. Therefore, it should not exceed 220-250 USD per 1000 cm.

IMF role in Ukraine's making first steps toward energy market reform should not be underestimated. IMF succeeded to establish a model of 'tough but constructive conditionality'. The conditions are well targeted, tightly sequenced and unforgiving, as concluded by James Sherr⁴⁵⁵. Further ranches would be disbursed only after the government raised household gas prices. It was clear that IMF policy would remain unequivocal and severe, which at the end would not provide Ukrainian government with any sliding possibility to escape so painful but needed reforms.

5.1.3. Gas market reform and the revision of the Energy Strategy

Another important step toward liberalization of the gas market was the adoption of Law 'On the Principles of the Natural Gas Market Operation in Ukraine' (further Gas Law) as of 8 July 2010, which introduced new rules for the gas market. The Law was the first step to meet Second EU Gas Directive 2003/55/E and Regulation EC 1775/2005. The main purpose of implementing reforms in accordance with EU's standards was an attempt to transform Ukraine's gas market into competitive gas market model, which would provide consumers with the free choice of natural gas suppliers and operators with free access to the network infrastructure (local pipelines and underground gas storage facilities)⁴⁵⁶.

Initially the process of gas market opening first implied free choice of distributor and supplier. Though in practice the choice of supplier for industrial customers was still limited to two main companies 'GazPromZbut' or 'Naftogaz Ukraina', while households would theoretically get this choice only starting from 2014⁴⁵⁷.

As stipulated in article 7 of the Gas Law 'Natural gas market entities have equal rights for free access to the gas transport system of Ukraine'. The operator of Ukrainian gas pipeline system is state-owned Ukrtransgaz SC, as affiliated company of Naftogaz. The operator in his turn was obliged to make infrastructure available to all interested parties under the same conditions. For now three main institutions were defined responsible to form the principles and rules of the access to the natural gas transport system of Ukraine: National Commission for State Energy Regulation (NERC), Ministry of Fuel and Energy and Naftogaz Ukrainy. So far the document, which should develop the access to gas

455 Sherr, James. (August 2010). *The Mortgaging of Ukraine's Independence. Briefing Paper*. (1, 11). Chatham House, REP BP 2010/01.

456 The Law itself was developed in 2002 on the assignment of the Cabinet of Ministers of Ukraine, but the adoption was postponed for 8 years.

457 Samofalov, Andrey, Mokro, Tatiana. (September 21, 2012). Oleg Popov: Kakoi inostranniy investor vlozhytsia v ukrainskiye shahty? <http://money.comments.ua/rules/2012/09/21/361262/oleg-popov-kakoy-inostranniy.html>, accessed October 10, 2012.

transport system, is currently under development⁴⁵⁸.

The other important steps in gas market reform to comply with European standards included: opening of the gas market; separation of gas market organization by functions (transport, distribution, supply and storage of natural gas) and establishing an independent regulator in the gas market. If we take a precise look at the developments of these three robust reform sections, it will give us an understanding the way reforms took place.

The part of the gas market opening included diminishing the role of Naftogaz, which possessed a unique monopoly over gas purchase from abroad. Therefore, the Law on the exclusive right of Naftogaz to purchase gas abroad adopted by Yuliya Tymoshenko was revoked by the Decree No. 939 of Cabinet of Ministers as of October 3, 2012. According to Dmytro Marunych, the head of the Institute of Energy Strategies: 'From now on every company, which obtained license for the sale of gas inside the country, issued by the National Commission for State Energy Regulation, could import, get customs clearance and sale imported gas. Main seller of imported gas in this case will become regional gas enterprises, city gas enterprises and other gas traders, working in the regions'⁴⁵⁹. This Decree was presented as a part of the gas sector reform to satisfy the requirements of the EU as well as an attempt of de-monopolization of the gas sector. Therefore, a member of Committee on the issues of fuel-energy complex Oleksandr Gudyma neatly pointed out that this decree is the most beneficial to Dmytro Firtash, who controls the biggest quantity of the oblgases in Ukraine and recently increased his presence in district gas enterprises⁴⁶⁰ (See, *Figure 4*. Map. Who owns regional gas enterprises in Ukraine?). As a result Ostchem imported 4.78 bcm of gas in 2011 under more favorable import prices in the second and third quarters of 2011 than Naftogaz⁴⁶¹.

Second main section of gas reform was separation of functions of gas network. In order to harmonize Ukrainian legislation with EU regulations, and, namely in order to meet the directive of EU 2003/55/EU, energy infrastructure should have been clearly unbundled

458 Zakon Ukrainy. (July 8, 2010). Pro zasady funktsionuvannia rynku pryrodного gazu, <http://zakon2.rada.gov.ua/laws/show/2467-17?test=4/UMfPEGznhh/1H.ZiYaxcREHI48Qs80msh8le6>, accessed October 9, 2012.

459 Gavrysh, Oleg, Chernovalov, Aleksandr. Torguiut vse. (2012, October 16). Kommersant Ukraina, No. 163 (1653), <http://www.kommersant.ua/doc-rss/2045426>, accessed October 16, 2012.

460 Though the owners of the company 'Gaztek' are four Cyprus companies (Porala Venchers Limited, Pasler Enterprises Limited, Nesiba Venchers Limited and Krezer Holdings Limited), the company is associated with gas monopolist Dmytro Firtash. Since the beginning of August 2012 'Gaztek' purchased shares in further district gas enterprises: 24 % in Crimea, 25 % in Zaporizhzhia, Ivano-Frankivsk and Sevastopol, 26 % in Luhansk, and Dnipropetrovsk, 25.8 % in Sumy, 15.8 in Zhytomyr, 20.4 % in Chernivtsi. See, Gavrysh, Oleg, Chernovalov, Aleksandr. Torguiut vse. (2012, October 16). Kommersant Ukraina, No. 163 (1653), <http://www.kommersant.ua/doc-rss/2045426>, accessed October 16, 2012.

461 International Energy Agency. (2012). *Ukraine 2012*. OECD/IEA, p. 105.

by specialization: sale, delivery, transport.

In November 2011 the biggest gas supplier ‘Gaz Ukrainy’ announced about its liquidation by joining Naftogaz Ukrainy. Moreover in April 2012 Cabinet of Ministers gained the right to reorganize independently state companies of Naftogaz Ukrainy. Therefore in June 2012 by decision of Cabinet of Ministers two daughter companies of Naftogaz ‘Ukrgezvydobuvannia’ and ‘Ukrtransgaz’ were transformed into public joint-stock companies. This should have prepared energy sector for partial privatization as it was announced by President Viktor Yanukovich⁴⁶². Minister for Fuel and Energy Yuriy Boyko expects to receive from 5 to 6 billion USD by selling 20-25 % of Naftogaz’s shares on foreign stock markets⁴⁶³. Therefore, Naftogaz and its daughter companies are prepared for initial public offering (IPO)⁴⁶⁴.

In practice Ukrtransgaz would take over the function of the independent operator of gas network, and the operators of the regional networks would be separate legal entities. Therefore the necessity of structural reform of Naftogaz, which would take place at root and branch level, emerged. It also should be pointed out that Naftogaz’s financial state was rather poor, especially after gas debt pay off in the amount of 12.1 billion cm to RosUkrEnerg⁴⁶⁵. New law required operator to be financially independent, though at the time Ukrtransgaz was a subsidiary company of Naftogaz and Naftogaz was appointing management of Ukrtransgaz as well as controlling and regulating its daughter company’s activity. Therefore new law was ambiguous in its regulations concerning full independence of the operator of the gas transport system, and demanded just separation of personnel functions and financial autonomy. National Commission for State Energy Regulation (NERC) was responsible for determining the rate for gas transportation. However, as summarized by Slawomir Matuszak, ‘If the separation of extraction, transportation and sale of gas into different financially and legally independent companies were to go ahead as

462 Being *Daughter Company* of Naftogaz meant that Naftogaz created the company, and was responsible for the its charter fund formation, appointment of the director and personnel, and was responsible for reorganization and liquidation of the company. *Public joint-stock company* is liable only by the property of the company, it takes independent decisions of the shareholders meetings, and what is even more important could attract investors from shareholders as well as from outside.

463 Shapovalova, Natalia. (May 6, 2011). Ukraine’s Energy Reform. *Revolve*, <http://www.revolve-magazine.com/home/2011/05/06/ukraine-reform/>, accessed October 9, 2012.

464 Socor, Vladimir. Ukrainian Government Prepares Public Opinion for Possible Sales of Naftogaz Assets.(July 11, 2011). *Eurasia Daily Monitor*, Volume 8, Issue 132.

465 The gas was returned to RosUkrEnerg according to the decision of the Arbitration Tribunal of the Stockholm Chamber of Commerce (March 2010). The disputed gas was taken by government of Tymoshenko as part of the agreement between Gazprom and Naftogaz in order to eliminate RosUkrEnerg from the gas trade. Governmental interests were at most badly defended at the court maybe due to the sponsorship of Dmytro Firtash in presidential campaign of Yanukovich.

planned by 2015, Ukraine would witness fierce competition for the takeover of the most profitable of the new companies – particularly in the gas extraction sector⁴⁶⁶.

In August-September 2012 State Property Fund of Ukraine announced sale of shares (15-26 %) of regional gas enterprises (oblgases), responsible for distribution of gas. Though this process was depicted as a part of privatization, which should lead to liberalization of gas market, shares sale appeared to be a unique opportunity for certain interest groups to strengthen their position in the market. Not surprisingly the winner of the majority of the auctions appeared to be Public joint-stock company ‘Gaztek’, which belongs to Dmytro Firtash group⁴⁶⁷. Just before the auctions government wrote off a debt of the oblgases in the amount of 20 billion UAH, hence the director of the Energy Program of Razumkov Centre Volodymyr Omel’chenko insists that was done ‘to create the most favorable conditions for the new owners ... The monopolization of this market increases. And at the end customers will pay for this monopolization’⁴⁶⁸. The sale of the shares appeared to be a trick to hand them to a close circle of Yanukovich’s associates, who already had their stake in the energy sector.

In parallel with Firtash’s take over gas sector, Rinat Akhmetov applied the same tactics in the electricity market. In December 2011-January 2012 DTEK Company, which belonged to Akhmetov, won tender and therefore became an owner of the shares of three thermal power plants: Zakhidenerho⁴⁶⁹ (45 %), Dniproenerho (25 %), Kyivenerho (25 %), Donetskoblennerho group (40 %)⁴⁷⁰. Together with earlier obtained shares Akhmetov controlled over 30 % of the produced electricity in Ukraine⁴⁷¹. Other sector where Rinat Akhmetov prevailed was coal industry. He owned over 50 % of the market, including an integrated chain of production (coal mining, enrichment, production and distribution of energy). Therefore, providing oligarchs with exclusive monopoly in certain part of the energy sector activated the process of ‘oligarchisation’ of Ukrainian energy.

466 Matuszak, Slawomir, Sarna, Arkadiusz. (March 2013). From stabilization to stagnation. Viktor Yanukovich’s Reforms. Centre for Eastern Studies. *Point of View*, No. 32, p.35.

467 Firtash za try tyzhni skupyv usi oblgazy, shcho vystavliayls na prodazh. (September 19, 2012). *Ekspres*, <http://expres.ua/news/2012/09/19/73701>, accessed October 10, 2012.

468 Omel’chenko, Volodymyr. (September 10, 2012). Uriad polegshuye umovy dlia novykh vlasnykiv oblgaziv za rahunok spozhyvachiv. Razumkov Centre, http://www.razumkov.org.ua/ukr/expert.php?news_id=3639, accessed October 10, 2012.

469 By acquisition of Zakhidenerho, which included Burshtyn Island (power plants integrated with the ENTSO-E system used in the EU), Akhmetov took the control of Ukraine’s electricity exports to EU countries. Therefore electricity networks are unlikely to become available to Russian electricity exports.

470 Krasnolutska, Daryna, Choursina, Kateryna. Ukraine DTEK Buys 25 % Stake in Electricity Producer Dniproenergo. (March 12, 2012). Bloomberg, <http://www.bloomberg.com/news/print/2012-03-12/ukraine-dtek-buys-25-stake-in-electricity-producer-dniproenergo.html>, accessed October 17, 2012.

471 Akhmetov controls four of the six energy generating companies with total capacity of over 18 GW.

The third main sector of reforms was dedicated to the establishing of an independent regulator in the gas market, namely NERC. NERC was a state agency regulating activities in the energy market. The main objectives of NERC included: implementation of unified state policy in energy market; state regulation of the activities of natural monopolies in oil, gas and electric power generation industries; promotion of competition by balancing public interests with monopolies' interests; definition of tariff policy; protection of consumer rights and licensing entities for gas and electricity production and supply⁴⁷².

The last function of NERC seemed to be most underdeveloped and vague from the point of practical implementation. According to the Gas Law sellers and suppliers existed in a free market, but their activity was regulated by NERC, which was issuing the licenses. Though the process of issuing licenses in Ukraine should be unbiased, in practice Commission itself remained completely subordinated to the government. Another pitfall of the law obliged gas-extracting companies with 50 % of state shares to sell gas to Naftogaz at the prices defined by NERC. This gas will be spared for the general public consumption and the heating sector. Due to low amount of private companies dealing with gas extraction, regulated prices would apply on this part of the market.

The law by introducing partial liberalization neglected another EU directive of 2009, which intended to limit access to the market by external investors, which did not meet the criteria of separation of functions. Therefore the law opened up the possibility for Gazprom to expand its activity in Ukrainian gas market. In 2009 GazPromSbyt Ukraina though possessing a license to sell 7.5 cm of gas, had sold only 2.8 cm of gas⁴⁷³. Government price and regulation policy apart from global economic crisis affected the reduction for gas demand.

After the visits of special missions of the Secretariat of Energy Community, in March 2011 road maps for every gas acquis communautaire were presented. Road maps consisted of detailed recommendations to be adopted on legislative level. In accordance to meet these recommendations the Ministry of Fuel and Energy prepared a plan of legislative acts preparation for 2011-2012. The Decree of Cabinet of Ministers as of 25 July 2012 classified customers of gas sector into two groups: industrial (annual consumption over 3 million cm of gas) and other customers (population, budget organizations, small and

472 <http://zakon2.rada.gov.ua/laws/show/715/2014?test=4/UMfPEGznhhQXG.ZiUixb/1HI4/os80msh8Ie6>

473 Gorska, Anna. (21 July, 2010). Changes on the Ukrainian gas market. *EastWeek*, No. 25 (218), Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2010-07-21/changes-ukrainian-gas-market>, accessed October 9, 2012.

medium business). Moreover, gas customers according to its classification obtained the right to choose gas supplier independently⁴⁷⁴.

The law of 6 July 2010 partially satisfied such requirements of Brussels declaration of March 2009 and Directive 2003/55/EC as independence of the operator of GTS (article 16) and equal access to the GTS (article 9). One should dully understand that energy reform was largely implemented as the result of pressure from the EU and the IMF on the Ukrainian government. Nevertheless, Gas Law appeared to be one of the first steps to market liberalization in accordance with EU standards.

As neatly pointed by researcher Natalia Shapovalova: ‘It took Kiev eight years to develop and adopt the law on the functioning of the gas market. Though Ukraine agreed in the 2005 joint Memorandum with the EU to establish an independent energy regulatory body, this commitment has yet to be fulfilled. Draft laws to define a clear role and responsibilities for the national regulator have been stuck in parliament for years’⁴⁷⁵. The law itself possessed faulty lines, where further modifications were to be introduced to increase the level of NERC transparency in issuing licenses. Another shortcoming was that solutions introduced by new law could lead to gas extraction concessions for private investors (Ukrainian and foreign). Therefore, state would still possess the influence on the gas-related entities, and hence such an actor as Gazprom could expand its presence on Ukrainian gas market. In the view of Gennadiy Riabtsev the Law ‘was transformed into a fig leaf, by means of which ‘nude’ Ukrainian energy sector tries to hide 3-years of the systemic reform absence’⁴⁷⁶. The reforms under the cover of liberalization of the gas market followed the so common trend of rent-seeking where murky auctions and legislation possessing pitfalls enabled opaque trade deals to be concluded.

It should be mentioned that none of the interest groups, being tied to the energy market, was not interested in totally free and fair competition. The reforms were implemented in the way that the interests of big business were not damaged or even some interest groups were directly benefitting from it (as in case of privatization of regional gas enterprises by Firtash). Therefore, the delay of energy sector reform was also caused by the lack of agreement on the reform among interest groups. Nevertheless, partial harmonization

474 Industrial customers obtained this right from 1 May 2012, budget institutions from 1 January 2012, entities that consume gas to produce heating for population from 1 January 2014, and public customers from 1 January 2014.

475 Shapovalova, Natalia. (May 6, 2011). Ukraine’s Energy Reform. *Revolve*, <http://www.revolve-magazine.com/home/2011/05/06/ukraine-reform/>, accessed October 9, 2012.

476 See, Analitichna zapyska shchodo stanu realizatsiyi Zakonu ‘Pro zasady funktsionuvannia rynku pryrodного gazu’. Dixi Group, 2012, p. 4, http://ua-energy.org/upload/files/Gas%20market%20analysis_final.pdf, accessed October 10, 2012.

with EU in energy sector, especially privatization and respect of ownership rights was viewed by big business as being one step forward in the direction of market liberalization.

Other important development that took place at the pace of energy reforms was the project of the update of the Energy Strategy of Ukraine. In summer 2011 president entrusted the government with the task of updating the Strategy, hence Ministry for Fuel and Energy was appointed to be the responsible authority. The work on Strategy was divided among further institutions: the National Agency of Ukraine on Ensuring Efficient Use of Energy Resources, the Institute of General Energy, the Foundation for Effective Governance etc. The last in the above-mentioned list of organizations was non-profit, independent organization close to the government, which appeared to be responsible for the whole updating process. Regardless the request of independent experts and NGOs addressed to president in order to make process of Energy Strategy update more transparent, all the preparation took place under the closed doors.

New document was announced for the debate on June 11, 2012 at the website of the Ministry of Fuel and Energy of Ukraine⁴⁷⁷, though it should have been adopted at least in 2011⁴⁷⁸. This document could be criticized by possessing the faulty lines that undermine its value. Some of the main reasons need to be listed below.

First of all, the way this update was prepared seems to be inadequate. Energy Strategy of Ukraine though being a state integration model should not have been prepared as a branch document, but should have been harmonized with other state strategies (Strategy of national security, Strategy of economic development), Laws (Law on the Foundations of internal and foreign policy of Ukraine), and Agreements (Agreement of Energy Community) etc. Moreover, regardless many factors including economic crisis, which necessitated drastic change of the Strategy, government preferred to review it rather than to create new document and moreover the same time frames till 2030 indicate that even when approved Strategy will still be of temporary nature and will be in need of revision in near 2-3 years. The document was prepared by anonymous authors from private think tank 'Foundation for Effective Governance'⁴⁷⁹, who were reverberating the interests of important

477 Onovlennia Enerhetychnoi stratehii Ukrainy na period do 2030 roku. Proekt dokumentu dlia hromadskykh obhovoren. (June 7, 2012), http://mpe.kmu.gov.ua/fuel/control/uk/publish/article?art_id=222022&cat_id=104126, accessed June 25, 2012.

478 Energy Strategy was adopted in 2006 and further updates were scheduled at every 5 years.

479 Foundation for Effective Governance was founded in 2007 by Rinat Akhmetov. Main focus of the Foundation is development of long-term national economic programs for Ukraine. Moreover, a person who was in charge of Energy Strategy Update coordination was project manager Roman Rubchenko. Being a MA graduate of Michigan University and having worked in Boston Consulting, in Boston he was in charge of strategy and economy consulting of private and state clients among others about oil and gas industry in CIS. See, Zachem meniat Energeticheskuiu strategiiu Ukrainy. (October 26, 2012). LB.ua, http://economics.lb.ua/state/2012/10/26/175975_zachem_menyat_energeticheskuyu.html, accessed October 30, 2012

energy actor in Ukraine.

Concerning important missing points of the Strategy, comparative risks and threats that were challenging Ukraine in the context of realization of neighbors' energy strategies were not evaluated⁴⁸⁰. Therefore, potential expansion of Gazprom and other Russian energy companies was neglected, which questioned comprehensive understanding of Ukraine's energy security.

Second, data represented in the updated Strategy proved to present over-optimistic prognosis, which hardly corresponded the realistic flow of economic development. The basis for the Strategy constituted the unsubstantiated positive prognosis of post-crisis economic development, according to which GDP will increase twice (pessimistic scenario) or three times (optimistic scenario). While the development of all energy sectors was being scrutinized under the terms of active investment (total amount of 170 billion EUR till 2030), audit and preliminary assessment of financial capacities of nowadays owners of energy assets in Ukraine as well as interest of foreign investors in energy sector were not estimated. Moreover, Ukraine's even poor rating in 2011 according to Doing Business Report (149 position) and Corruption Perception Report (152 position) did provide with little hope of investment change⁴⁸¹.

Third, data also lacked compliance with European standards, which caused their misrepresentation. Energy balance of Ukraine was concluded based on Soviet methodology of profits and losses and hence distorted the forecast accuracy and did not coincide with the standards of methodology of International Energy Agency.

Sector analysis scrutiny provided with further conclusions. In nuclear sector the construction of five new nuclear reactors was mentioned as efficient tool to increase energy production. As Ukraine was totally dependent on Russian nuclear fuel this would mean just deepening of dependency of Russia. But recent development in nuclear sector stated Ukraine's decision to construct nuclear fuel production plant in cooperation with Russia, which could change the equilibrium of nuclear fuel dependency on Russia and as well as introduce nuclear fuel export potential of Ukraine to other countries⁴⁸².

480 See, NOMOS. Kontseptualni zavvazhennia Tsentru 'NOMOS' shchodo 'Onovlennia Enerhetychnoi stratehii Ukrainy na period do 2030 roku. Proekt dokumentu dlia hromadskykh obhovoren'. (July 19, 2012). UA-Energy, <http://ua-energy.org/post/22390>, accessed June 20, 2012.

481 Doing Business 2011, accessed on July 8, 2015, <http://www.doingbusiness.org/~media/FPKM/Doing%20Business/Documents/Annual-Reports/English/DB12-FullReport.pdf>, p. 6; Corruption Perceptions Index 2011, accessed on July 8, 2015, p. 4, http://www.transparency.org/whatwedo/publication/corruption_perceptions_index_2011

482 An ambitious project started in October 2012 and is scheduled to be fully operational in 2015. Ukraine in the past obtained nuclear fuel for its 15 nuclear reactors from Russia and the United States. With the plant in operation Ukraine will be able to sell nuclear fuel to Bulgaria, the Czech Republic, Slovakia and Hungary. This project claims to strengthen the positions of Ukraine as potential electricity producer and exporter (as half of the Ukrainian

In coal sector contradictory aims were listed, such as increase of mines and decrease of the anthropogenic impact on the environment. Coal sector according to the Strategy should be privatized, though it remained unclear while state should further support privatized mining companies, which would mean subsidizing of the new owners. Gas sector of the Strategy stipulated that Ukraine would be able to satisfy up to 90 % of the internal market need for gas till 2030. The main source would be non-traditional gas production, which would conclude 30-47 billion cm. Therefore, the biggest stake was put on non-traditional gas production, which actually had so far no real approval to have this great potential. Gas Transmission System of Ukraine is determined as one that lost its status of transit exclusiveness. The only way to maximize transit in long-term perspective is to create Consortium of GTS joint management⁴⁸³.

Another solution offered to reduce gas dependency was the shift from gas to coal. In practice, it meant the construction of plants, which were synthesizing gas from coal. The construction of five plants of this exact function was scheduled to start in 2013 according to the President Yanukovich. The syngas⁴⁸⁴ plants were planned to get the investment in the amount of 3.5 billion USD and Chinese technology of coal gasification and coal-water production would be used⁴⁸⁵.

It is important to mention that until 2009 Ukraine had no economic incentives to actually diversify import sources and transport routes due to preferential price policy of Russia. Diversification policy seemed to suffer from inconsistency. Ukraine's will to import gas from Azerbaijan was acknowledged through the pipeline of 'White Stream', though not only the project was missing, but also countries that would potentially support it. Moreover, the government defined its readiness to participate in competing project to 'White Stream' project of 'Transanatolian pipeline' (TANAP)⁴⁸⁶. The profits and risks of Ukraine's

electricity is produced by nuclear power) as well as net nuclear fuel exporter. Ukraine Makes Another Step Toward Energy Independence. (October 10, 2012). Worldwide News Ukraine, <http://wnu-ukraine.com/news/economy-business/?id=2240>, accessed on November 16, 2012.

483 NOMOS. Kontseptualni zavvazhennia Tsentru 'NOMOS' shchodo 'Onovlennia Enerhetychnoi stratehii Ukrainy na period do 2030 roku. Proekt dokumentu dlia hromadskykh obhovoren'. (July 19, 2012). UA-Energy, <http://ua-energy.org/post/22390>, accessed June 20, 2012.

483 Doing Business 2011, accessed on July 8, 2015.

484 Synthesis gas (syngas) is a gas mixture that is comprised of carbon monoxide and hydrogen. The energy density of syngas is approximately 50 % less than of natural gas. According to George Muntean, the Department of Energy's Pacific Northwest National Laboratory, 'coal gasification offers one of the most versatile and clean ways to convert coal into electricity, hydrogen and other valuable energy products'. See, Coal gasification – myths, challenges and opportunities. Science Codex, http://www.sciencecodex.com/coal_gasification_myths_challenges_and_opportunities, accessed on November 16, 2012.

485 Ukraine Starts Syngas Production Plants Construction in 2013. (October 17, 2012). Worldwide News Ukraine, <http://wnu-ukraine.com/news/economy-business/?id=2256>, accessed on November 16, 2012.

486 As noted by the Ambassador Oleksandr Mishchenko political decision about Ukraine's participation in TANAP has been made. See, Gasanov, A. Ukraina zainteresovana v pokupke doli v TANAP. (April 11, 2012). TREND, <http://www.trend.az/capital/energy/2013130.html>, accessed May 16, 2012.

participation in the projects as ‘NABUCCO’, ‘Interconnector Italy-Greece-Turkey’, ‘Transadriatic pipeline’ were lacking comprehensive scrutiny. Moreover, South Stream should have been analyzed as a constituent of Russia’s energy policy with consequent risks for Ukraine.

The rate of nontraditional and renewable energy was defined as 10 %, which indicated that the recommendations of State Agency for Energy Efficiency and Energy Saving of this rate to reach at least 22 % till 2030 were not taken into consideration⁴⁸⁷ and it also contradicted EU Directive 2001/77/EU and 2009/28/EU, where the constituent of the renewables should be at least 20 %. Ecological patterns of the of Energy Strategy were not mentioned at all due to the absence of Strategic Environmental Assessment, which was common for EU countries⁴⁸⁸.

And one of the most important parts of the Strategy, especially in terms of cooperation with the EU, increase of energy efficiency seemed to be underdeveloped. The rate of the energy intensity decrease was defined by 3 % per year (60 % till 2030) and seemed to be not ambitious enough and too low to reach its goal. As today’s level of energy intensity is 2.5 times higher than of Poland, Ukraine’s main priority should be consequent reduction of energy intensity at the rate at least 5 % per year⁴⁸⁹. To confirm these words an expert of non-governmental organization ‘Energy Cities’ Svyatoslav Pavlyuk mentioned that ‘Losses on home boilers are 30 percent; 20-40 percent more goes up into the air during transportation. Consumers get only 21 out of 100 burned cubic meters of gas’⁴⁹⁰.

On 19 October 2012 International Energy Agency published ‘Ukraine Energy Policy Review’⁴⁹¹, where IEA listed recommendations how current Energy Strategy could be improved. In general IEA gave positive feedback on the updated Strategy, but pointed out the necessity to concentrate more on the competitiveness and transparency of the energy markets. Among the slow pace developments IEA mentions government’s refusal to further

487 Instytut enerhetychnykh doslidzhen. (21 June, 2012). Ekspres-revizija. Enerhetychna stratehiya Ukrainy: oberezžno i bagatovektorno, <http://ua-energy.org/post/21431>, accessed July 28, 2012.

488 Malygina, Kateryna. Stratehichna ekolohichna otsinka Enerhostratehii Ukrainy – shliakh do staloho rozvytku. (June 13, 2012). UA-Energy, <http://ua-energy.org/post/21074>, accessed June 20, 2012.

489 Denysenko, Artur. Proekt onovlenoi enerhetychnoi stratehii Ukrainy do 2030 roku. Komentari ta propozyzii. (July 8, 2012). *Natsionalnyi ekolohichniy tsentr Ukrainy*, http://ua-energy.org/upload/files/NECU_Comments%20to%20Energy%20Strategy.pdf, accessed July 20, 2012.

490 Tuchynska, Svitlana. Quest for cheap gas leads to Germany. (November 8, 2012). KyivPost, <http://www.kyivpost.com/content/business/quest-for-cheap-gas-leads-to-germany-315819.html>, accessed on November 10, 2012.

491 International Energy Agency. (2012). Energy Policies Beyond IEA Countries: Ukraine Energy Policy Review 2012. OECD Publishing, http://www.oecd-ilibrary.org/energy/energy-policies-beyond-iaa-countries-ukraine-energy-policy-review-2012_9789264187450-en, accessed October 23, 2012.

increase prices. The main policy of successful energy reform should include two parallel processes of increase of internal energy production together with more consistent efforts to decrease energy inefficiency and cancelation of cross-subsidies. The statistics provided in the updated Strategy did not coincide with worldwide norms; therefore further energy balances should be adopted according to international standards. Future membership in Extractive Industries Transparency Initiative would among others enable Ukraine to reach international standards of reporting. The amount of investment, which equaled to 170 billion EUR, seems to be too difficult financial task to fulfill, especially taking into consideration Ukraine's poor ranks in corruption (2.3 points out of 10) and poor performance in favorable business environment (Ukraine got the last position among the countries in the region according to Doing Business Report in 2011⁴⁹²).

The main focus of IEA was a decrease of energy intensity, which was 10 times bigger than average of OECD countries and to focus on energy efficiency. In gas sector apart from consequent gas tariff increase, IEA insisted on the gas metering devices installation. Restructuring of Naftogaz should be concluded by efficient work of the newly created companies, whereas equal access to the pipelines and gas storages would be guaranteed. Necessary legislation should be adopted to enable reverse exploitation of the Ukraine's gas storages by European companies. The transparency of the gas sector should be guaranteed by the unbiased and independent work of Antimonopoly Committee and National Commission for State Energy Regulation⁴⁹³.

Moreover, Executive Director of International Energy Agency Maria van der Hoeven in her presentation stated the possibility of the energy revolution in Ukraine. The revolution would require large increase in domestic nonconventional and conventional gas production together with rigorous efforts to increase energy efficiency. As a result the main obstacle to economic development – gas imports would be removed by 2030⁴⁹⁴. She defined energy efficiency as a 'hidden fuel'. The reason was mentioned as follows: 'You can't sell it, you can't buy it or put it in your tank', but efficiency played as much important role as

492 The International Bank for Reconstruction and Development / The World Bank. (2010). Doing Business 2011, accessed on November 11, 2015, <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB11-FullReport>

493 International Energy Agency. (2012). Energy Policies Beyond IEA Countries: Ukraine Energy Policy Review 2012. OECD Publishing, http://www.oecd-ilibrary.org/energy/energy-policies-beyond-iea-countries-ukraine-energy-policy-review-2012_9789264187450-en, accessed October 23, 2012.

494 Van der Hoeven, Maria. (October 19, 2012). Energy Policies Beyond IEA Countries. Ukraine 2012 Review. International Energy Agency, <http://www.iea.org/newsroomandevents/speeches/121019UkraineIDRLaunchPresentation.pdf>, accessed October 23, 2012.

unconstrained energy supply⁴⁹⁵.

5.1.4. Reducing gas dependency: diversification and alternative energy resources

During second year of Yanukovich's presidency the return of the privileged energy treatment of Ukraine by Russia was fully understood as impossible. To reduce dependency on Russian gas, which was a key objective of the updated Energy Strategy, Ukraine stepped up the efforts to attract international companies to invest and develop Ukraine's gas fields and increase the share of alternative energy resources in general energy balance of Ukraine.

With the absence of energy price revision, Ukraine tried to increase domestic production, which for now meets about a third of the country's needs. In 2010-2011 Naftogaz and Gazprom signed a Memorandum establishing a joint venture that would extract mine gas in Ukraine⁴⁹⁶. However, it appeared to be not in the interest of Gazprom to increase gas production in Ukraine. As a result Yanukovich addressed the West and two companies, Chevron and Shell, agreed to invest into shale gas development projects about 7 billion USD.

Ukraine was defined as fourth largest shale gas reserves in Europe. As neatly pointed out by Roman Olearchyk: 'In refusing Viktor Yanukovich's repeated requests to reduce gas import prices to lower levels, Gazprom appears, ironically, to have helped to change Ukraine's investment policy for the better'⁴⁹⁷. Therefore, in May 2012 Shell and Chevron obtained the right to develop Ukrainian shale gas fields Oleske and Yuzivske respectively. These fields were expected to provide Ukraine with up to 10 % of domestically consumed natural gas by 2020. In October 2012 Royal Dutch Shell together with Ukrainian public company Ukgazvydobuvannia already started the drilling of the first exploration well in Kharkiv oblast⁴⁹⁸.

Moreover, four companies American Exxon Mobil, Dutch-British Royal Dutch Shell, Romanian OMV Petrom and Ukrainian state company Nadra won the right to develop

495 Carr, Mathew. Energy Efficiency Can Buy 5 Years for Climate Deal, IEA Says. (November 12, 2012).The Washington Post with Bloomberg, <http://washpost.bloomberg.com/Story?docId=1376-MDD9896TTDST01-03KVINDSIAR3SBOO2QS1TVA2TM>, accessed on November 15, 2012.

496 Matuszak, Slawomir, Sarna, Arkadiusz. (March 2013). From stabilization to stagnation. Viktor Yanukovich's Reforms. Centre for Eastern Studies. *Point of View*, No. 32, p.38.

497 Olearchyk, Roman. Energy: Outsiders boost power sector. (September 17, 2012). The Financial Times, <http://www.ft.com/intl/cms/s/0/0b99d186-f8e0-11e1-8d92-00144feabdc0.html#axzz2COst7JbY>, accessed on November 16, 2012.

498 The Contract was signed in September 2011 and foresaw Shell's investment of 800 million into gas development project. The first stage of Contract stipulates exploration and extraction of hydrocarbons from compacted sand from the total area of 1300 square km within 5-6 months with first investment of 200 million USD, during next 3-4 years other wells will be drilled.

oil and gas reserves of underwater Black Sea deposits at the Scythian field (Skifske)⁴⁹⁹. The commercial production could have started in 6-8 years and could reach annually 3-4 billion cm of gas. As concluded by the president of the American Chamber of Commerce in Ukraine Jorge Zukoski: ‘These projects, if successful, will be a big paradigm shift for Ukraine helping the country to take a giant stride towards energy independence while at the same time providing an opportunity for the government to prove to the world that they can attract and retain multibillion-dollar investment projects’⁵⁰⁰. Richard H. Jones, IEA Deputy Executive Director, speaking at an energy symposium in Ukraine emphasized: ‘The potential alternative gas reserves in Ukraine may come up to 5 trillion cubic meters’. With a shale gas forecasted amount about 1.3 trillion cm and coal-bed methane reserves forecasted at 3 trillion cm, Ukraine could even export gas to Europe⁵⁰¹. Indeed with estimated volume of shale gas production of 20 billion cm per year, Ukraine would be able to replace the deliveries of Russian natural gas⁵⁰². In this situation it was clear why Russia wanted to downplay the importance of the shale gas as it seemed to be a real alternative for Ukraine’s lowering of dependency. Moreover, unconventional gas being a national source of fuel supply, would undoubtedly strengthen Ukraine’s energy security, and moreover its did not demand state subsidies like renewables, nuclear power or coal. It would also improve the investment climate in Ukraine as energy sector lacked expertise or technology in horizontal drilling and hydraulic fracturing.

Controlled opening up of the market was foreseeing an opportunity for Yanukovich and his close associates to enter those projects under the terms of local partners (which was an obligatory part of PSA). That was another chance to extract rents out of onshore energy projects, when ‘stuffing company’ (kompaniya-prokladka) without the need to unveil its identity would participate and make sufficient profit. This tendency confirms a unique skill of Ukrainian politicians to extract rents just by creating favorable legislative ground for it⁵⁰³.

499 Shell Starts Drilling for Hydrocarbons in Ukraine. (October 26, 2012). Worldwide News Ukraine, <http://wnu-ukraine.com/news/economy-business/?id=2285>, accessed on November 16, 2012.

500 Olearchyk, Roman. Energy: Outsiders boost power sector. (September 17, 2012). The Financial Times, <http://www.ft.com/intl/cms/s/0/0b99d186-f8e0-11e1-8d92-00144feabdc0.html#axzz2COst7JbY>, accessed on November 16, 2012.

501 Olearchyk, Roman. Ukraine cuts dependence on Gazprom. (November 16, 2012). *The Financial Times*, <http://blogs.ft.com/beyond-brics/2012/11/16/ukraine-cuts-dependence-on-gazprom/#>, accessed on November 19, 2012.

502 Tuohy, Emmet, and Bulakh, Anna. (April 23, 2013). Shale Gas Perspectives for Ukraine: Where Does Illusion End and Reality Begin? *International Centre for Defence Studies* (RKK/ICDS), republished by Natural Gas Europe, <http://www.naturalgaseurope.com/shale-gas-perspectives-ukraine>, accessed on April 23, 2013.

503 Interview with Alla Yeremenko, Editor of the Department of Economic Security of the newspaper “Dzerkalo tyzhnia” (Mirror of the week), conducted in Kyiv (Ukraine), on 3 June 2013.

Biogas was announced as another source of Ukraine's energy independence. According to the State Program on Energy Efficiency 2010-2015. In September 2012, it was announced that Ukrainian agroholding Avangard planned to build biogas production plants at two of its poultry farms in 2013. The company would cooperate with Polish state-owned company PGNIG-energy to achieve better results⁵⁰⁴. The actual volume of the produced biogas could reach 30-35 million cm, while the plants will start working in 2013⁵⁰⁵. The other way to produce biofuel was by conversion unprofitable alcohol plants into ethanol production plants. According to the Agreement signed with China in February 2012 an estimated annual production would reach 60 000 tons of ethanol⁵⁰⁶.

Solar energy was one of the most developed alternative energy resources for the latest period. In the last 30 months Ukraine built 20 solar stations with the total capacity of 270 MW. Besides in 2011 the largest in Europe and CIS solar power park Perovo in Crimea was launched with capacity over 105 MW. The Macquire Research based on the data from European Photovoltaic Industry Association sketched a forecast of Ukraine's solar energy production to reach 600 MW in 2012⁵⁰⁷.

Pledges of diversification were carried out by signing a Contract between Naftogaz and German RWE Supply & Trading GmbH on gas supply in the amount of 56.7 million cm for two months (1 November 2012 – 1 January 2013). Since November 1, 2012 Ukraine had been receiving 1 million cm of gas every day from German RWE. According to Energy Minister Boyko this gas, which flew through Germany and Poland, was even cheaper than Russian one. Unlike the estimation of price carried out by energy experts, which varied from 390 to 415 UAD per 1000 cm of gas⁵⁰⁸, the price disclosed by Vadym Chuprun,

504 IEA Speaks of Ukraine's Potential for Energy Revolution. (October 22, 2012). *Worldwide News Ukraine*, <http://wnu-ukraine.com/news/economy-business/?id=2262>, accessed on November 16, 2012.

505 For construction of two plants the investment of 100-120 million EUR is needed. These plants could become the beginning of the promising biogas revolution due to Ukrainian powerful agrarian sector. The only obstacle of biogas was its further transportation as pipeline transportation was not applicable in this case.

506 Ukrainian Company Agrees to Supply Biogas to EU. (September 24, 2012). *Worldwide News Ukraine*, <http://wnu-ukraine.com/news/economy-business/?id=2197>, accessed on November 16, 2012.

507 Ukrainian President: Energy Independence – Our Strategic Goal. (August 27, 2012). *Worldwide News Ukraine*, <http://wnu-ukraine.com/news/economy-business/?id=2076>, accessed on November 17, 2012.

508 As assumed by director of the Energy Studies Institute Dmytro Marunych is should be at least 15 USD cheaper than Russian gas (430 USD). While another expert Valeriy Borovik, head of the board of Alliance 'New Energy of Ukraine' presumes that the price could be estimated at 380-390 USD per 1000 cm. See, Tuchynska, Svitlana. Quest for cheap gas leads to Germany. (November 8, 2012). *KyivPost*, <http://www.kyivpost.com/content/business/quest-for-cheap-gas-leads-to-germany-315819.html>, accessed on November 10, 2012; Ponomarev, Oleg. Ekspert rasskazal, za skolko Azarov pokupaet gas u Germanii. *Golos.Ua*, http://ru.golos.ua/ekonomika/12_11_08_ekspert_rasskazal_za_skolko_azarov_pokupaet_gaz_u_germanii, accessed November 11, 2012.

deputy Board Chairman of Naftogaz, was 100 USD cheaper than that of Gazprom⁵⁰⁹. It was estimated that Ukraine theoretically could receive up to 10 billion of cm gas each year from Germany through pipelines in Poland, Hungary and Slovakia⁵¹⁰.

At the time the purchase of gas from German RWE would not sufficiently change Ukrainian dependence on Russian gas. But fulfillment of this Contract could bring us to several conclusions about the counterparts' expectations. First of all, Ukraine obtained a real opportunity to receive gas cheaper than Russian one (the price for fourth quarter of 2012 reached 436 USD). Second, for Ukraine this purchase had a great meaning of being a psychological 'irritating factor' for Russia. Baring her teeth, Ukraine treated this diversification as a first step to destroy big monopoly of Gazprom. Third, for the time being the amount of contracted gas to be supplied till the end of the year would not be of interest to any of the big chemical and metallurgical factories due to its small quantity.

From the other side, Germany's interest, as one of the biggest operator in European gas market, in selling gas to Ukraine could also be treated as a power demonstration, especially when other EU countries put Gazprom on a trial. The other reason, which could increase German's favor to support this gas supply to Ukraine, is Contract between RWE Dea (which is one of the RWE companies) and Naftogaz and Chornomornaftogaz about joint participation in discovery and exploitation of carbohydrates in northern-eastern part of Prykerchenskyi shelf of the Black Sea.

In March 2013 Ukrainian government signed technical agreements with Hungarian FGSZ and Polish Gaz-System to use their pipelines in the reverse mode for delivering gas to Ukraine. Combined deliveries through two countries in June 2013 reached 263 million cm of gas, while price was declared to be 30-50 USD lower than Gazprom's one. The last country, through which reverse gas supplies could take place, was Slovakia. Reverse supplies had already undermined Gazprom's monopoly and proved to be effective diversification tool. By increasing reverse supplies from EU countries, Naftogaz reduced annual gas purchases significantly. And as concluded by Vladimir Socor by reduction of Russian gas imports and unprecedented reverse-flow gas supplies from EU territory 'Ukraine is now developing some degree of immunity vis-à-vis Russian gas supply

509 Interfax-Ukraine. Naftogaz: Ukraine to cut gas purchases from Russia to 20 billion cubic meters of gas in 2013. (November 16, 2012). Kyivpost, <http://www.kyivpost.com/content/ukraine/naftogaz-ukraine-to-cut-gas-purchases-from-russia-to-20-billion-cubic-meters-import-5-billion-cubic-meters-of-gas-from-europe-in-2013-316217.html>, accessed on November 18, 2012.

510 Turchynska, Svitlana. Quest for cheap gas leads to Germany. (November 8, 2012). KyivPost, <http://www.kyivpost.com/content/business/quest-for-cheap-gas-leads-to-germany-315819.html>, accessed on November 10, 2012.

disruptions and related forms of pressure⁵¹¹.

Another option of diversification was a possibility of liquefied gas purchase from Azerbaijan, Egypt, Qatar and Algeria in the amount of about 5 billion cm. The receipt of this gas could become a reality under the terms of construction of liquefied gas terminal, which was scheduled by government to be finished by 2015 and with the investment amount needed of at least 1.5 billion USD. The construction of the LNG terminal has officially started on 26 November 2012. In the future the annual capacity of the LNG terminal would be increased by 10 billion cm by 2018. Therefore, by the completion of the bypassing pipeline South Stream, Ukraine most probably would be able to receive at least 5 billion cm of gas through LNG terminal⁵¹².

LNG terminal construction would be really a good progress in the direction of Ukraine's energy independence, if not a misfortune deal, when Spanish 'negotiator' Jordi Sarda Bonvehi breached authority by signing cooperation agreement with Ukraine on behalf of the Gas Natural Fenosa (Spain)⁵¹³. The latter company soon after issued a statement, declaring that neither it had any representatives in Kyiv, nor it agreed to join a consortium to build a 1 billion USD LNG terminal in Ukraine. Ukraine-Spain deal, which was to become a landmark of Ukraine's energy independence, appeared to be a hatched charade, which questioned the competency of negotiators and watered the grounds of LNG project. Though another version of this fake agreement was put on the Russians, who 'might have pressured Spanish firm Gas Natural Fenosa from investing in a project to build an LNG Black Sea terminal'⁵¹⁴. As stated by political scientist Volodymyr Fesenko, head of the Center of Applied Political Researches 'Penta', though the event was show off and from one side reflected internal power conflict, the Gazprom's influence should not be neglected⁵¹⁵. This project unless financially supported by European investors would end up to be an illusionary solution, which was destined to be left on the paper. To sum up the main argument of LNG terminal was to diversify gas import sources; access lower priced gas supplies; strengthen Naftogaz's bargaining position vis-à-vis its traditional supplier; and

511 Socor, Vladimir. (2013). Ukraine Diversifies Gas Supplies, Slashes Imports from Gazprom. *Eurasia Daily Monitor*, July 15, Vol. 10, Issue 129.

512 Ukraine's LNG Fiasco. Whatever happens – blame the Russians! (December 3, 2012). *Ukrainian Energy*, <http://ukrainian-energy.com/en/news/show/economy/details/539>, accessed on December 5, 2012.

513 Alic, Jen. Ukraine Crushed in \$1.1bn Fake Gas Deal. (November 29, 2012). OilPrice, <http://oilprice.com/Energy/Natural-Gas/Ukraine-Crushed-in-1.1bn-Fake-Gas-Deal.html>, accessed on December 4, 2012.

514 Ukraine's LNG Fiasco. Whatever happens – blame the Russians! (December 3, 2012). *Ukrainian Energy*, <http://ukrainian-energy.com/en/news/show/economy/details/539>, accessed on December 5, 2012.

515 Fesenko: bez rosiian v intsydenti z LNG-terminalom ne obiishlos. (December 5, 2012). *UNIAN*, <http://economics.unian.net/ukr/detail/149407>, accessed on December 5, 2012.

strengthen Ukraine's energy security in the event of a supply disruption. In addition it aims to create business synergies in combination with Ukraine's storage facilities⁵¹⁶.

The construction of Trans-Anatolian gas pipeline (TANAP), which was declared by Azerbaijan and Turkey in June 2012, appeared to be at the top of the agenda of Ukrainian gas supply diversification plans. 80 % of the project shares belong to Azerbaijan, while 20 % to Turkey. SOCAR plans to leave 51 % to hold the majority ownership, while 29 % will be sold to the interested parties. This appears to be a chance for Ukraine to achieve a stake in the project, which is of high interest because it does not demand the construction of any additional gas pipeline⁵¹⁷. Ukrainian Prime Minister Mykola Azarov confirmed that Ukraine is ready to 'make a financial contribution and provide pipes and compressor stations' to the TANAP project⁵¹⁸, while Ambassador Sergiy Korsunsky confirmed the ongoing negotiations with Azerbaijan about Ukraine's 10 % stake in TANAP⁵¹⁹. Unfortunately, plans of Ukraine to become a party of the Consortium were officially rejected by Azerbaijan due to the fact that 'Ukraine does not produce gas and the gas pipeline will not be built through its territory'⁵²⁰. Nevertheless, the construction was planned to end in 2018.

Meanwhile the continuation of TANAP the Trans-Adriatic Pipeline (TAP) seemed to be another chance for Ukraine to diversify gas supplies and to reduce reliance on Russian gas. Croatia, Hungary and Ukraine agreed to expand their existing pipelines to create a corridor that would carry natural gas through these countries and connect to TAP. As a result, they would create one more corridor that could transport 10 bcm of Azeri gas from Turkey to Eastern Europe. It was mentioned that the project, which would be officially announced as a pact of three countries in the near future, could also benefit from European funds⁵²¹.

The option to cooperate with Turkmenistan, who was a primary gas supplier till

516 International Energy Agency. (2012). *Ukraine 2012*. OECD/IEA, p. 108.

517 The existing pipelines infrastructure will assure the gas transfer from Turkey to Bulgaria, from Bulgaria to Romania, and finally from Romania to Ukraine. These pipelines are currently used to supply Russian gas through Ukraine, Moldova, Romania and Bulgaria to Turkey could be used in reverse mode replacing Russian gas with that of Azerbaijan.

518 Ukrainian PM: Ukraine Ready to Participate in TANAP. (May 8, 2012). Natural Gas Europe, <http://www.naturalgaseurope.com/-ukraine-ready-to-participate-tanap-6268>, accessed on November 13, 2012.

519 Ukraine May Seek Interest in TANAP. (May 16, 2012). Natural Gas Europe, <http://www.naturalgaseurope.com/ukraine-seeks-tanap-interest>, accessed on November 13, 2012.

520 Turan Information Agency. (June 24, 2013). Azerbaijan Refuses to Include Ukraine in TANAP Pipeline Project. *Downstream Today*, http://www.downstreamtoday.com/news/article.aspx?a_id=39895&AspxAutoDetectCookieSupport=1, accessed on October 24, 2013.

521 Kuzmanovic, Jasmina. (October 23, 2013). Croatia, Hungary, Ukraine to Create Adriatic Gas Corridor. *Bloomberg*, <http://www.bloomberg.com/news/2013-10-23/croatia-hungary-ukraine-to-create-adriatic-gas-corridor.html>, accessed on October 24, 2013.

2006, was now disputable, but seemed rather improbable due to the Russia's opposition to construction of another pipeline under the Caspian Sea, which would bypass Russia. From historical perspective negotiations between Turkmenistan and Ukraine did not achieve any long-term gas supplies agreements. Moreover, as Turkmenistan opted for new customers (Iran, China, Pakistan and India) and cooperation with them tended to have more benefits rather than cooperation with Ukraine, which relied on low Turkmen gas prices, it seemed that Ukraine would be undervalued as potential partner for long-term cooperation. Above all, Turkmenistan's gas deposits suffered from inconsistencies, while Turkmen Geologiya amounts 43 trillion cm, German Federal Institute for Geosciences and Natural Resources estimated only 9 trillion cm⁵²², which also questioned Turkmenistan's ability to export big quantities of gas abroad.

5.2. Rapprochement with Russia and the role of the interest groups

Second foreign trip of Yanukovych was scheduled to Russia and took place on 5 March 2010. The meeting with Russian president Dmitry Medvedev and Prime Minister Vladimir Putin was aimed to improve the hostile climate of bilateral relations, which existed under Yuschenko's presidency. Among vital issues to be discussed included the revision of unfavorable 2009 Tymoshenko-Putin gas deal conditions, under which Ukraine had been buying gas at one of the highest price in Europe. In return for these concessions Kyiv was ready to discuss Russia's extension of the agreement on the Black Sea Fleet's stationing in Crimea. Yanukovych again resumed the idea of tripartite Consortium with Russia.

The development of Russian energy sector during 2010-2012 proved a tendency of full state control of this strategic sector. Putin's establishment of the Commission, which handed energy sector directly to Putin's hands, sharpened this tendency. At the same time controlled energy market opening strategy provided Russia with unique opportunity to enter foreign energy markets and hence to raise its influence abroad. These steps led to the situation when all instruments were used in order to keep countries like Ukraine and Moldova (which recently became EEC) in own sphere of interests. EU's position lacking unanimity and consistency ended with some of EU's countries supporting Russian bypass projects, while withdrawing from EU-led pipeline projects. Therefore, Russia's thoroughly shaped energy strategy brought quite fruitful results.

522 Götz, Roland. (2007). Ukraine and Belarus: Their Energy Dependence on Russia and their Roles as Transit Countries. In Hamilton, Daniel and Mangott, Gerhard. (Eds.). *The New Eastern Europe: Ukraine, Belarus, Moldova*. Center for Transatlantic Relations, Austrian Institute for International Affairs, pp. 157.

5.2.1. Changes of Russia's domestic energy policy and its effect on Ukraine's energy policy

Before the appointment of Putin as a president of the Russian Federation on May 7, 2012, Medvedev conducted quite different energy policy. On March 30, 2011 Medvedev declared the need of exclusion of ministers and other officials from the boards of state companies⁵²³. This step was explained by the need of investment climate improvement and was treated as an attempt to decrease government's influence over energy companies. Surprisingly, close affiliates of Putin (including Igor Sechin) were in practice removed from their positions in energy companies. The follow-up investigation ordered by Putin in November 2011 proved that half of the heads of the energy companies were involved in money laundering through offshore companies, eight of them resigned afterwards⁵²⁴.

Alteration of Medvedev's policy in energy sector took place after his Putin's inauguration. The come back of Sechin as chairman of the Board of Directors of Rosneftegaz symbolized new era of Putin in power. Rosneftegaz was designated to become the key investor in energy sector. It all resembled the times when 'in 2004-2005 Sechin aspired to create a huge oil and gas monopoly in Russia, combining Gazprom and Rosneft'⁵²⁵.

Introduction of new concept of energy sector management by Vladimir Putin resulted in two main outcomes, which shifted control of this sector into the hands of Putin⁵²⁶ and increased Russian energy sector engagement and influence abroad. Domestic policy of partial energy market opening⁵²⁷ took place in parallel with obtaining shares of leading foreign energy companies. Stronger internal position led to Russian more persistent and adamant opposition against EU-led energy market liberalization. These developments shaped Moscow's foreign policy behavior toward neighbors, who pursue harmonization in compliance with EU's *acquis*, and increased energy leverage as most effective bargaining chip.

523 Gusev, Alexander. (October 15, 2012). Putin increases control over Russian energy. *European Energy Review*.

524 Ibid.

525 Ibid.

526 This happened due to Putin's policy of 'soft dirigism' or statism, which meant the state-administered creation of market infrastructure and structural economic reforms. More on this, Sakwa, R. (2007). *Putin: Russia's Choice*, New York: Routledge, 2nd Edition.

527 Putin preferred a model of international collaboration in which Russian company had a majority stake in the project. As gas branch was considered strategic Russian government could even fight to get the control over some important companies back. This policy was further strengthened by amendments to Subsoil Law (2007) and further ratification of the law limiting foreign investment in strategic branches (2008). See, Heinrich, Andreas. (November 2008). Under the Kremlin's Thumb: Does Increased State Control in the Russian Gas Sector Endanger European Energy Security? *Europe-Asia Studies*, Vol. 60, No. 9, pp. 1543-1544.

One of the important developments, which are worth mentioning, is the establishment of the President's Commission for the Strategic Development of the Fuel and Energy Complex and Environmental Safety on June 15, 2012⁵²⁸. This Commission was chaired by Vladimir Putin, while closest aide of the President Igor Sechin⁵²⁹ was appointed as secretary. Commission including wide range of ministerial institution and national energy market's regulatory authorities, gained a very wide authority. The functions of this Commission comprised the foundations of the oil and gas sector operation, from price controls on the internal market, fiscal policy, granting concessions for research and development of resources to strategy development as a whole and in the regions in particular.

The establishment of Presidential Commission proved the ongoing trend of Russia's energy sector flowing into the hands of Vladimir Putin. The creation of this Commission in the time when an alternative government committee headed by Deputy Prime Minister Arkady Dvorkovich, who is close tie to Dmitry Medvedev, still exists, which means marginalization of Medvedev and strengthening of Putin's authority in energy sector. Presidential Commission signaled to be the first stone in renewing the political subordination, which existed during Putin's first two terms (2000-2008), when Ministry of Energy acted as contractor of Kremlin's decisions.

Since 2011 Russia continued a policy of controlled opening-up of the energy sector to foreign investors, which due to economic crisis in 2008 was suspended. The objectives of the strategy were twofold 'to use foreign capital and technology to increase extraction in Russia, and to strengthen Russia's presence on foreign markets by exchanging assets with businesses outside Russia'⁵³⁰. Limited amount of foreign companies⁵³¹ entered the market only under the political consent of Russian government and their activity would be rather limited by possessing a minor voice in decision-making of the strategic energy sector. This state-controlled energy market opening aimed at engaging more experience and technology

528 Putin Sets Up Oil Industry Development Commission. (June 15, 2012). *RIA Novosti*, <http://en.rian.ru/business/20120615/174052485.html>, accessed on December 11, 2012.

529 Igor Sechin is the president of Rosneft, and during Putin's term of prime minister (2008-2012) he was the Deputy Prime Minister for energy and headed a government commission on fuel and energy.

530 Wisniewska, Iwona. (March 3, 2011). Controlled opening-up of Russia's energy sector to foreign investors. *EastWeek*, No. 9 (244), Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2011-03-09/controlled-opening-russia-s-energy-sector-to-foreign-investors>, accessed on December 6, 2012.

531 French energy company Total bought 13 % of Novatek (largest gas producer, independent from Gazprom), BP took 9.5 % of Rosneft (Russian state-owned oil group), Indian company ONGC acquired 25 % of Bashneft (Russian private oil group). See, Wisniewska, Iwona. (March 3, 2011). Controlled opening-up of Russia's energy sector to foreign investors. *EastWeek*, No. 9 (244), Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2011-03-09/controlled-opening-russia-s-energy-sector-to-foreign-investors>, accessed on December 6, 2012.

into energy sector of Russia, while Russian investors obtained attractive shares in companies, which had direct access to consumers in Europe. This strategy succeeded in killing two birds with one stone, Russian energy sector increased the extraction of raw materials and Russian business expanded beyond the role of raw suppliers. Though it did not improve investment climate, foreign energy business attracts high interests from foreign investors due to high revenues.

The other tendency showed another instrument of Moscow to control so dear energy markets by buying shares of foreign companies. Therefore, in October 2012 50 % of TNK-BP shares were to be bought by Rosneft⁵³². This most expensive transaction in the history of the energy sector of Russia proved Kremlin's real intentions to strengthen its strategic influence in oil sector. TNK-BP owned in Ukraine one of the biggest oil refineries Lysychansk oil refinery, which meant that this factory moved under the influence of Russia. Moreover, the strategy of exchange of shares of Russian and foreign investors threatened Ukraine's energy sector as this was used by Russian government as an instrument to enter Ukraine's energy sector.

Strengthening energy sector under precise state control also developed Russia's foreign policy priorities to clearly counterbalance and oppose EU's liberalization process. Moreover, by issuing 'A Conceptual Approach to the New Legal Framework for Energy Cooperation' in 2009, Moscow boycotted EU's liberalization process and declared the preservation of the status quo in energy market. This document though treated as propaganda reflected Russia's intentions in energy sector. Therefore, Russia's relations with EU and non-EU countries followed the same trend to counter liberalization process stipulated by the Energy Charter. A great example was observed in Moldovan case, when in September 2012 Russia gave an ultimatum to Moldova: either gas discount of 30 % or adoption of Third Energy Package, which is stipulated by the membership of the European Energy Community⁵³³. As Moscow owned controlling share package in Moldovagaz, adoption of Third Energy Package would completely remove Gazprom's control of the Moldovan company. Therefore, Moscow's pressure aimed at Moldova's withdrawal from Energy Community and further signing of Deep and Comprehensive Free Trade Agreement. Russia's pressure increased also taking into consideration that Russia's trump card would lead to blackmailing with Transnistria's gas debt to be paid by Moldova.

532 BP sells TNK-BP stake to Russia's Rosneft. (October 22, 2012). *BBC News*, <http://www.bbc.co.uk/news/business-20030610>, accessed on December 6, 2012.

533 Wierzbowska-Miazga, Agata. (September 19, 2012). Russia's energy ultimatum to Moldova. *EastWeek*, No. 30 (306), Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2012-09-19/russia-s-energy-ultimatum-to-moldova>, accessed on December 10, 2012.

These changes in Moscow's energy policy resulted in fully state-controlled energy sector, which used energy tool (gas discounts, representation in the European energy companies, energy debts etc.) as an instrument to achieve foreign policy goals. Russia's position toward Ukraine and Moldova as new members of the Energy Community concluded ambitions to push these countries for withdrawal from the Energy Community and therefore for suspension of the energy market liberalization in accordance with EU's acquis. Kremlin neatly used Gas Contracts as bargaining chips to freeze energy market reforms as lack of transparency and high level of corruption raised Gazprom's chances to control the countries.

Internal changes in Russia's energy sector, which led to more centralized and state-controlled management of energy sector, implicitly affected Ukrainian energy equilibrium. Ukraine's 4.3 billion USD of outstanding debt in the first half of 2012⁵³⁴, was slowly but consequently pushing Ukraine either to stick to IMF conditions on gas price increase or to reconsider options of Russia's crediting Ukraine. Moreover, claims of Russia that Ukraine's gas arrears reached 7 billion USD initiated new ways of explanations according to the which, Russia was punishing Ukraine for cooperation with Shell or Firtash, who also bought gas last year, had fully paid for it so far⁵³⁵. Whatever the reason of the gas arrears was, taking Russia's regional integration ambitions into consideration, new gas deal or loan options could hardly be reached without significant concessions from Ukraine's side. Therefore, Russian domestic and foreign policy priorities rather created such an environment, when pressure exposed on Ukraine possessed growing tendency.

To sum up, domestic and foreign policy of Russia in energy sector proved its commitment to counterbalance and oppose European energy liberalization process. Controlled market opening and foundation the Putin's Commission on energy strengthened energy tool domestically and transferred this power into foreign policy paradigm. Unwillingness of EU energy liberalization to be spread around the borders of Russia, initiated more aggressive behavior of Moscow, when all possible leverage was used in order to suspend this process. Hence, not only Ukraine, but also Moldova and other EU countries faced more intractable position of Russia when it came to energy issues.

534 Lovasz, Agnes, Krasnolutska, Daryna. (November 23, 2012). Ukraine's Options Wane as Payment Time Nears Amid IMF Freeze. *Bloomberg*, <http://www.bloomberg.com/news/2012-11-22/ukraine-s-options-dwindle-as-payment-time-nears-amid-imf-freeze.html>, accessed on December 10, 2012.

535 Weekly Analytical Report. (January 28 – February 3, 2013). UA Energy, DIXI Group, http://ua-energy.org/upload/files/Weekly28_01_03_02.pdf, accessed on February 23, 2013.

5.2.2. Kharkiv Agreement and 'Fleet for Gas' formula

Ukrainian Parliament ratified the Agreement on the Russia's lease extension for the stationing of the Black Sea Fleet in Crimea until 2042 on 27 April 2010. Almost the same time Russian State Duma unanimously ratified the same document. In return Ukraine gained short-term benefit of lower price for gas imported from Russia. This Agreement was signed together with the Resolution on deepening cooperation in the nuclear industry between two countries.

The agreement was of pure political nature: in exchange for gas discount, Yanukovich agreed to the extension of the Black Sea Fleet lease, which was only to expire in 2017. Signing two agreements at once proved to be a faulty behavior of two actors, where commercial and political interests were mixed. Moreover, asymmetrical relations between Ukraine and Russia proved disadvantageous position of Ukraine, for which fault lines (high base price, annual gas quantity, take-or-pay clause) remained unchanged.

'Fleet for gas' formula was completed by the amendment to the gas agreement from 19 January 2009. This amendment altered the price of gas by reducing it by 30 % if the contract price does not exceed 330 USD per 1000 cm or reducing it by 100 USD if the price is higher than 330 USD. The quantity of gas for 2010 has also increased from 33 billion to 36.5 billion cm, but remained unchanged for the remainder of the contract until 2019 (52 billion per annum). The agreement now excluded penalties resulting from the 'take or pay' clause, though the clause itself was not removed. Reduction of the gas price followed also the reduction of the transit rates to 0.24 USD per 1000 cm over a distance of 100 km, but no guaranteed quantities of gas to be transmitted were mentioned⁵³⁶.

The amendment apart from consequences of political nature also had economic implications. Actually the discount Ukraine obtained to the terms of the Amendment was equal to an exemption from export duty granted by Russian government⁵³⁷. The base price for gas (which was calculated on the basis of 50% gasoil, 50% fuel oil) was left on the European level, hence in the first quarter of 2010 price was 305 USD, in second quarter it increased to 336 USD without discount. Without a doubt net gas price appeared to be a great burden for the budget, where the gas price was envisaged at much lower level of 260 USD.

536 Kharkivske dopovnennia do gazovogo kontraktu Tymoshenko-Putina. Tekst dokumentu. (2010, April 22). Ukrains'ka Pravda, <http://www.pravda.com.ua/articles/2010/04/22/4956389/>, accessed October 6, 2012.

537 Ibid.

In addition to high base price ‘take-or-pay’ clause was another shortcoming, which was not altered. In the time when Ukraine’s gas demand declined dramatically, Ukraine was obliged to pay heavy penalties for lower off-take. Though in 2009 Gazprom agreed to reduce annual contract quantity, which was documented in separate addendum, but the total gas quantity to be bought for the period of 2011-2019 remained the same at the level of 52 bcm/year⁵³⁸.

Though the transit rates were reduced, no corresponding ‘ship-or-pay’ obligation was introduced. This situation directly meant the possibility of Gazprom to reduce transit volumes through Ukraine without any further penalties. This tendency was vividly observed in 2009 when Russia transited 24.2 bcm of gas less than it was stipulated in the contract⁵³⁹.

The usage of Ukraine’s gas storage capacities as main compensation offered to Gazprom transpired on 16 of April 2010. After 2006 gas crisis it should be noted that Ukraine gas storages (which are stated by Naftogaz to amount 40.1 bcm) were used by RosUkrEnergo, which represented the interests of Gazprom. As RosUkrEnergo was ousted from gas business since 2009, it is not clear on what conditions Russian gas is stored in Ukraine. More importantly, Ukraine’s storage capacities could become a key element of European gas storage. As surveyed by Gas Infrastructure Europe thirty European countries possess gas storage capacity of 85.08 bcm⁵⁴⁰, while Ukraine alone has little less than half of it, and moreover half of the storages are located in geographical proximity to Europe (western border of Ukraine). The storage capacities though could be interesting for Europe cannot be used in full capacity as storage itself belongs to Naftogaz’s subsidiary, means is state-owned, and therefore neither third-party access arrangements are possible nor any other information on spare volumes capacity is being publicly announced. Therefore, lack on storage provisions leaves room for murky practices.

Kharkiv Agreement cannot be analyzed without making a parallel with akin 1997 Agreement, where ‘gas-for-fleet’ formula was firstly applied. Russia did reduce the gas supply by 25 % before Massandra Summit and during the Summit the multi-billion dollar debt for energy was cancelled in exchange for full control over the Black Sea Fleet⁵⁴¹. But

538 Pirani, S., Stern, J., Yafimava, K. (June, 2010). The April 2010 Russo-Ukrainian gas agreement and its implications for Europe. *The Oxford Institute for Energy Studies*, p. 14, http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/05/NG_42.pdf, accessed October 6, 2012.

539 Yeremenko, Alla. (April 17, 2010). Osobennosti pravki gazovykh kontraktov. *Zerkalo Nedeli*, No:15, http://zn.ua/ECONOMICS/osobennosti_pravki_gazovyh_kontraktov-59877.html, accessed October 8, 2012.

540 GSE Storage Map Database, June 2010, <http://www.gie.eu/index.php/maps-data/gse-storage-map>, accessed October 8, 2012.

541 Van Hamm, Peter. (February, 1994). Ukraine, Russia and European Security: Implications for Western Policy. *Chaillot Papers*: 13, Institute for Security Studies, Western European Union.

there is still an important difference 1997 Black Sea Agreement was a compromise reached to find the way out from an economic impasse, which nevertheless raised the risk of foreign fleet movement without Ukraine's notification⁵⁴². The foreign fleet dislocation within the territory of Ukraine is a time bomb, which is working against Ukraine. Black Sea Fleet is de facto the largest single economic actor in Crimea, with vast known and unknown functions⁵⁴³. Therefore, extension of the lease will just strengthen already quite influential position of Russia in Crimea.

Kharkiv Agreement was first of all an attempt to improve relations after Yushchenko's deteriorating political relations with Russia. The negotiators from Ukrainian side prolonging the lease of the Black Sea Fleet in Crimea for 25 years could hope to get an essential gas discount. Instead the discount appeared to be 'virtual', and Ukraine continues to pay the most expensive gas price in the whole Europe.

This Agreement appeared to be a great failure of the Yanukovich's administration, which undervalued Ukraine's bargaining capacity and therefore opened the door for Russia to lay claims to Ukraine's further concessions. As noted by James Sherr: 'In signing these agreements, Yanukovich and Prime Minister Mykola Azarov have displayed a conspicuous lack of apprehension regarding Russia's intentions, an artless lack of caution in allowing that country's leverage to be strengthened and a casual (if, lamentably, better grounded) faith that the West will welcome them as further step towards 'stability'⁵⁴⁴.

The concerns raised by the opposition demanded the renouncing of the Kharkiv Agreement, which actually did not lead to any real actions. But in case of fulfilling Ukraine's losses would prevail over benefits as Russia would definitely withdraw gas discount and Ukraine's reputation of poor implementation of international agreements would be blackened.

Kharkiv Agreement weakened Ukraine's negotiation position, as the formula of the gas price, most vital part of the Agreement, had not been changed. Price leverage was used as an effective political tool by Russia. As stressed by Frank Umbach gas price was always an effective leverage of Russia: 'Moscow has therefore punished Ukraine, Georgia and the three Baltic states for their pro-NATO and Western-oriented foreign, security and energy

542 Russian actions against Georgia in August 2008 Georgian War.

543 According to the former SBU Chairman Nalyvaichenko, 'Russian counter-intelligence have undertaken on our territory unfriendly actions, including the covert collection of ... secret information'. See, Sherr, James. (August 2010). *The Mortgaging of Ukraine's Independence. Briefing Paper*. (16). Chatham House, REP BP 2010/01.

544 Sherr, James. (August 2010). *The Mortgaging of Ukraine's Independence. Briefing Paper*. (3). Chatham House, REP BP 2010/01.

policies'⁵⁴⁵. Taken into consideration Ukraine's heavy industry dependence on gas prices, Russia will play gas card much more in order to achieve its goals in foreign policy. Bypassing projects will strengthen Russia's position in gas price negotiations, and as defined by Putin will lead to 'slowly and surely turning away from the dictate of transit states'⁵⁴⁶.

5.2.3. Ukrainian-Russian gas negotiations: Naftogaz-Gazprom Merger and Customs Union accession.

After signing Kharkiv Agreement the repercussions of the ill-functioning economy, low growth rates, corruption and inflation cemented Ukraine's dependence on Russian gas. As Taras Kuzio neatly pointed out, 'The weaker the economy, the greater the likelihood of economic pressure, foreign influence, dependence on imports, and an ability to pay for budgetary outlays on defence'⁵⁴⁷.

Boom of 30 % gas price cutoff after Kharkiv Agreement evaporated and a clear picture that 'virtual discount' costs nothing led to unavoidable conclusions of badly needed negotiations to be held in order to revise immensely high gas price. Russian negotiators offered Ukraine just two options from which Ukraine had to choose: one, Naftogaz and Gazprom's merger (different from previous attempt of tripartite Consortium⁵⁴⁸) and another, which included Ukraine's accession to the CIS Customs Union of Belarus, Kazakhstan and Russia. With these two options in hand Ukraine explicitly appeared to be in a 'losing' position, where political concessions were prioritized over legal measures.

Putin's offer of Gazprom and Naftogaz's merger on April 30, 2010 seemed more like an offer of takeover as described by Frank Umbach, which perfectly reflected Russia's debt-for-equity privatization model in the 1990s⁵⁴⁹. An offer of the merger of Naftogaz, which is a 'bankrupt, wholly owned by the Ukrainian state, which regularly props it up

545 Umbach, Frank. (2011). Ukraine's Energy Security Challenges: Implications for the EU. In T. Kuzio, D. Hamilton (Eds.). *Open Ukraine. Changing Course towards a European Future*. (108). Washington, DC: Center for Transatlantic Relations.

546 Nord Stream to make supply disruptions a thing of the past. (September 6, 2012). RT, <http://rt.com/business/news/russia-nord-stream-start-929/>, accessed on November 28, 2012.

547 Kuzio, Taras. (1995). *Ukrainian Security Policy*. Praeger Publishers, p. 43.

548 One should not forget that an attempt to manage Ukraine's transmission network was already done in 2002 by Gazprom, Ruhrgas and Naftogaz. Due to the lack of progress Ruhrgas withdrew from this project, and consortium ended with one pipeline project. According to 1995 law, is forbidden to be transfer or sell transmission network of Ukraine to any foreign company. Therefore, Ukraine instead of ownership rights can only offer Russia management rights, which is not that much beneficial for Russia.

549 Umbach, Frank. (2011). Ukraine's Energy Security Challenges: Implications for the EU. In T. Kuzio, D. Hamilton (Eds.). *Open Ukraine. Changing Course towards a European Future*. (101). Washington, DC: Center for Transatlantic Relations.

financially because of the social and political, in addition to economic, functions it performs' and Gazprom, which 'prides itself as an effective business with favorable access to capital markets' could be better interpreted as a 'corporate raid on Ukraine'. In opinion of Edward Chow, senior fellow in the Center for Strategic and International Studies in Washington, D. C., such a corporate raider as Gazprom intends to strip the most valuable asset of Ukraine – Gas Transportation System and it could be done only with the help of the insider when bankrupt company turns to be a converted asset of Russia⁵⁵⁰.

It is important to mention that Naftogaz-Gazprom merger project even if being successful did not guarantee Russia's withdrawal from South Stream project, which appeared to be 'a vivid manifestation of informational manipulation'⁵⁵¹. After commissioning Nord Stream pipeline, Russia's intentions toward construction of the South Stream sounded as a threat, which would end with suspension of the usage of Ukrainian GTS. Therefore, these declarations had only one aim to put Ukraine into impasse and to accept Russia's proposals. But irrespectively of any steps Ukraine had taken, South Stream pipeline would remain a 'priority project', therefore Yanukovich's confidence that privileged energy relations would remove the rationale from the bypassing project appeared to be false.

Among others Viktor Medvedchuk criticized Ukraine's passive role, which burried the idea of tripartite Consortium. He stated, 'By the way, eight years ago real opportunity to create joint project existed, and it was not just about Ukrainian Gas Transportation System. In exchange for the share in national GTS, we could have claimed on analogical Naftogaz's participation in European and Russian projects. Both related to gas transportation and extraction as well. Moreover, we were offered to extract gas in Siberia. This would be totally different quality of economic relations of Ukraine with its neighbors. This would mean that Ukraine became fully-fledged participant of European politics' by carrying out its commitments, and not just asking for money and assistance. Our government appeared not to be ready for it. Now even when Gas Consortium idea is mentioned (though I fully understand it is all about just empty talks), grandiose idea ends up with triviality: give us

550 Chow, Edward C. (May 7, 2010). Neighborly Corporate Raid. Kyiv Post, <http://www.kyivpost.com/opinion/op-ed/neighborly-corporate-raid-66079.html>, accessed on November 26, 2012.

551 EU-Ukraine-Russia Energy 'Triangle': Dependency, Interests, Contradictions. (2012). In *EU-Ukraine-Russia relations: Problems and Prospects. Analytical Report*. (32). Razumkov Centre: Kyiv.

money'⁵⁵². The Consortium idea, which had chances to transform into much more efficient tool to ensure Ukraine's role as equal partner with its neighbors perished.

Second option of Ukraine's accession to the Customs Union offered by Russia was seducing with promises of cheap gas prices equal to Russian domestic gas prices (about 160 USD per 1000 cm), elimination of export duties on oil and oil products as well as safeguard measures in bilateral trade, which will lead to increase of Ukrainian export to Russia. Apart from political will two important obstacles were restraining Ukraine from joining Customs Union: WTO membership and Constitution, which prohibits from surrendering decision-making powers to any supra-national authority⁵⁵³.

Russia insisted that Ukraine's choice of the Customs Union would be a pragmatic choice, though no substantial evidence of benefits were provided. The same time Russia warned that once free trade area with the EU is formed, it could threaten Russia with cheap EU exports. In this case Moscow will be forced to impose stricter control on the Customs Union's border. Russia flexed its political muscle, when during summer of 2011 Customs Union's members raised customs duties for certain food categories of Ukraine and introduced antidumping measures against several steel pipe manufactures in Ukraine⁵⁵⁴.

As neatly pointed out by Olga Shumylo-Tapiola 'For Russia, striving to rebuild a closely linked economic area within the post-Soviet space, Ukraine plays a key role. Without Ukraine, the post-Soviet space's second largest economy, the Customs Union and further integration projects may be unsustainable in the long-term⁵⁵⁵. Moreover, 40 % of Ukraine's trade is with the countries of Customs Union, which theoretically would 'fall within Ukraine's national interests', but on the other hand, 30 % of its trade with the EU and political association would also 'answer to the national interest', as it was defined by Prime Minister Mykola Azarov⁵⁵⁶. Though Prime Minister announced that cooperation with two

552 Translation mine. See, Ukrayini potribno bulo samii zaproponuvaty stvorennia gozotransportnogo konsortsiumu z Rosiyeyu i ES, - Medvedchuk. (December 5, 2012). *RBK Ukraine*, <http://www.rbc.ua/ukr/newline/show/ukraine-nuzhno-bylo-samoy-predlozhit-sozdanie-gazotransportnogo-05122012130700>, accessed on December 5, 2012.

553 To join Customs Union Constitution of Ukraine should have been amended by Parliament or public referendum in the way to allow surrendering decision-making power to supra-national authority. Withdrawing from the WTO membership, in other hand, would most probably force Ukraine to pay fines to other WTO members (app. 1.5-2 billion USD annually). See, Shumylo-Tapiola, Olga. *Ukraine and Russia: Ever Closer Neighbors?* (June 8, 2011). Policy Outlook. (7) Washington, D.C.: Carnegie Endowment for International Peace.

554 Shumylo-Tapiola, Olga. (April 2012). *Ukraine at the Crossroads: Between the EU DCFTA & Customs Union*. (22). Russia.Nei.Reports No.11. IFRI: Paris, http://www.ifri.org/?page=contribution-detail&id=7104&id_provenance=97, accessed on November 27, 2012.

555 Shumylo-Tapiola, Olga. (April 2012). *Ukraine at the Crossroads: Between the EU DCFTA & Customs Union*. (4). Russia.Nei.Reports No.11. IFRI: Paris, http://www.ifri.org/?page=contribution-detail&id=7104&id_provenance=97, accessed on November 27, 2012.

556 Azarov: Russia promises Ukraine gas for \$160 if it joins Customs Union. (October 9, 2012). *Kyiv Post*, <http://www.kyivpost.com/content/ukraine/azarov-russia-promises-ukraine-gas-for-160-if-it-joins-customs-union-314122.html>, accessed on November 27, 2012.

sides rather than choosing one would be the most beneficial, in practice CIS Customs Union membership was shelved as Ukraine's EEC membership initiates first steps in energy market liberalization. Instead Ukraine offered to cooperate with the Customs Union on the basis of the '3+1' formula, therefore when the common tariff scheme would be adopted, Ukraine was to renegotiate existing bilateral free trade agreement with these countries as a unified block.

None of the two options offered by Russia, including merger of Naftogaz and Gazprom or joining CIS Customs Union, had not been accepted by Ukrainian government. Russia's inability to treat Ukraine as an equal partner resulted that 'Yanukovich gave away so much, so quickly, for nothing – including the mythical 30 percent gas 'discount'⁵⁵⁷. At the end Ukrainian president confessed that Russian position could be described as 'humiliating': 'We will not allow to talk to us in such a way ... (They) pushed us in the corner, at first, and then started to dictate terms. Today it humiliates not only me, but it humiliates the state, and I cannot allow it'⁵⁵⁸.

The reasons why Consortium idea never worked are clear. From Russian perspective, modernization of Ukrainian GTS could be performed only under conditions of Russia's possessing 51 % of shares. The idea of tripartite joint venture including the EU was never of great attention for Gazprom. Not surprisingly understanding the potential Belarus scenario, which Ukraine could face, in February 2007 parliamentarians adopted the Law preventing selling, leasing or renting of energy infrastructures to foreign investors. This was the time, when deputies realized that if Russia controls Ukrainian gas and oil pipeline network, entire economy would be directly handed to Russia. Customs Union accession was used by Moscow as a carrot along her 'stick-and-carrot' policy, where low gas price would play a role of short-term concession and Kyiv would be trapped to follow Belarusian scenario.

As cited by Yushchenko's deputy in energy issues Bogdan Sokolov'skyi 'If to say sincerely, nowadays our GTS of Ukraine is being under Russian control much more than it could be under terms of official Consortium'⁵⁵⁹. Moreover, for Russia Consortium idea could be late as it already focused on transit diversification of Nord and South Stream. But as Prime Minister Putin pointed Russia's commitment to Nord Stream 'of course reduces

557 Kuzio, Taras. Poor Ukrainian-Russian Ties Reflect Yanukovich-Putin Relationship. (September 30, 2011). *Eurasia Daily Monitor*, Vol. 8, Issue 180.

558 Solovyov, Dmitry, Ostroukh, Andrey. (September 3, 2011). Ukraine to Seek Better Gas Deal without Gazprom Merger. *Reuters*, <http://uk.reuters.com/article/2011/09/03/uk-ukraine-russia-gas-idUKTRE7821EX20110903>, accessed on November 27, 2012.

559 Makarenko, Aleksandr. (March 5, 2010). Gazovye shakhmaty. *Vzgliad*, <http://vz.ru/economy/2010/3/5/381585.html>, accessed October 8, 2012.

our interest in participating in work on the Ukrainian gas transport system. But we are still interested'⁵⁶⁰. Unless concessions on ownership rights are offered, Russia would concentrate on diversification projects.

Moreover, Putin's ambitions toward Ukraine are far more reaching, 'If Putin was interested in Ukraine only as a market for Russian gas sale, he undoubtedly would respond to Kyiv package proposals, including modernization of the GTS. [...] But as Putin needs all Ukraine, and not only its gas market, one should not hope that Russia will loosen the gas price lasso, with the help of which it is dragging Ukraine into the Customs Union'⁵⁶¹. As a conclusion, Russia does not see any commercial rationale to be interested in the expansion of Ukrainian gas transport system.

In his speech at Congress concluded that 'Kharkiv Agreement essentially confirmed and locked his new government into the terms of the agreement made by then-Prime Minister Yulia Tymoshenko and Prime Minister Vladimir Putin in January 2009, the unfairness of which she is currently accused and jailed'⁵⁶². On October 11, 2011 Tymoshenko was trialed because of the highly unfair contract that she agreed to sign with Russia in 2009, which was further defined as the biggest damage to Ukraine's national interests. Nevertheless, European and US politicians vastly opposed these charges and even protested them during EURO-2012. On May 17, 2012 in the Resolution of the Senate of the United States politicized and selective prosecution, which led to the imprisonment of Yulia Tymoshenko, was condemned and defined as one that threatens to jeopardize ties between the United States and Ukraine'⁵⁶³. Moreover, this Resolution also offered to introduce a visa ban against those responsible for Tymoshenko's imprisonment.

April Agreement suspended an effort of depolitisation of Ukraine-Russia gas relations. An offer of 'political discount', which would amount about 3 billion USD per year, to be paid by Russian government confirmed the statement that Russian government agreed to pay for it rather than extract it through Gazprom's balance sheet. The amendment to the January 2009 Agreement left more disputable questions, which will not possess durable effect and further changes should be expected. The role of two main actors to

560 Namek na soiuz. (March 30, 2010). *Energobiznes*.

561 Liuta, Ganna. 'Nikto ne dast nam izbavlenia' – ni Bog, ni Putin, ni 'Gazprom' ... (December 7, 2012). *Zerkalo Nedeli*, No. 45, http://dt.ua/POLITICS/nikto_ne_dast_nam_izbavleniya__ni_bog_ni_putin_ni_gazprom-113452.html?print, accessed on December 16, 2012.

562 Chow, Edward C. (February 1, 2012). Statement before the Senate Foreign Relations Committee, Subcommittee on European Affairs 'Ukraine at a Crossroads: What's at Stake for the U.S. and Europe?' *Energy and National Security Program Center for Strategic and International Studies*, p. 5, http://csis.org/files/120201_tschow.pdf, accessed October 7, 2012.

563 Senate of the United States. (2012). Resolution. Calling for the release from prison of former Prime Minister of Ukraine Yulia Tymoshenko (No. 466). Washington, D.C.

influence Ukraine's energy sector will depend on Ukraine's will to offer some concessions (in case of Russia) and political will to introduce painful but necessary energy reforms (in case of EU). Any Ukrainian concession to Moscow proved to lead to short-term benefits and immense long-term losses. Diversification was not a topic during April talks. Hence, the need to resume direct gas sales from Central Asia to two main gas consumers Rinat Akhmetov's metallurgical group and Konstantin Grigorishin power producer group did not find support from Russian counterpart⁵⁶⁴. Consortium idea regardless EU's initiative in organizing conference on Ukraine's energy sector restructuring slowed down and consequently is losing its sense. While new ways of finding investment for network maintenance could be found, the possibility of substantial investment diminishes and hence Ukraine could become a 'residual transit route of last resort'⁵⁶⁵. But these developments push Ukraine into the arms of the EU, namely into more close cooperation in energy sector, as for the time being it seems to be the only future prospect to decrease dependency of Russia.

Kharkiv Agreement cemented so far established relations of unequal and unbalanced partnership. Yanukovych regardless his pro-Russian policies, obtained less leverage that Kuchma had ever had when he was manipulating NATO cooperation with the support of the USA. And Russian position becomes even more severe with suspension of pre-payment practice for the transit of Russian gas to EU territory. Gazprom disbursed the last pre-payment in the amount of 1 billion USD at the end of June and Gazprom's CEO Alexei Miller announced that Gazprom 'would never again, under any circumstances' use Ukraine's gas storage system in the process of delivering Russian gas to Europe via Ukraine⁵⁶⁶. Importantly to note that Naftogaz was using pre-paid transit fees in order to keep up with gas payments to Gazprom. Therefore, suspension of pre-payment directly increases Russian leverage through harsher financial pressure on Ukraine. As neatly pointed out by Vladimir Socor: 'Combining exorbitant price levels with relatively insignificant price relief devices, Gazprom retained Ukraine as the biggest paying customer for Russian gas; albeit a

564 Since 2005 Gazprom became monopsonistic buyer of central Asian gas exports, and since 2009 Gazprom started to pay Central Asian countries European-related prices for gas, direct sales from Central Asia were out of question.

565 Pirani, S., Stern, J., Yafimava, K. (June, 2010). The April 2010 Russo-Ukrainian gas agreement and its implications for Europe. *The Oxford Institute for Energy Studies*, p. 41, http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/05/NG_42.pdf, accessed October 6, 2012.

566 Socor, Vladimir. (2013). Future of Ukraine's Gas Transit System Linked with Ukraine-EU Association Agreement. *Eurasia Daily Monitor*, Vol. 10, Issue 129.

captive customer, with Naftogaz constantly on the verge of bankruptcy and exposed to Russian takeover.⁵⁶⁷

5.2.4. The role of Ukrainian interest groups in Ukraine-Russia energy cooperation

Attitude of the interest groups to Russia's policy of stick-and-carrot could be determined by high dependency of Ukrainian business on Russian market. Russia's seducing offers of the benefits that Ukrainian business will face after entering Customs Union and later Eurasian Union include the benefits of four freedoms (goods, services, capital and labor) and additionally lifting customs tariffs, lower prices for oil and gas. Definitely these promises as well as Ukraine's third part of export (most of the industrial products are not competitive on the EU market) orientated on Russia, makes Ukrainian business highly vulnerable and dependent on the eastern neighbor. Moreover, big interest groups involved in a trade with Russia are not only against any kind of dispute with Moscow, they would even advocate customs reduction. But Ukraine's membership in the Customs Union still looks improbable due to one important reason. The tariffs applicable in the CIS by the Customs Union are higher than the ones Ukraine was granted upon WTO accession.

Dependence of Ukrainian interest groups on Russia transcends the structure of Ukrainian politics and Russian criminal authorities. In leaked cable sent by US Ambassador to Ukraine William Taylor the direct interconnection between energy business and criminal activities was stated. According to the Wiki Leaks Firtash stated that many Westerners do not understand that Ukraine was like after the break up of the Soviet Union, adding that when a government cannot rule effectively, the country is ruled by 'by the laws of the streets'. He noted that it was impossible to approach a government official for any reason without also meeting with an organized crime member at the same time. Firtash acknowledged that he needed, and received, permission from Mogilevich when he established various businesses, but he denied any close relationship to him⁵⁶⁸.

Another carrot to attract the support from energy-related interest groups was the reduction of energy raw materials prices. Undoubtedly, when in the second quarter of 2012 Ukraine was paying 426 USD per 1000 cm of gas, the price that Russia promised after joining the Customs Union was just 160 USD, which was equal to internal Russian price for

567 Socor, Vladimir. (2013). Future of Ukraine's Gas Transit System Linked with Ukraine-EU Association Agreement. *Eurasia Daily Monitor*, Vol. 10, Issue 129.

568 US embassy cables: Gas supplies linked to Russian mafia. (December 1, 2010). *Guardian*, <http://www.guardian.co.uk/world/us-embassy-cables-documents/182121>, accessed on December 18, 2012.

gas. The leading expert in Energy Programmes in Razumkov Center Serhiy Diachenko reaffirmed that unlike the expectation of the increase of the export of energy-intensive industries of Ukraine, they will be rather defeated in the competition by Russian companies as well as decision-making center will be transferred from Ukraine to Russia⁵⁶⁹.

The proposals offered to Kyiv are hard to be accepted, as it would mean extensive concessions of actually handing part of Ukraine's economic sovereignty to Russia and consequent expansion of Russian presence in Ukraine. The position of the energy-related groups in this issue is not unilateral. On the one hand, Firtash group more than other would advocate the reduction of gas prices generally ignoring the expense it will entail. Moreover, Firtash is believed to conclude a cooperational agreement with Russian businessman Arkady Rotenberg to jointly buy chemical enterprises in Ukraine and Russia⁵⁷⁰. On the other hand, Rinat Akhmetov fears harsh competition if ever entered the Customs Union.

Another important aspect to be revealed is the ongoing competition between Ukrainian oligarchs and Russian businessmen in Ukraine. The presence of Russian capital in oil, electricity and gas sectors gradually increased since 2008. The attitude of Ukrainian oligarchs did not specifically approve this state of affairs and therefore an attempt of Ukrainian oligarchs to overtake the control in gas and electricity sector by Firtash Group and Rinat Akhmetov respectively took place under Yanukovich's presidency. An attempt to keep Russian ownership in key industries to a minimum, confirms a statement made by Tor Bukkvoll, that 'even the most pro-Russian Ukrainian oligarchs are likely to defend some degree of Ukrainian independence, from self-interest if not from patriotism'⁵⁷¹.

Therefore, we reach the situation where the interests of some interest groups come into conflict with state interests. And if the interests of the oligarchs are under threat, they would always prefer to take care of their own interests. It is difficult to determine which oligarchs are supporting EU and which are supporting Russia. The behavior of the oligarchs is rather situational and could be interpreted as pro-Russian and pro-European, while in reality it could mean just implementation of their own business interests. An example of such a behavior could be the case of Akhmetov, when Ilich Steel and Iron Works were

569 Diachenko, Serhiy. Pryiednannia do mytneho soyuzu zarady deshevogo gazu bude ekonomichnoyu i politychnoiu pomykoiu. (October 15, 2012). Razumkov Centre, http://razumkov.org.ua/ukr/expert.php?news_id=3689, accessed on November 2, 2012.

570 As reported further by newspaper 'Vedomosti' Firtash thanks to this deal obtained 1 billion USD as loan from Gazprombank. And 50 % of shares of newly purchased enterprises belong to Rotenberg. See, Terentyeva, Aleksandra, Reznik, Irina. (September 9, 2011). Rossijskii bank oplatil ambitsii ukrainskogo biznesmena (Russian bank paid for ambitions of Ukrainian businessman). *Vedomosti*, http://www.vedomosti.ru/companies/news/1361218/ukrainu_udobrili_dengami_gazprombanka#ixzz1XQldW9Md, accessed on April 4, 2013.

571 Bukkvoll, Tor. (2004). Private Interests, Public Policy. Ukraine and the Common Economic Space Agreement. *Problems of Post-Communism*, Vol. 51, No. 5, September/October, p. 17.

taken from Russians. This disproved Russian-friendly behavior of Akhmetov, but confirmed his ambition to strengthen his own position in metallurgy. Therefore, sphere of influence of Russian oligarchs in Ukraine was diminished. The same situation happened when Ukraine rejected the possibility of export of Russian electricity to Europe, as Akhmetov is the most important actor in electricity sector, his direct interest was in exporting Ukraine's electricity directly to Europe rather than also competing with Russian one, which is even cheaper. Therefore, potential export electricity competitor was eliminated through state mechanisms and Russia got refusal. Ukrainian oligarchs are deemed with short- and medium term energy dependency on Russia, while being tempted by the attractiveness of rising opportunities of the EU open market.

Pro-Russian position of Dmytro Firtash was again revealed by the statement of Vladimir Putin to additionally supply 5 bcm of gas to Firtash-owned Ostchem with 30 % discount. Regardless that this discount will cost Gazprom approximately 700 million USD, it will enable Gazprom to kill with one stone two birds. From one perspective, Gazprom guarantees itself the right to purchase unused amount of gas back from Firtash in order to supply Europe during winter period. From the other perspective, Gazprom won't spend money on storing gas in Ukraine as charge for this service was raised 4.4 times. Therefore, so called 'assistance to Ukraine' turns into pure benefit for Gazprom and affiliated with it interest group, who will make big profits by selling the gas surplus after the winter season⁵⁷².

The mechanism of selling gas to Ukraine through middlemen became so frequently used that according to Reuter's calculations the net profit that Firtash made for four years by selling Gazprom's gas to Ukrainian government reached 3 billion USD⁵⁷³. Interestingly Gazprom by selling cheap gas to Firtash stripped common Russian citizens as well, as price for gas sold to him was subsidized by Moscow. Another carrot Russia used to attract middlemen was cheap credit lines up to 11 billion USD. Having access to cheap loans made Firtash monopolist in chemical and fertilizer sectors. Therefore, by utilizing such a middlemen as Firtash Moscow achieved influence over gas sector as well as over other important sectors in economy of Ukraine.

To conclude I will use the words of Slawomir Matuszak, who pointed out that 'An evaluation of the impact the oligarchs have had on politics and the economy reveals some

572 Sarna, Arkadiusz. (October, 9, 2013). Russia's gas discount for Ukraine is in Gazprom's interests. *EastWeek*, No. 32 (350), Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/eastweek/2013-10-09/russia-s-gas-discount-ukraine-gazprom-s-interests>, accessed on October 21, 2013.

573 Grey, Stephen, Bergin, Tom, Musaieva, Sevgil. (November, 26, 2014). Special Report – Putin's allies channeled billions to Ukrainian oligarch. REUTERS, accessed on December 15, 2015, <http://uk.reuters.com/article/russia-capitalism-gas-special-report-pix-idUKL3N0TF4QD20141126>

benefits for Ukraine. The greatest benefit is the protection of Ukraine's economy from being dominated by Russian business⁵⁷⁴. Ukrainian oligarchs protect Ukraine from excessive Russian influence only due to the need to entrench their own business interests. But by saying this, I do not exclude the fact that there are oligarchs who act more in accordance with Russian interest. Therefore, we sometimes observe how interests of a neighboring country could be transcended into the domestic politics of the other.

5.2.5. Gazprom's stake in Ukrainian gas business

Consolidation of energy sector under the governmental control, lack of foreign investments in energy sector and full reliance on energy exports for economic development crafted a situation quite vulnerable for Russian economy. Gazprom turned from a company, which was selling cheaper gas to households in order to win autonomy to pursue its pricing policy abroad⁵⁷⁵, into the one vastly controlled and managed by the President Vladimir Putin.

At international arena Gazprom while renegotiating gas contracts with European counterparts, faced the EU antitrust investigation. Europe still fully relied on Gazprom's gas supply, and 75 % of Gazprom's benefits were coming from Europe. This mutual dependence in the era of shale gas boom produced more strict position of the EU towards Gazprom. EU's gas imports were falling, which affected the decline of financial support for the system constructed by Vladimir Putin. This kind of cold relations produced quite favorable conditions for Russia again in order to attempt to bring Ukraine into Moscow's orbit.

Gazprom, which ranked 98th out of 105 with 2.8 points in the top non-transparent international companies, appeared to be the only Russian company in the rating⁵⁷⁶. Undoubtedly, Gazprom remained an important tool (with a government controlling the majority share) in the hands of Putin to produce quite aggressive policies toward Ukraine. This situation was benefitting from Ukraine's quite slow reform pace, which was still accompanied by nontransparent business practices.

574 Matuszak, Slawomir. The Oligarchic Democracy. The influence of Business Groups on Ukrainian Politics. *OSW Studies*, No. 42, September 2012, p. 74, http://www.osw.waw.pl/sites/default/files/Prace_42_EN.pdf, accessed on November 1, 2012.

575 Woodruff, David M. (1999). It's Value That's Virtual: Bartles, Rubles, and the Place of Gazprom in the Russian Economy. *Post-Soviet Affairs*, Vol. 15, No. 2, 132.

576 Gazprom Ranked Among Most Non-Transparent Global Companies – Transparency International. (July 10, 2012). *RIA Novosti*, <http://en.rian.ru/business/20120710/174519090.html>, accessed on December 5, 2012.

A number one monopolist at energy market of Russia, and what was even more important a company that was bearing unilateral control over Russia's pipeline network, thus Gazprom's position seemed to be sacrosanct⁵⁷⁷. Gazprom's position during Yanukovych's presidency though forecasted to be softer turned out to be even harsher in relations with Ukraine. Incompliant behavior led to price reduction deadlock and further demands for Ukraine's concessions in order to get any revision of the current Gas Contract. Government of Azarov did not succeed in any price revision and left its position with full fiasco in gas deal. Gazprom's position fully followed Russia's energy strategy toward Ukraine and showed direct expectations for Ukraine's major concessions in handing Ukrainian GTS to Russia and joining CIS Customs Union. Ukraine by rejecting these offers was left in impasse.

Some indirect connections prove that Gazprom was acquiring greater leverage in governmental circles in Ukraine. One of the examples to be listed here was the recent appointment of the chairman of National Bank of Ukraine Ihor Sorokin, who was originally born in Donetsk. His father, who had currently lived in Moscow, was Deputy Director of the Construction and Investment Department of Gazprom, while the affiliate of Gazprom's entity in Donetsk employed Ihor's sister⁵⁷⁸.

The Russian capital in Ukraine was mainly operating through financial groups in the sectors, which significantly affected the industrial growth of Ukraine. In 2007 the presence of these groups in energy sector equaled to 90 % in oil sector, 36 % in electricity sector and 20 % in gas sector⁵⁷⁹. Moreover, Russia gained a great stake at metallurgy and aluminium industries, which were dependent on energy prices. This situation flourished during Kuchma's and Yushchenko's presidencies, when Gazprom's interests were deeply rooted in corrupted intermediary schemes. According to Global Witness, indeed Russian energy traders preferred to work with shadow energy market of Ukraine as it strengthened their position in a competitive advantage against multinational and local enterprises⁵⁸⁰. The creation of opaque subsidiaries in Ukraine was the source of huge clandestine profits. These words were also confirmed by Vadym Gryb, former Analyst in the Security Service of Ukraine (SBU), who stated that in 2010 SBU analyzed Russian presence in Ukrainian

577 Heinrich, Andreas. (November 2008). Under the Kremlin's Thumb: Does Increased State Control in the Russian Gas Sector Endanger European Energy Security? *Europe-Asia Studies*, Vol. 60, No. 9, pp. 1549.

578 Leshchenko, Serhiy. (January 11, 2013). Sorokin appointed to NBU. Family finished squeezing oligarchs. *Ukrainska Pravda*, <http://www.pravda.com.ua/articles/2013/01/11/6981269/>, accessed on March 17, 2013.

579 Blyakha, Nataliya. (2009). Russian foreign direct investment in Ukraine. *Electronic Publications of Pan-European Institute*, No. 7, p. 7.

580 Global Witness. (2006). *It's a Gas: Funny Business in the Turkmen-Ukraine Gas Trade*. Washington, DC, April, p. 5.

economy and discovered 19 different sectors, which were vastly controlled by Russia. Among these sectors he mentioned chemical industry, metallurgy, shipbuilding, oblgas and oblenergo, chain of gas stations and oil-processing factories. He also said that such individuals as Firtash, Grygoryshyn, Novynskyi were acting as Russia's proxies⁵⁸¹. Some of these middlemen were disclosed and stripped of power in the energy chain, Gazprom lived through trauma, when immense illegal cash flows being cut left Russian energy monopolist without additional opaque cash flows.

The other way Russia was striving for getting control over Ukraine's economy was the issue of ruble-denominated government bonds. As IMF assistance was suspended in 2011 and sale of government bonds failed to attract Western investment, thus Ukraine launched negotiations to issue ruble-denominated government bonds with Russia's Central Bank, Gazprom and two finance ministries. The bonds were discussed to be purchased by Russian banks active in the Ukrainian market: VTB (President Vladimir Putin as Chairman), Russia's Sberbank, Alfa-Bank and Vnesheconombank (VEB) in order to raise 500 million USD⁵⁸². It is important to mention that Ukraine had already borrowed 2 billion USD from VTB Group to be able to pay for Russian gas, while another credit line of 2 billion USD was also negotiated from Gazprombank⁵⁸³. If to omit pointing the increased effect of political dependence on Russia, which would follow this decision, economic rationality was also rather questioned. As evaluated by Taras Kuzio 'loans in rubles will be 2-4 percent more expensive than bonds in US dollars or Euros. The ruble's exchange rate was highly dependent on the price of oil and gas. The cost of imported gas would be dependent on the Russian currency which, if it devalues against the US dollar, would reduce the price, and if it strengthened the price would rise.'⁵⁸⁴ Therefore, the issue of ruble-denominated government bonds was neatly managed by Russian counterpart and would lead to greater economic and political losses for Ukraine.

Another sphere, where Russia's influence was quite vivid was security sector. According to the article published in Polish newspaper 'Gazeta Wyborcza' Yanukovich for Putin's support promised to consult with Moscow over government appointments in Security Service, meaning that 'the list of these candidates should be personally agreed by

581 Komakha, Aleksei, Liamets, Sergei. (December 26, 2013). Interview with Vadym Gryb. *Ekonomichna Pravda*, <http://www.epravda.com.ua/rus/publications/2013/12/26/412038/>

582 Kuzio, Taras. (May 2, 2012). Russia's Growing Influence in Ukraine: Economics and Energy. *Eurasia Daily Monitor*, Vol. 9, Issue 83.

583 Naftogaz asks Gazprombank for 2 billion USD credit for 7 years. (March 29, 2012). *Rosbalt Ukraine*, <http://www.rosbalt.ru/ukraine/2012/03/29/963176.html>, accessed on March 17, 2013.

584 Kuzio, Taras. (May 2, 2012). Russia's Growing Influence in Ukraine: Economics and Energy. *Eurasia Daily Monitor*, Vol. 9, Issue 83.

Putin⁵⁸⁵. Among pro-Russian appointees were listed Chairman of the Security Service of Ukraine Ihor Kalinin and Minister of Defense Dmitri Salamatin, who happened to have direct connections with Russian strategic sectors⁵⁸⁶. These appointments as summarized by Kuzio ‘have removed the security forces from under the control of the oligarchs and placed them under ‘The Family’ with more influential Russian factor⁵⁸⁷.

As neatly pointed out by Washington Post ‘Gazprom is widely viewed as a major enabler of corruption here, using proxies to spread money throughout the political class, though plenty of Ukrainians say the blame lies primarily on their side of the border. And Gazprom has been the most important tool in Putin’s often aggressive policies toward Russia’s big neighbor’⁵⁸⁸.

Gazprom’s harsh attitude toward Ukraine was also explained by the redirection of its investment programme to East. Increase of the capital expenditures to around 31 billion USD was mostly realized in accordance with Eastern Gas Programme transmission system (Sakhalin-Khabarovsk-Vladivostok). Following Putin’s order to maximally accelerate the implementation of the Eastern Gas Programme would lead to the creation of the new production center in eastern Siberia, which would connect Russia with markets of China, South Korea and Japan. These developments were taking place while being provoked by raising competition from LNG supplies and unconventional energy sources⁵⁸⁹.

5.2.6. Russia’s bypassing projects and its effect on Ukraine’s energy policy

In October 2000 Putin signed a strategic energy partnership with the EU, which foresaw formation of the consortium with leading European companies to build pipelines bypassing Ukraine. Economic motivations seemed to be central to such European countries as Germany and France. The deal was essential as ‘it will allow Gazprom to bypass

585 Wojciechowski, Marcin. (March 1, 2012). Tajna historia przejmowania Ukrainy przez Rosję. *Gazeta Wyborcza*, http://wyborcza.pl/1,76842,11261360,Tajna_historia_przejmowania_Ukrainy_przez_Rosje.html, accessed on March 17, 2013.

586 Dmitri Salamatin, an illegal holder of dual citizenship, all his working career spent in Russia and was son-in-law of former Russian First Deputy Prime Minister Oleg Soskovets. Salamatin headed Ukrstetsexport, Ukraine’s arms export agency. Ihor Kalinin originally born in Moscow spent his career in Soviet KGB. During Yushchenko’s term he served in Security Service Alpha spetsnaz forces, but remained loyal to Yanukovich. See, Kuzio, Taras. (March 19, 2012). Russia Takes Control of Ukraine’s Security Forces. *Eurasia Daily Monitor*, Vol. 9, Issue 55.

587 Ibid.

588 Englund, Will. Gazprom and Ukraine in lucrative and difficult tango. (October 19, 2012). *The Washington Post*, http://www.washingtonpost.com/world/europe/gazprom-and-ukraine-in-lucrative-and-difficult-tango/2012/10/18/80f9d7ea-fcfe-11e1-8ade-499661afe377_story.html, accessed on November 11, 2012.

589 Sotiropoulos, Stylianos A. (2015). *Russian Energy Strategy in the European Union, the Former Soviet Union Region, and China*. Lexington Books, p. 196.

Ukraine, which owes Russia over 2 billion USD for gas imports and is accused of siphoning off gas destined for European customers⁵⁹⁰.

Regardless forecast of EU shrinking gas purchase and Gazprom's declining condition of gas extraction, Gazprom insisted on costly pipeline projects, which were planned to bypass Ukraine. An attempt to devalue attractiveness of Ukrainian Gas Transportation System proves Russia's insistence with construction new pipelines circumventing so troublesome neighbor as Ukraine.

After finalizing Nord Stream, Gazprom consequently negotiated the necessity to proceed with South Stream. About 26 billion EUR pipeline was aimed to pump gas across the Black Sea to South East Europe. Recently, South Stream⁵⁹¹ so far one of the most expensive infrastructural projects of Russia, appeared to be narrowed to the construction of just northern branch, which includes Bulgaria, Serbia, Hungary, Slovenia and Austria. This project due to high cost of implementation and high cost of maintenance expenses of existing pipelines seems quite unfeasible. Gazprom had not guaranteed any raw material base for the South Stream, and the assurances made so far seem to be not enough to fill the pipeline⁵⁹². The other problematic side of the project was financial commitments, which still remained hazy⁵⁹³. Regardless all of the above mentioned Russia's determination in its efforts proved its readiness to take a risk in order to maintain its dominant position in European market.

South Stream was planned to satisfy growing gas demand in Europe, and by ensuring diversification of gas transport routes from Russia to Europe and to decrease dependency on such transit states as Ukraine. However, the construction of this second pipeline was 'seen by Moscow as a tool it can use to push through its geopolitical plans. Goal number one was to eliminate (the maximum agenda) or at least significantly reduce the role of Ukraine as the main transit route in Russian gas exports to Europe'⁵⁹⁴. It seemed tangible that under the condition of South Stream construction total Russian gas would

590 Myers Jaffe, Amy, and Manning, Robert A. (2001). Russia, Energy, and the West. *Survival*, Vol. 43, No. 2, p. 137.

591 Initially the *South Stream* envisaged the construction of a gas pipeline with a total length of approximately 2340 km, including two branches: northern (mentioned above) and southern (Bulgaria, Greece, Italy).

592 The plans to use gas from Central Asia is lacking grounds due to the engagement of these countries in other projects (Azerbaijan in TANAP) or to increasing gas exports to China (in case of Turkmenistan).

593 Gazprom promised to incur costs of Bulgarian side in exchange for Bulgaria lifting transit fees for the gas transported via South Stream for 15 years.

594 Kardas, Szymon, Paszyc, Ewa. At any price: Russia is embarking on the construction of South Stream. (December 7, 2012). *OSW Commentary*, Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/osw-commentary/2012-12-07/any-price-russia-embarking-construction-south-stream>, accessed on December 18, 2012.

reach a number about 165 billion cm⁵⁹⁵, and therefore Ukraine's gas transmission system could turn to be entirely redundant.

Gazprom's politically constructed project of South Stream according to Vladimir Socar had four political functions: 'to pre-empt Nabucco; to keep Turkmenistan's gas out of European markets; to threaten Ukraine with bypassing its transit system, unless Ukraine surrenders control of its transit system to Gazprom; and, through South Stream, to establish joint control of pipelines in European Union member countries'⁵⁹⁶. The later goal clearly violated the EU's anti-monopoly legislation, namely Third Energy Package.

This policy aimed at blackmailing Ukraine with marginalization of GTS, therefore could possibly lead to a scenario when in despair Ukraine would follow Belarusian scenario by making the concession and handing the management of GTS to Russia. Trilateral GTS consortium, though defined by EU Energy Commissioner Gunther Oettinger as of great interest for each party due to 84 billion cm out of total 138 billion cm of Russian gas transited through Ukraine to Europe⁵⁹⁷, it seemed to be attractive for Russia only in bilateral format.

The construction of these pipelines as well as price increase pushed Ukraine to grand revision of energy market priorities and further gradual energy reform to reduce gas dependency. Indeed, a decade ago Ukraine consumed about 50 billion cm of gas, while this year the amount of imported gas would reach 27.7 billion cm⁵⁹⁸. The forecast presumed about 20 billion cm of gas for 2013 with its gradual decrease for the following years. Moreover, at least 5 billion cm of gas would be purchased in reverse regime⁵⁹⁹. Another accent was made on energy-efficiency, among others such vital projects of shifting steel sector from gas-powered technology to electric technology deserved a great attention in realization of these plans.

595 Total Russian gas capacity of 165 billion cm of gas will include 63 billion cm from South Stream, 55 billion cm from North Stream, 31 billion cm from Yamal and 16 billion cm from Blue Stream. Therefore 145 billion cm Ukrainian GTS capacity will face great reduction of Russian gas supply. See, Kardas, Szymon, Paszyc, Ewa. At any price: Russia is embarking on the construction of South Stream. (December 7, 2012). *OSW Commentary*, Centre for Eastern Studies, <http://www.osw.waw.pl/en/publikacje/osw-commentary/2012-12-07/any-price-russia-embarking-construction-south-stream>, accessed on December 18, 2012.

596 The First Research Conference of the Regional Stability within the Greater Black Sea Area Working Group. New Security Challenges in the Black Sea Area: Towards a Cooperative Agenda. Policy Recommendations and Conference Report. May 27-30, 2012, Turkey: Istanbul, p.29.

597 Interfax-Ukraine. (May 2, 2013). EU Commissioner Oettinger: Kyiv, Moscow and Brussels to jointly try to find the optimal, mutually beneficial solution on Ukrainian GTS.

598 Firtash's company OSTCHEM is importing gas by separate scheme for its chemical factories, and the amount of gas is equal to 8 billion cm.

599 Interfax-Ukraine. Naftogaz: Ukraine to cut gas purchases from Russia to 20 billion cubic meters of gas in 2013. (November 16, 2012). Kyivpost, <http://www.kyivpost.com/content/ukraine/naftogaz-ukraine-to-cut-gas-purchases-from-russia-to-20-billion-cubic-meters-import-5-billion-cubic-meters-of-gas-from-europe-in-2013-316217.html>, accessed on November 18, 2012.

The inauguration of the South Stream was held on December 7, 2012 and led to the situation when Russia lost its interest in the modernization of Ukraine's Gas Transportation System. Indeed the format of tripartite Consortium was never treated as attractive to Russia, while two parties merger was threatening Ukraine's national interests. Therefore, unreachable Ukraine's GTS shook Russia's geopolitical ambitions, but which were promptly loomed by South Stream project activation.

To secure support of European countries, Gazprom used again energy as a tool to renegotiate gas prices in exchange for South Stream support. This tactics produced fruitful results, when Bulgaria, Serbia, Hungary and Slovenia agreed to finalize preparations for the implementation of a Russian strategic energy project of South Stream. European countries by signing new gas contracts maintained formula, which stressed on the interconnection of the gas discount and support of Russian pipeline projects.

The successful completion of the South Stream Project could be guaranteed only after some legal problems would be resolved. Therefore, it was important to mention that Russia demanded exclusive status for its pipelines. Gazprom offered to exempt the South Stream gas pipeline from the European Union's Third Energy Package. Russian Energy Minister Alexander Novak stressed on different nature of the Russia-led pipeline projects as they were 'completely different from the status of pipeline projects within Europe'. His accent was made on the fact that South Stream would run through the countries like Russia and Serbia, which were not members of the European Union⁶⁰⁰.

It contradicted EU's diversification projects, such as Nabucco and gas interconnector with Romania, Greece, Serbia and Turkey. European countries most probably would continue to support European pipeline projects but with rather falling interest and their importance would become of secondary nature as they would serve to secure supplies in emergency situations. Moreover, the countries where EU's pipelines would pass would rather gain from transit revenues, than from regular supplies.

In case of Europe Gazprom's pipeline projects (South Stream and Nord Stream) aimed at preserving Russia's status of Europe's key gas supplier. By lobbying its own projects, Russia also tried to prevent the construction of European pipelines, which could easily become competitive and challenge Russian position on the gas market. One of the priorities in this case was an effort to prevent access to Central Asian gas to fill the Southern Gas Corridor pipelines.

600 Minister Seeks Exemption From EU Energy Package for South Stream. (December 14, 2012). *The Moscow Times*, Issue 5035, <http://www.themoscowtimes.com/business/article/minister-seeks-exemption-from-eu-energy-package-for-south-stream/473115.html>, accessed on December 16, 2012.

It needs to be mentioned that with present pipelines capacities in place⁶⁰¹, which amount almost 250 billion cm per year, Russia already extended any possible exports for present and in the medium term. Kremlin nevertheless pursued further promotion of new gas pipelines (South Stream, Nord Stream Three and Four, Yamal-Europe Two), which altogether would add some 133 billion cm per year. Under the conditions that planned pipelines are built, Russia is supposed to be able to export about 380 billion cm of gas per year. One should bear in mind that before the crisis at the peak of Gazprom's exports the number did not exceed 180 billion cm, therefore the gap between capacity use and capacity availability will increase more. Undoubtedly, Putin's plans for new 'under-utilized, colossal but redundant pipelines' will enable him 'to manipulate various consumer and transit countries in Europe more effectively than he has already done'⁶⁰². As stated by the Press Secretary of the CEO of Gazprom Sergey Kupriyanov the answer to all these pipeline projects lies in Gazprom's plans 'to export gas to Europe only by pipelines that it owns by at least 50%'⁶⁰³. Remarkably the whole transit system of Ukraine was excluded from the list of above-mentioned pipelines.

To sum up, as determined by Smith Stegen, 'Russia with the Soviet Union's energy resources but without its obligations (such as supplying cheap energy to its republics) may become mightier than the Soviet Union ever was'⁶⁰⁴. Successful implementation of the Nord Stream would lead to consequent persistence with implementation of second Russian strategic project of South Stream. Regardless of a range of questions (high cost of investments, unguaranteed gas demand and gas supply, unresolved legal and ecological regulations), which still needs to be solved, Russia will undoubtedly persist on lobbying of the South Stream as the one to be excluded from EU's Third Energy Package. For Ukraine it will mean losing the role of the key transit state, but as profitability of the South Stream is questionable, the chances of the EU to get back to Ukraine's GTS modernization are still high. For the EU as South Stream's profits do not reflect any clear picture, implementation of this project will mean greater dependence of a single gas supplier, which vividly contradicts EU's diversification objectives.

601 Nord Stream One and Two (55 billion cm), Yamal-Europe pipeline (33 billion cm), Blue Stream pipeline (16 billion cm), pipelines to Finland, Estonia and Latvia (12-15 billion cm). See, Socor, Vladimir. (April 19, 2013). High-Cost Redundancies: Gazprom's Pipeline Projects in Europe. *Eurasia Daily Monitor*, Vol. 10, Issue 74.

602 Socor, Vladimir. (April 19, 2013). High-Cost Redundancies: Gazprom's Pipeline Projects in Europe. *Eurasia Daily Monitor*, Vol. 10, Issue 74.

603 Korchemkin, Mikhail. (April 10, 2013). Gazprom to Export Gas Only by its Own Pipelines. *East European Gas Analysis*, republished by Natural Gas Europe, <http://www.naturalgaseurope.com/gazprom-pipeline-export-policy>, accessed on April 23, 2013.

604 Smith Stegen, Karen. (2011). Deconstructing the 'energy weapon': Russia's threat to Europe as case study. *Energy Policy*, No. 39, p. 6510.

5.3. Enhanced cooperation with the EU with deadlock

First foreign trip of Yanukovich was scheduled to Brussels on 1 March 2010. Ukrainian President met with the top EU leaders, including the European Council president Herman Van Rompuy, the president of the European Commission Jose Manuel Barroso and the EU High Representative for the Common Foreign and Security Policy Catherine Ashton. Indeed the visit aimed to overcome the widely spread image of Yanukovich as a pro-Russian politician. President tried to present himself as quite pragmatic leader, who did not build castles in the air and was fully aware of impossibility of rapid accession to the European Union. Another vector of Ukraine-EU cooperation was financial aid that Ukraine was so badly in need of. EU financial assistance package as well as introducing free-trade area agreement and roadmap for abolishing visa regimes appeared at the top of the agenda.

Yanukovich's presidency coincided with important events in Ukraine-EU energy cooperation. Among others one can name, Energy Community accession with further legislative update, fulfillment of the EC-MAGATE-Ukraine project on nuclear security, the beginning of the process of Naftogaz restructuring. Collaboration with the EU brought wider opportunities for the integration with European energy markets. EU programmes and institutions provided finance for investments, assistance to government to design effective energy market and offer sector budget support measures. Moreover, European companies and banks provided technology support and financing for Ukraine's energy and industry sectors.

In October 2011 Contracting Parties of Energy Community Treaty, among others Ukraine, decided to adopt Third Energy Package by January 2015. The regulations stipulate the unbundling of production, transport and distribution in the gas and electricity sectors, granting more competences and independence to regulatory bodies and higher protection of consumers' rights. Moreover, third package sets the rules that unable third party to access transport infrastructure or to take control over transmission systems. By the acceptance to adopt Third Energy Package Ukraine not only sent a clear political message of the will to join transparent rules of the energy market, but also to use Third Package as a tool to reinforce its position in the dealings with Russia. The package foresees vast liberalization process, which will include restructuring of state-controlled energy companies (especially in transport and distribution).

5.3.1. EU's external energy policy and cooperation with Ukraine

Though two founding treaties⁶⁰⁵ were dedicated to energy, it is important to understand that the real discussion of a European energy policy started in the late 1980s though at that time mainly focusing on environmental policy and emerging internal market. As new challenges, such as decreased internal energy production, increased energy consumption and dependency on limited energy suppliers, emerged, EU faced a vital need to tackle these issues. However, differences between member states' energy markets, energy policies and level of import dependency made this task much more difficult. The last decade proved that the EU has limited leverage when it comes to 'the double energy crisis'⁶⁰⁶, therefore energy security topped the agenda. As a result EU produced a policy in energy sector, which reflects conflicting opinions of EU member states on the issue of energy security, and lacks coherence.

It is important to note that ongoing debate inside the EU about the direction EU's external energy policy should have triggered the Clingendael International Energy Programme (2004)⁶⁰⁷. By providing scholars with a platform, this Programme presents various scenarios of EU's energy policy. The main debate could be defined between scholars, who support institutional approach, based on promoting liberalization of the third countries and energy governance by means of multilateral institutions, and those who are argue for a more geopolitical approach, based on strategic relations with key energy suppliers and transit countries. Though natural gas market and electricity market became more liberalized, EU's policy-makers struggle with a lack of consensus over a long-term vision for these markets, which prolongs uncertainty for market players. Regardless different level of liberalization success in EU member states⁶⁰⁸, the energy market model was exported abroad. One should realize that this model is not a 'one size fits all' and works best in the countries with self-sufficient, mature gas industry. So in the countries with import energy dependency, like Ukraine, the reform process is heavily constrained by political and business relationships between producers and consumers.

With a statement that 'energy must become a central part of all external EU relations'⁶⁰⁹, EU developed a framework through which external energy policy is

605 The European Coal and Steel Community (1951) and the Euratom Treaty (1957).

606 Müller-Kraenner, Sascha. (2008). *Energy security: re-measuring the world*. London, Sterling, VA : Earthscan.

607 See, <http://www.clingendaelenergy.com>

608 Many EU member states have been reluctant to fully implement EU directives on market liberalization, as energy sector is still perceived in the EU as a strategic sector for the national economy and national security. See, Westphal, Kirsten. (2006). Energy Policy between Multilateral Governance and Geopolitics: Whither Europe? *European Energy Policy*, Vol. 4, pp. 51-52.

609 European Commission. (2007). *Energy Policy for Europe*. COM (2007) 1 final, Brussels, p. 17.

implemented. Youngs neatly points out that ‘Reflecting the EU’s unique nature as an (intra-European) international body itself devising an (extra-European) international policy, its ‘external’ policy extends the nature of ‘internal’ cooperation already developed between member states.’⁶¹⁰ The framework for external energy policy among others also includes European Neighbourhood Policy, the Eastern Partnership, the Energy Community and the Extractives Industry Transparency Initiative. ENP constructed as an alternative to membership for countries like Ukraine does not fully provide incentive to adopt changes in compliance with EU legislation, but it serves as a platform to launch initiatives like Baku Initiatives to interconnect the regions. The Energy Community pursues extension of the EU’s internal energy market by creating a legal and economic framework in relation to ‘Network Energy’. The main goals are to create a stable and regulatory market framework capable of attracting investment; to create a single regulatory space for trade; to enhance security of supply; to improve the environmental situation and to develop electricity and gas market competition on a broader geographical scale. The Extractives Industry Transparency Initiative (EITI), launched by former British Prime Minister Tony Blair in 2002, aims at introduction of greater transparency and reduction of corruption through information sharing and is pursued to link EU’s energy governance and energy security policies.

Prange-Gstöhl determines three main reasons why non-EU countries agree for deeper integration: first, they tend to demonstrate their capability to become part of the Club (identification motive); second, they seek greater independence from regional hegemon in its ‘near abroad’ (independence motive); third, they foresee considerable economic gains after adoption of the legislation (economic motive)⁶¹¹. He continues that Ukraine seeking full EU membership and being disappointed by ‘the lack of ambition’ in the ENP, treated Energy Community membership as a tool to reiterate its political will for closer EU integration. Independence motive could be seen through expectations from Ukrainian side to exert pressure on Russia to restrict usage of energy as foreign policy tool⁶¹². And direct economic motive for Ukraine after is observed through synchronization of its power system in order to increase electricity exports⁶¹³ and attraction of foreign investments.

610 Youngs, Richard. (2007). *Europe’s External Energy Policy: Between geopolitics and the Market*. CEPS Working Document, No. 278, November, p. 4.

611 Prange-Gstöhl, Heiko. (2009). Enlarging the EU’s internal energy market: Why would third countries accept EU rule export? *Energy Policy*, Vol. 37, p. 5297.

612 Menkiszak, M., Kononczuk, W., Kaczmarek, M. (2008). *CIS Countries’ Interests vis-à-vis the European Union and Its Eastern Policy*. CASE Network Studies and Analyses, Warsaw, No. 365, p. 13.

613 Hofer, S. (2007). Unwelcome Europeans: EU external governance and shallow Europeanization in Ukraine. In de Bièvre, D., Neuhold, Ch. (Eds.). *Dynamics and Obstacles to European Governance*, Cheltenham: Edward Elgar Publishing, pp. 129-130.

Benita Ferrero-Waldner claims that the EU's 'added value' to external energy policies is to ensure that rule of law principles prevail through 'enhanced legal framework[s]'⁶¹⁴. Hence, the establishment of energy partnership with Ukraine proved EU's approach toward attempt to use contractual agreements to extend EU's *acquis* abroad. The official establishment of EU-Ukraine energy cooperation dates back to 2005, when during EU-Ukraine Summit a Memorandum of Understanding on energy was signed within the context of implementation of the EU-Ukraine Action Plan. This Memorandum included five roadmaps, and therefore every year during EU-Ukraine Summit Progress Reports have been endorsed. Yanukovich's presidency coincided with Polish Presidency in the EU in 2011, which provided Ukraine with one more reliable advocate of Ukraine for Ukraine's integration with the EU.

It is important to mention that EU-Ukraine energy cooperation got a new impulse during Yanukovich's presidency. EU not only developed and enhanced its own instruments to assist Ukraine in energy reform, but also supported Ukraine in its intentions to join organizations, which are not EU-led, but which envisage greater transparency in energy sector.

EU's position in energy cooperation with Ukraine can be characterized as 'cautious supporter'. To my mind the definition of 'cautious supporter' constitutes an actor, who by all means realizes the strategic importance of such a neighbor as Ukraine, but behaves cautiously to provide assistance only when the progress is vividly observed and at the same time avoiding irritation of Russia, who treats Ukraine as a part of the 'near abroad' policy. Therefore, the EU balancing policy is quite discreet, especially taking into consideration political insecurity, which lowers the chances for prompt and effective energy reforms.

The nature of energy cooperation with Ukraine constitutes a quite complex system of EU-led bilateral and multilateral initiatives. Bilateral cooperation is based on Partnership and Cooperation Agreement and following the EU-Ukraine Action Plan, while declaring the progress by preparing annual reports. Hence, during Yanukovich's presidency, Ukraine and the EU signed so far nine Joint Reports, indicating progressive integration of the Ukrainian energy market with EU's energy *acquis*.

The EU addresses its financial support through three types of programmes: budget support, technical assistance and sectoral support. The Programmes and initiatives developed by the EU, which address the issues of energy, include the European Neighborhood Policy, the Eastern Partnership, INOGATE, TACIS and the European

⁶¹⁴Ferrero-Waldner, Benita. (2006). Opening address, External Energy Policy conference, 20 November, Brussels.

Energy Community. The Initiative of Extractive Industries Transparency is used as an additional tool to achieve greater openness of the energy market. Cooperation with the European Investment Bank, the World Bank and the European Bank of Reconstruction and Development raise additional financial funds to ensure the implementation of the energy-related projects in Ukraine.

EU's support in liberalization of Ukraine's energy market resulted in adoption of a range of Laws. The Law 'On the Principles of Functioning of the Natural Gas Market' adopted in July 2010 was assessed by the European Commission as being a sound basis for starting to align the Ukrainian Gas Market to European standards⁶¹⁵. The Law 'On the National Commission for regulation of the communal services of Ukraine' was adopted on 9 July 2010, which foresees the establishment of the new regulator who shall determine the tariffs for communal services. Other laws are still in the process of revision and will be adopted in the near time. EU's role is essential and substantive especially in legislative integration, as the EU not only comments on the draft laws, but also provides special assistance if required in order to adopt legislation, which comprises EU and international standards.

Apart from legislative assistance, EU is supporting Ukraine's electricity sector reform. As in 2011 Ukraine and Moldova presented joint application to join ENTSO-E (the European Network of Transmission System Operators for Electricity), a Large Scale Project on the 'Feasibility Study on Synchronous Interconnection of Ukrainian and Moldovan Power Systems to ENTSO-E Continental European Power System' was approved by the EU. A grant provided by the EBRD and EIB concludes 10 million EUR under the Neighborhood Investment Facility (NIF). Targeting Ukrainian high voltage power network integration with ENTSO-E, EU improves reliability of Ukraine and increases cross-border integration in the field of electricity⁶¹⁶.

Moreover, EU conducted 2.5 million EUR feasibility study and technical/social impacts assessments of the modernization of the Ukrainian GTS and underground storage funded under NIF. The first track of the project on the 'Reconstruction of Line Facilities of the Urengoy-Pomary-Uzhgorod Natural Gas Pipeline' has already started and greater engagement of EBRD is expected. EBRD First Vice President Varel Freeman noted that modernization of Urengoy-Pomary-Uzhgorod gas pipeline is very perspective due to plans

615 Fifth Joint EU-Ukraine Report. Implementation of the EU-Ukraine Memorandum of Understanding on Energy Cooperation during 2010. (November 22, 2010). *Ukrainian Energy*, http://ua-energy.org/upload/files/2010_11_22_report.pdf, accessed on November 15, 2012.

616 Fifth Joint EU-Ukraine Report. Implementation of the EU-Ukraine Memorandum of Understanding on Energy Cooperation during 2010. (November 22, 2010). *Ukrainian Energy*, http://ua-energy.org/upload/files/2010_11_22_report.pdf, accessed on November 15, 2012, p. 4, 10.

for construction of a terminal in Poland to receive liquefied gas. ‘Ukraine needs more flexibility in exploiting this pipeline and cooperation with Poland would be extremely interesting, since Poland has plans on the LNG terminal construction. This project is an extremely important aspect of energy saving and energy efficiency’⁶¹⁷.

The other important field of cooperation is efficiency. EU in accordance to ‘20-20-20’ targets aims at reduction in primary energy use by improving energy efficiency. Ukraine as a top country possessing highly inefficient energy sector launched the reform. As a result a new draft ‘On the efficient use of energy resources’ includes a number of provisions from the EU Directive 2001/31 on energy services⁶¹⁸.

At the EU-Ukraine roundtable on gas market developments participants recognized progress, where Ukraine acquired an opportunity to ‘develop beyond its important traditional role as a transit country and also become a gas hub for Eastern Europe due to its conventional and unconventional gas resources, its extensive pipeline network and its important gas storage facilities’. The importance was issued to ‘ensuring both bidirectional physical flows and virtual reverse flows for gas ... with a priority being placed on facilitating a solution for such flows between the Ukrainian and Slovakian transmission system operators’. It was agreed on establishment of a consultative committee consisting of representatives of the Commission and Ukrainian authorities, the Energy Community Secretariat, the concerned EU Member State and interested companies and financial institutions. By meeting on an ad hoc basis, this Committee will be a forum for gas sector reforms’ discussions. As a result it will produce recommendations for the European Commissioner and the Ukrainian Minister for Energy and Coal Industry⁶¹⁹.

Yanukovich’s presidency, though for temporary time brought so long awaited by the EU stability, did not bring rapid reforms in energy sector. Moreover, situation was further aggravated by consequently increasing gas import prices and IMF freezing of the loan programme.

617 Ukraine interested in EBRD credit for reconstruction of Urengoy-Pomary-Uzhgorod gas pipeline – Azarov. (June 7, 2012). *UKRINFORM*, http://www.ukrinform.ua/eng/news/ukraine_interested_in_ebrd_credit_for_reconstruction_of_urengoy_pomary_uzhgorod_gas_pipeline___azarov_283605, accessed on November 17, 2012.

618 Sixth Joint EU-Ukraine Report. Implementation of the EU-Ukraine Memorandum of Understanding on Energy Cooperation during 2011. (March 22, 2012). *Ukrainian Energy*, http://ua-energy.org/upload/files/2012_03_22_mou_progress_report6.pdf, accessed on November 15, 2012.

619 European Commission. *EU-Ukraine Conclusions on the Roundtable Gas Market Developments in Ukraine*. MEMO, Brussels, May 3, 2013.

5.3.2. European Neighborhood Policy – energy component

The European Neighborhood Policy (ENP) was introduced by the EU as external relations policy with its closest neighbors especially after EU enlargement. It should be mentioned that ENP was ‘new policy in the sense that it aims at combining the traditional EU approaches of stabilization and integration toward neighborhood... It offers privileged partnership, as which is less than full membership but more than associate membership’⁶²⁰. Fabrizio Tassinari outlined that ‘EU addressed the neighbourhood challenge essentially by oscillating between integration and security. It either focused on security and by stabilising its peripheries and largely by keeping neighbours at arm’s length or it focused on integration by promising membership, and thus by inviting neighbours into the European project’⁶²¹. But the leverage of the EU in ENP seemed to be missing the most effective incentive – a promise of membership perspective. Thus, the weak point of this initiative was lack of conditionality and internal tensions within the ENP, which raised doubts about the EU’s ability to introduce reforms to wider Europe.

It is also significant to understand as claimed by Cremona that the establishment of the ENP was treated by EU leaders as a choice between exporting stability and security to its near neighbors or risking importing instability from them⁶²². In these terms energy security played an essential factor, which should have been taken under control.

The exclusion of Russia from this initiative and shifting cooperation with Russia to a strategic partnership prevented the conflict of interests, when Russia required to be treated as *primus inter pares* in the EU’s relations with its neighbours⁶²³. Therefore, ENP, as defined by former EU Commission President Romano Prodi, was designed to offer ‘more than a partnership and less than a membership’ and to share with the partner countries ‘everything but institutions’ in exchange for internal reforms⁶²⁴. Though, this approach by not offering the prospects of the membership clearly lacked conditionality, for the time being it was the only efficient initiative to enhance the existing level of cooperation with ENP countries.

620 Kahraman, Sevilyay. (2005). The European Neighbourhood Policy: the European Union’s New Engagement Towards Wider Europe. *Perceptions*, Winter, p.2.

621 Fabrizio Tassinari. (2005). Security and Integration in the EU Neighbourhood: The Case for Regionalism, *CEPS Working Document*, No.226, July, p.1.

622 Cremona, Marise. (2004). The European Neighbourhood Policy: Legal and Institutional Issues. *CDDRL Working Papers*, No. 25, 1 November, p.3.

623 Gromadzki, Grzegorz. (2005). *Will the Orange Revolution Bear Fruit?* Warsaw: Stefan Batory Foundation.

624 Prodi, Romano. (November 26, 2002). Europe and the Mediterranean: Time for Action. Speech by the President of the European Commission at the Belgian Université Catholique de Louvain-la-Neuve.

In European Neighbourhood Policy Strategy Paper published in May 2004 it was noted that enhancing strategic energy relations with neighbours (stressing out Ukraine's importance as a transit country) is one of the key element of ENP. Ukraine was defined as a country, which seeks access to the energy market of EU, and improving energy network connections in terms of legal and regulatory convergence was presented as strong mutual interests for both sides.

The basic instruments of ENP were the Action Plans, Country Reports and Strategy Papers. Action Plans of EU-Ukraine cooperation under ENP were to be a tool to increase energy dialogue and set up concrete steps to be accomplished⁶²⁵. Country Report was a tool to assess bilateral relations, among others in energy sector. Meanwhile, the European Neighborhood and Partnership Instrument (ENPI) was defined as a financial instrument to monitor the mechanism for the implementation of the Action Plans and harmonization to EU policies. Moreover, Ukraine was defined as a priority country within ENP with the largest affiliated budget⁶²⁶.

According to EU-Ukraine Action Plan, where in articles 51-57 the main tasks of EU-Ukraine cooperation in energy sectors were mentioned, the first area of urgent reforms was gas and electricity sectors restructuring. EU neatly specified the need for gradual convergence toward EU principles in these markets, which would follow by adoption and implementation of laws strengthening the position of NERC as independent regulator; gradual price increase; development of the detailed plan (including time schedules) of gas and electricity sector restructuring⁶²⁷. Therefore, EU prioritized two main sector of energy market, namely gas and electricity for further focus.

The Action Plan though envisaging the medium term priorities for the sectoral cooperation lacked clear strategies, procedures and more importantly deadlines for efficient implementation of the reforms. The Action Plan, which is drawn by two main principles, joint ownership and differentiation⁶²⁸, seems to be lacking political conditionality⁶²⁹. The

625 Commission of the European Communities. European Neighbourhood Policy. Strategy Paper. (May 12, 2004). Brussels. COM (2004) 373 final.

626 Under ENPI Funding 2007-2013 budget designated for Ukraine amounted 494 million EUR. See, European Neighbourhood and Partnership Instrument (ENPI). Funding 2007-2013, http://ec.europa.eu/world/enp/pdf/country/0703_enpi_figures_en.pdf, accessed November 6, 2012.

627 EU – Ukraine Action Plan. (February 21, 2005), http://ec.europa.eu/world/enp/pdf/action_plans/ukraine_enp_ap_final_en.pdf, accessed on November 7, 2012.

628 *Joint ownership* is based on the awareness of shared values and common interests. Two parties clearly recognize mutual interests in addressing a set of priorities. Therefore, EU does not seek to impose priorities or conditions on its partners. *Differentiation* principle reflects the existing state of relations with each country, its needs and capacities, as well as common interests. See, European Commission. (2004). *European Neighbourhood Policy Strategy Paper*, Communication from the Commission COM 373 final, p. 3, 5.

629 Young, Richard. (2001). European Union Democracy Promotion Policies: Ten Years On. *European Foreign Affairs Review*, Vol. 6:3, p. 357.

mechanism of ENP cooperation was rather basing on further mechanism: if ENP country effectively implements reforms in compliance with EU *acquis*, and EU in return will grant closer economic integration with this country.

Twinning Programmes and TAIEX⁶³⁰ appeared to be robust tools to achieve the priorities mentioned in the Action Plan. EU as an active reform facilitator assisted Ukraine in energy sector reform by introduction four Twinning Programmes, which were funded by the EU and aimed at assisting energy sector reform in harmonization with EU's standards in energy sector. All projects were focused on the vital role of NERC as there was no predecessor of independent regulator in market economy during Soviet times. Therefore, assistance in strengthening the role of independent market regulator was an important approach to reach open energy market aims. So far three completed Twinning projects in energy sector proved a great ease in Ukraine's first steps in gas sector restructuring.

The first Twinning Project under the title 'Regulatory and Legal Capacity Strengthening of Energy Regulation in NERC' appeared to be the first Twinning project to be launched in Ukraine and in the Eastern European Neighbourhood area. Three respective Twinning partners from Austria, Czech Republic and Italy provided consultation and worked together with Ukrainian colleagues in six following areas: Institutional Strengthening of the NERC; review and harmonization with the EU Energy Legislation; Multi-year Incentive-Based Regulation and Benchmarking; Development of a Quality of Service Regulation Programme; selected support in monitoring of the Wholesale Electricity Market and selected support in the Unbundling process⁶³¹.

With a Project's budget of 1.1 million EUR financed by TACIS, two years of its fulfillment ended with thorough review of the legislation, sharing with best EU practices in energy sector and determining the gaps, which were to be fixed in the future. This Twinning Project enabled Ukrainian state workers together with their EU counterparts to strengthen the position of the regulator NERC⁶³² and to draft law on competitive tariffs and assessments in quality of service regulation. Moreover, the project enabled Ukrainian

630 TAIEX is the Technical Assistance and Information Exchange instrument managed by the Directorate-general Enlargement of the European Commission. Twinning is an institutional building tool, which provides direct exchange of specific national experience in EU legislation implementation. For TAIEX see, http://ec.europa.eu/enlargement/taix/what-is-taix/index_en.htm, accessed November 8, 2012; for Twinning see, <http://twinning.com.ua>, accessed November 8, 2012

631 EU-funded Twinning Project: 'Regulatory and Legal Capacity Strengthening of Energy Regulation in NERC'. UA/2006/PCA/EY/02, http://www.enpi-info.eu/files/publications/A5_Engl1.pdf, accessed on November 7, 2012.

632 According to EBRD Transition Report 2005 NERC was defined as a regulator, which is lacking independence. Though substantial measures have been done to provide NERC with greater political, legal and functional independence, much more needs to be done to strengthen NERC financial independence and autonomy in decision-making. See, EU TACIS Project Twinning Fiche. Regulatory and Legal Capacity Strengthening of Energy Regulation in NERC. p.7, http://www.e-twinning.at/portal/page/portal/TW_HOME/Ukraine/fiche_ua06pcaey02.pdf, accessed on November 7, 2012.

counterparts to define the gaps in Ukrainian legislation, which were to be amended by adoption of secondary legislation.

The reform process in the gas sector was facilitated through second EU twinning assistance Program under the title ‘Regulatory and Legal Capacity Strengthening of Natural Gas Regulation in NERC.’ The overall objective of the program was to harmonize Ukrainian gas market regulations in line with the *Acquis Communautaire*. More specifically twinning project addressed the issue of strengthening the capacity of national regulator (National Commission for State Energy Regulation) in policy design and implementation of legislation (on quality of supply standards, unbundling of distribution and supply, regulated tariff, transmission pricing). The twinning project touched upon six main topics: harmonization of the Ukrainian regulatory framework in the gas sector with the European *Acquis communautaire*; development of the methods for formulating boosting rates; application of boosting rates for investments in the gas sector; achievement of gas service quality standards in line with European ones; management of the separation between regulated and competition-based activities; definition of rates aiming to protect the population during the transition toward the free market, with particular reference to low-income households.

This twinning project contributed significantly in assisting Ukraine with achieving a number of commitments under the Energy Community, in particular the adoption of Gas Law and the beginning of gas market opening signaled the promising development. This Twinning Programme also provided great support to NERC in introducing best EU practices to strengthen the capacity of NERC as independent regulator. These developments took place in compliance with the EU Directive 2003/55/EC.

The third Twinning Programme on ‘Support to NERC in the process of implementation of gas implementation of gas legislation in line with the provisions of Energy Community Treaty’, which got a designated budget of 600 000 EUR and lasted 1 year, prioritized the development of secondary legislation to comply with EnCT requirements. NERC was defined as a quasi-independent body, which is financed by the State budget and therefore government still has a final say over its decision-making process, especially in gas sector⁶³³. As a result of the previous Twinning Programmes laws had been drafted to give the NERC more powers, but they have not been implemented fully. Therefore, third Twinning Project intended to assist NERC in developing secondary

633 EU Delegation to Ukraine. Twinning Workplan. Support to NERC in the process of implementation of gas implementation of gas legislation in line with the provisions of EnCT. (July 7, 2011), p. 5, http://www.autorita.energia.it/allegati/docs/11/040-11gop_alla_1.pdf, accessed on November 9, 2012.

legislation in compliance with EnCT requirements, among others in unbundling of the Oblgaz distribution business; gas market opening and review of the methodologies applied to determine gas tariffs.

The fourth Twinning Project on ‘Improvement of the Policy Framework in the Sphere of Energy Efficiency and its Approximation to the Requirements of the EU Legislation’ was completed in September 2013. With the budget of 1.25 million EUR this project aimed at establishing of an operational system of effective legislation and policy in the sphere of energy efficiency aligned to the requirements of EU legislation. According to International Energy Agency the energy intensity of Ukraine’s GDP is 2,5 times higher compared to the world leading countries⁶³⁴. In terms of great potential of Ukraine in energy saving the ultimate goal is to reduce energy consumption and wastage as well as the consumption of the primary energy sources. This project, which was implemented with the assistance of the German-French Consortium, targeted three main areas: adaptation of the Ukrainian legislation to the required energy efficiency EU acquis; creation of a basis for an EU compliant system of standards in the field of the energy efficiency; strengthening of the Beneficiary Country capacity to manage developments in energy efficiency. It is important to mention that this Project contributed to the National Development Plan, PCA, ENP, EU-Ukraine Association Agenda and EU-Ukraine Memorandum of Understanding on Energy Cooperation. Moreover, other donors and international financial institutions, like EBRD, International Financial Corporation (IFC), Swedish International Development Agency (SIDA) etc., contribute to the implementation of projects related to energy efficiency.

As it is concluded in the report of Razumkov Center ‘Implementation of the EU energy legislation in Ukraine is occurring in the regime of imitation. At the internal gas and electricity markets instead of development of competitiveness, and protection of customers and investors rights, the corruption schemes domination is observed, which is based on the coalescence of the current power and big business’⁶³⁵. As reform implementation lacks coherency and needs to be carried out more thoroughly not only on paper, but also in practice, Yanukovich, being unable to resolve gas price disputes with Russia, appeared to be rather politically short-sighted with the EU and did not fully embrace the benefits of Twinning programmes for the future of energy sector.

634 Delegation of the European Union to Ukraine. (2011). Twinning Project Fiche ‘Improvement of the Policy Framework in the Sphere of Energy Efficiency and its Approximation to the Requirements of the EU Legislation’, p. 9, <http://www.esteri.it/MAE/Gemellaggi/Tacis/Ucraina/Twinning%20Fiche%20-%20SAEEEC.pdf>, accessed on September 19, 2013.

635 Razumkov Center. EU-Ukraine-Russia relations: problems and prospects. National Security and Defence magazine, No. 4-5 (133-134), 2012, p. 34.

5.3.3. Eastern Partnership: multilateral track

With the intention to go beyond ENP and to send Eastern neighbors a message of support for their democratic and market-oriented reforms, EU in 2009 by the Joint Declaration of the Prague Eastern Partnership Summit launched the Eastern Partnership (EaP)⁶³⁶. This so badly needed, but so diversely approached policy aimed at accelerating political association (Association Agreements) and economic integration (Deep and Comprehensive Free Trade Agreement) with Eastern Neighbors. EU member states possessed divergent visions of the EaP, which led to the lack of political backing and ended with rather low financial support from EU's side⁶³⁷.

Further implementation of the EaP's goals was planned to be achieved at two levels: bilateral and multilateral. Bilateral level fully reflected the existing ENP instruments, while multilateral level is of real importance in energy terms as it introduced new instruments. Therefore, below I will focus on multilateral energy cooperation within EaP, which became a forum for open discussion.

Multilateral track of Eastern Partnership provided a new framework where common challenges were to be addressed. The main tool of multilateral track was determined as a Platform. Among four main platforms Platform No. 3 entitled 'Energy Security' was to address energy problems. The core objectives of this innovative Platform intended to enhance framework conditions and solidarity, to support infrastructure development, interconnections and diversification of supply, to promote energy efficiency and the use of renewable resources, and to approximate regulatory framework and energy policies⁶³⁸. Biannual meetings of senior officials under Third Platform resulted in multiple meetings and conferences. The platform reports to the annual meetings of the Ministers of Foreign Affairs on the progress achieved.

Under the Third Platform a Flagship initiative on 'Regional Electricity Markets, Energy Efficiency and Renewable Energy Sources' was launched, which provided not only more clear vision of energy problems but also played a role of mobilizing multi-donor support and funding from different international financial institutions (EIB, EBDR etc.).

636 Though the idea of the common policy toward Eastern neighbors was firstly introduced by the Polish Minister of Foreign Affairs, Bronislaw Geremek in his speech inaugurating Poland's accession negotiations in 1998. Depo, Bogdana. The Eastern Partnership two years on: Success or failure for the diversified ENP. (July 7, 2011). Eastern Partnership Community, <http://www.easternpartnership.org/publication/2011-07-07/eastern-partnership-two-years-success-or-failure-diversified-enp>, accessed on November 20, 2012.

637 By lack of political backing I mean the manifestation while during EaP inauguration most influential EU figures were missing. Low financial support could be compared with EU's 2009 support to Turkey, which equaled EaP's budget and amounted 600 million EUR.

638 European Commission. Energy from abroad. The Eastern Partnership, http://ec.europa.eu/energy/international/eastern_partnership/eastern_en.htm, accessed on November 20, 2012.

This Flagship Initiative is supported through INOGATE programme. For 2010-2011 INOGATE included approximately 32 million EUR in support of regional energy markets. Another Flagship Initiative ‘Environmental Governance’ focuses on strengthening the capacities to promote more sustainable use of natural resources. This Initiative would as well enable conducting Environmental Impact Assessment and Strategic Environmental Assessments⁶³⁹.

In the report to the meeting of Foreign Affairs Ministers on December 13, 2010, several accomplishments were mentioned. One of the first developments was presentation of the Security of Supply Statements⁶⁴⁰ by each EaP country. This is especially vital taking into consideration that most of the countries (except Azerbaijan) are dependent on gas imports. Once a set of security of supply statements is available, regional solidarity schemes will be discussed, and concrete investment needs will be clarified. Another aspect of financial possibilities and challenges related to energy efficiency was unveiled during Workshop on Sustainable Energy Finance on 26 October 2010.

To conclude, in energy sector EaP played a role of an open forum, where important initiatives were launched. But the results are not tangible enough to attribute them explicitly to the Eastern Partnership. EaP rather played a role of mediator and fundraiser, which connected EaP countries under one platform with greater financial opportunities to fulfill the projects. For Ukraine EaP was rather disillusioned in terms of EU membership, but at the same time it was supportive in Ukraine’s intentions to comply with *acquis*.

5.3.4. Ukraine’s membership in European Energy Community

In November 2006 Ukraine obtained official status of observer at the Energy Community. Since that time an application was handed for full membership, which required implementation of *acquis communautaire* in the energy sector. In February 2011 Ukraine became a full member of the European Energy Community, an initiative aimed to foster harmonization of energy legislation of the countries beyond EU’s border with the EU standards. Actual membership was only the beginning of the long-term reforms so badly needed in the energy sector, but these reforms would also bring Ukraine to the level of

639 EuropeAid. Update on Eastern Partnership implementation. (September 29-30, 2011). EaP Summit, Warsaw, p. 3, http://ec.europa.eu/europeaid/where/neighbourhood/eastern_partnership/documents/update_on_the_eastern_partnership_en.pdf, accessed on November 20, 2012.

640 Security of supply statements is based on a template provided by Energy Community. See, European Commission. Implementation of the Eastern Partnership: Report to the meeting of Foreign Affairs Ministers. (December 13, 2010). MD 335/10 REV 2, http://www.eeas.europa.eu/eastern/docs/eap_meeting_foreign_affairs_131210_en.pdf, accessed on November 20, 2012.

greater competitiveness at the energy market as well as ensure transparency of the energy market rules. In the long run harmonization of the legislation would enable Ukraine to attract more investments in modernization and new technology, therefore dependency on energy imports would be reduced.

It is important to mention that membership of Ukraine in the European Energy Community appeared to have different expectations from both sides. While Janez Kopač, the head of the Energy Community Secretariat, defined the aim of Ukraine as ‘it wanted to make its legislation closer to the EU’s, which is reliable to investors’, Yuriy Boyko, former Minister of Energy in Ukraine insisted on two main reasons: to receive EU funding for its gas pipeline modernization and to ‘support against South Stream’⁶⁴¹. Therefore, different expectations brought some ungrounded complains from Ukrainian side about lack of investment and EU’s non-engagement in bypassing projects of Russia. As concluded by Olena Pavlenko, the President of ‘DiXi Group’, ‘Ukrainian government and the Energy Community Secretariat are speaking different languages, the main reason being the lack of deep and permanent dialogue. Both partners should improve existing and find new channels to communicate’⁶⁴².

Faulty Ukrainian expectations of the elimination or suspension of pipeline projects bypassing Ukraine turned into accusation of the Energy Community. President Viktor Yanukovich stated: ‘Regarding relations with the Energy Community, we have accepted the conditions set by this community. But, unfortunately, the interests of Ukraine are being violated by the Energy Community’⁶⁴³. President’s expectation of Energy Community’s membership led him to a conclusion that Energy Community should have opposed bypassing projects as it negates the significance of the Ukrainian gas transportation system. Frustration of Ukrainian authorities, which ended with acceptance that EC membership would not protect Ukraine from alternative pipelines projects was also intensified by the absence of rapid acquisition of funds to modernize Ukrainian gas transit pipelines. This was the time when Ukraine questioned the wisdom of Energy Community’s membership. Moreover, slowness of reform was due to the inefficiency of government as well as the lack of interest from big energy-related business. However, Ukrainian government took benefit

641 Think tank: EU, Ukraine speak different languages on energy. (April 19, 2013). *EurActiv*, <http://www.euractiv.com/europes-east/think-tank-eu-ukraine-speak-diff-news-519221>, accessed on April 20, 2013.

642 DiXi Group. (April 18, 2013). *Ukraine and the Energy Community: Two Years of Waiting*. Ukrainian Energy, <http://ua-energy.org/en/post/29041>, accessed on April 20, 2013.

643 Ukrainian News Agency. (December 19, 2011). Ukraine Accuses Energy Community of Violating its Rights and Interests, <http://un.ua/eng/article/366496.html>, accessed on November 23, 2012.

from its commitments to the EC as an excuse to favor certain oligarchic groups⁶⁴⁴. Therefore, Ukraine's dissatisfaction with EC membership and potential withdrawal from it, was rather declared as a result of Russia's pressure and was intended to be used as a bargaining chip during negotiations with Moscow on lower gas prices.

First years of membership though resulted in partial reforms, raised a wave of skepticism toward Ukraine's sincere ambitions and will to reform energy sector. A well-known energy expert Mykhailo Gonchar casted doubts that EEC membership would initiate true reform, but rather could turn into the imitation of it in order to distract attention from other vital problems in the sector⁶⁴⁵.

Nevertheless, full membership opened new opportunities for Ukraine. The most obvious advantage for Ukraine was an opportunity to have independent audit by the European Commission of the reliability of Ukraine as a gas transit country (Article 6, Directive 2004/67/EC). This was especially vital condition, which would finally prevent from possible Russian accusations on Ukraine's unauthorized gas extraction as it happened during 2009 gas war. Second, undoubtedly Ukraine would receive competent advices on harmonization of energy legislation with *acquis*. Third, in case of sudden disruptions of gas supply, Ukraine can request support from Energy Community members based on the mechanism of 'mutual assistance'.

On July 8, 2010 the Law 'On the Principles of the Natural Gas Market Operation in Ukraine' was adopted, which corresponds the requirements of the Gas Directive. The missing point was the absence of the secondary legislation. Along with the last annual report on the 'Implementation of the *Acquis* under the Treaty Establishing the Energy Community' published on September 1, 2012 (further 2012 Report), Ukraine's need of fundamental upgrade of energy laws according to *acquis communautaire* was stated as a vital priority⁶⁴⁶. Natural gas market was characterized by 'under-developed competition, excessive regulation, and a lack of either transparency or clear and objective criteria for new entrants. The supply market is dominated by one external source – i.e. Russia ... and one domestic gas producer covering 90 % of national gas production'⁶⁴⁷.

644 By revoking Naftogaz monopoly on gas imports, Ukrainian government met the interests of Dmytro Firtash Group, who officially got the right to purchase directly gas from Gazprom. Integration with the EU electricity network enabled Rinat Akhmetov to increase his profits in this sector.

645 Mikhail Honchar: 'Videlit li ES v etom godu sredstva na modernizatsiyu GTS?'. (August 18, 2011). Glavkom, <http://glavkom.ua/vblog/1861.html>, accessed October 26, 2012.

646 Energy Community Secretariat. Annual Report on the Implementation of the *Acquis* under the Treaty Establishing the Energy Community. (September 1, 2012), <http://www.energy-community.org/pls/portal/docs/1758177.PDF>, accessed on October 26, 2012.

647 Energy Community Secretariat. Annual Report on the Implementation of the *Acquis* under the Treaty Establishing the Energy Community. (September 1, 2012), p. 99, <http://www.energy-community.org/pls/portal/docs/1758177.PDF>, accessed on October 26, 2012.

2013 Annual Implementation Report of Energy Community stated an important market structure change. First of all, the monopoly of Naftogaz on gas imports was abolished, which resulted in the emergence of new gas import company Ostchem Holding, whose share equals to 14.9 % of Ukraine's whole gas consumption. Second, gas suppliers diversified their portfolios by purchasing reverse gas from Europe, namely from German RWE through Hungary and Poland. Third, market opening was followed by reorganization of vertically-integrated companies 'Ukrgezvydobuvannya' and 'Ukrtransgaz' into public joint stock companies, though ownership remained unchanged⁶⁴⁸.

The licensing process under *acquis* revision appears to be one of the blurred shortcomings of the Gas Law. It is defined by 2012 and 2013 Energy Community Reports that the process of obtaining license does not comply with *acquis*. Every gas trader is obliged to obtain a license, but the Gas Law does not determine any objective and non-discriminatory criteria to be possessed in order to get the license. There is also no procedure to appeal in case of refusal⁶⁴⁹.

The requirement for proper unbundling in gas sector is yet to be fulfilled. Though Gas Law stipulates standards for a combined operator, the clear separation of functions of Naftogaz and its subsidiaries was not fulfilled. Improvement in this direction is the adoption of Law No. 4658-VI 'On Amending Law of Ukraine On Pipeline Transport (regarding the reformation of oil and gas complex)', which enabled Cabinet of Ministers to obtain the right to reorganize Naftogaz. Reorganization of daughter companies of Naftogaz into Public Joint Stock Companies appeared to be the first step for Initial Public Offering. As in 2013 functional unbundling did not take place, and the appointment of the Board of Directors still depends on government and Naftogaz. Another vertically-integrated company 'Chornomornaftogaz' even has not started legal unbundling⁶⁵⁰.

The requirement for third party access to GTS is stipulated by the Gas Law under regulated and non-discriminatory conditions. Access is provided by Ukrtransgaz and can be contracted for a calendar year. This access is governed by the Resolution of the NERC 'On Approval of Procedure for Access to Unified Gas Transportation System of Ukraine', which was adopted and amended in 2012. This Resolution though does not fully comply with the

648 Energy Community Secretariat. Annual Implementation Report. (September 1, 2013), p. 123, <http://www.energy-community.org/pls/portal/docs/2304177.PDF>, accessed on October 25, 2013.

649 Energy Community Secretariat. Annual Report on the Implementation of the *Acquis* under the Treaty Establishing the Energy Community. (September 1, 2012), p. 101, <http://www.energy-community.org/pls/portal/docs/1758177.PDF>, accessed on October 26, 2012.

650 DiXi Group. (April 18, 2013). *Ukraine and the Energy Community: Two Years of Waiting*. Ukrainian Energy, <http://ua-energy.org/en/post/29041>, accessed on April 20, 2013.

Directive 2003/55/EC or Regulation 1775/2005 in Priority access/preferences to transmission grid violating the principle of non-discrimination⁶⁵¹. It also does not abolish the distinction between transmission and cross-border flow (transit). Moreover, certain elements of third party access are still missing, such as access to linepack, ancillary services and upstream pipeline networks.

The market opening procedure is mentioned both in the Gas Law and NERC resolutions and foresees dividing customers by the groups with their free choice of the supplier. But in practice two groups, such as households and those who are financed by a budget, do not possess any option of choosing their supplier. Moreover, according to Draft Resolution on Approval of the Procedure for Identification of the Guaranteed Suppliers of Natural Gas discriminatory principle is applied, which permits only one guaranteed supplier per administrative territorial unit. Market opening for households should take place as of 1 January 2014, but because of the lack of gas metering devices (and according to Gas Metering Law 100 % coverage of gas metering devices should be provide only by 2018), it seems to be impossible to fulfill. Meanwhile, monitoring and reporting of security of supply is not stipulated by the existing legislation, which does not transpose Directive 2004/67/EC. To sum up, gas acquis implementation takes a slow path. Energy Community indicates the need to establish the clear primacy of law and to eliminate overlapping. While finalizing the unbundling process, Ukraine should turn Ukrtransgaz into independent, profitable company.

Energy Community Secretariat stated that one of the main problems of cooperation with Ukraine is lack of communication with authorities. Incomprehensive adoption of legislative acts stems from the absence of regular communication: ‘Almost none of the draft acts are being communicated to the Secretariat for assessment. In addition Ukraine fails to use the available donor assistance to its full scale’⁶⁵². As a result high level of inconsistencies and even contradictions are observed in legislative acts.

With EEC membership Ukraine was also included in a ‘gas ring’ of the European pipeline network under the project of ‘Southern Gas Corridor’. This project will allow Ukraine to transport by means of own GTS gas coming from Azerbaijan through Turkey to Europe. Preliminary Ukraine has applied an official request to Shah Deniz Consortium⁶⁵³.

651 Energy Community Secretariat. Annual Report on the Implementation of the Acquis under the Treaty Establishing the Energy Community. (September 1, 2012), p. 101, <http://www.energy-community.org/pls/portal/docs/1758177.PDF>, accessed on October 26, 2012.

652 Energy Community Secretariat. Annual Implementation Report. (September 1, 2013), p. 124, <http://www.energy-community.org/pls/portal/docs/2304177.PDF>, accessed on October 25, 2013.

653 Boiko: Ukraine ready participate in Southern Gas Corridor pipeline project. (November 19, 2012). ForUm, <http://en.for-ua.com/news/2012/11/19/165122.html>, accessed on November 27, 2012.

With the interference of the European Commission Slovakia agreed to provide access to own Gas Transportation System. Therefore, import of gas from Europe regardless Gazprom's threats became plausible. So far this is just a theoretical opportunity, but under the condition of 18-20 million USD of investments, starting from 2014 Ukraine would be able to receive additional 10 billions cm of cheaper gas.

In 2014 Ukraine took the presidency in Energy Community. Minister of Energy Eduard Stavvytsky defined further priorities during Presidency as: 'functioning of the gas market in the reverse direction on the border between Ukraine and the EU and creation of the East European Gas Hub based on the Ukrainian underground gas storages (UGS); developing the alternative transit routes for security supply of energy resources; developing and adopting legislation; attracting the investments to implement the PEI projects'⁶⁵⁴. The presidency of Ukraine in Energy community unfortunately did not bring any vivid results due to the revolutionary events in Ukraine, so the focus was shifted on political instability rather than deeper energy cooperation. Nevertheless, some modest results were achieved, which cover the plans of construction of pipeline 'Urengoy-Pomary-Uzhgorod' till 2018 and 'Brody-Adamowo' till 2019⁶⁵⁵. These projects were included into Projects of Energy Community Interest (PEIIs). EBDR First Vice President Varel Freeman noted that 'Ukraine needs more flexibility in exploiting this pipeline and cooperation with Poland would be extremely interesting, since Poland has plans on the LNG terminal construction. This project is an extremely important aspect of energy saving and energy efficiency'⁶⁵⁶. Hence, the part of the pipeline, which goes to Poland needs urgent reconstruction to have the capacity to transfer LNG from Poland.

654 Energy Community. (October 24, 2013). 11th Energy Community Ministerial Council. Meeting Conclusions. Belgrade, p. 4.

655 GTS capacity of 112 billion cm of gas could be increased till 230 billion cm annually. The first stage of it was reconstruction of Urengoy-Pomary-Uzhgorod main gas pipeline, which carries gas from Western Siberia to the EU. European Bank for Reconstruction and Development (EBDR) approved the concept of the project on 'Modernization and reconstruction of the Urengoy-Pomary-Uzhgorod trunk gas pipeline'. EBDR and EIB plan to invest totally about 308 million USD under first stage of this project, but only under the terms of effective gas reforms.

656 Azarov, Mykola. Ukraine interested in EBDR credit for reconstruction of Urengoy-Pomary-Uzhgorod gas pipeline. (June 7, 2012). UKRINFORM, http://www.ukrinform.ua/eng/news/ukraine_interested_in_ebrd_credit_for_reconstruction_of_urengoy_pomary_uzhgorod_gas_pipeline___azarov_283605, accessed on October 26, 2012.

5.3.5. Prospects of Free Trade Agreement and its affect on EU-Ukraine energy cooperation

According to quantitative assessment of the effects of DCFTA on Ukrainian economy, Ukraine will get 11.8 % to GDP in the long run, while Customs Union would reduce it by 3.7 %⁶⁵⁷. The biggest impact comes from increased mutual trade due to the elimination of barriers. Shepotylo argues that under EU scenario Ukrainian exports will be equal to 46.1 %, while CU scenario foresees only 17.9 %⁶⁵⁸.

The year of 2011 appeared to be prioritized at signing Deep and Comprehensive Free Trade Area Agreements (DCFTA). The round of negotiations of both Association Agreement and DCFTA took place while Kremlin introduced active campaign to persuade Ukraine to join Customs Union of Russia, Belarus and Kazakhstan by providing some concessions on gas prices and guarantee of transit of Russian gas through Ukraine. Russian statements⁶⁵⁹ were not only aimed to affect Ukrainian government, but also Ukrainian oligarchs, who were tied with business in Russia. Therefore, statements made by lower-ranking representatives of government about the necessity of Ukraine joining Custom's Union most likely reflect the opinion of these businessmen.

Two main oligarchic groups headed by Rinat Akhmetov, a metallurgy magnate, and by Dmyto Firtash, who is tied with chemical and gas industry, secured their exports to global markets by Ukraine's WTO accession in 2008. Dmytro Firtash's good relations with Russia are a priority as gas price directly affects the profitability of his chemical industry. Akhmetov as a representative of heavy industry companies sees Russia rather as a rival because of the export of the same group of goods. Oligarchs not eager to spoil relation with Russia, still treat CU membership as unfavorable. Russia's offer of concessions will not be able to compensate profits oligarchs gained from WTO accession. Global market access is the source of main revenues for Ukrainian oligarchs, while CU will mean defeat of Ukrainian tycoons in competition with Russian companies.

DCFTA will not affect big oligarchs, as metal and mineral products were stopped of being subject to EU customs fees after WTO accession. Therefore, Firtash's chemical industry exports to Western countries could be boosted. But while openly supporting

657 Movchan, Veronika, and Gucci, Ricardo. (2011). *Quantitative Assessment of Ukraine's Regional Integration Options: DCFTA with European Union vs. Customs Union with Russia, Belarus and Kazakhstan*. Policy Paper, PP/05/2011, November. Institute for Economic Research and Policy Consulting, p. 11.

658 Shepotylo, Oleksandr. (2013). *Export Potential, Uncertainty, and Regional Integration: Choice of Trade Policy for the Ukraine*. Working Paper. Kyiv. School of Economics, p. 21.

659 Carrot-and-stick approach in form of promises as well as threats.

DCFTA Firtash can also face fierce conflict with Russia. Moreover, introduction of EU norms and standards according to DCFTA will pose a threat to the monopolistic position of the oligarchs in their sector of interests.

On 19-23 September 2011 18th round of negotiations was held between Ukraine and the EU on the Deep and Comprehensive Free Trade Agreement. Important decision has been made in energy sector, which indicated EU's decision not to seek compensation from Ukraine in the event of gas interruptions to the gas supply. The hope to sign Association Agreement and/or DCFTA was postponed till Ukraine-EU Summit Meeting in December. As Summit took reluctant pace of progress, Association Agreement though being ready was not initialed and even more Ukraine's perspective of EU membership was excluded from preamble. Summit ended with declaration; while President of the European Council Herman van Rompuy stated that the agreement would be signed and ratified on condition that the parliamentary elections in Ukraine scheduled for autumn 2012 are held in compliance with democratic standards. If to scrutinize this event from President Yanukovich's perspective, it becomes quite clear that president is ready to sacrifice closer bonds with the EU just to keep Tymoshenko in prison and to eliminate her from parliamentary elections. Therefore, till Tymoshenko is imprisoned, the Association Agreement seems to be postponed. From EU's perspective 2011 Summit showed a clear pace of crisis in Ukraine-EU relations, which could end with just sectoral cooperation and visa dialogue. Moreover, postponement of the signing of the Association Agreement diminishes Kyiv's role on the international arena, while the EU loses potential tools to influence the harmonization processes in Ukraine. But as neatly stressed by Valerii Khoroshkovskiy 'Association Agreement is more than just free trade. It is a civilizational choice. This is a point of no return to the past'⁶⁶⁰.

EU-Ukraine Summit, which takes place every year for the last 15 years, in 2012 did not take place. The postponement of 2012 EU-Ukraine Summit coincided with deterioration in EU-Ukraine relations under Yanukovich's presidency. These events continue to follow the consequent cancellation of meetings: with Yanukovich in October 2011 after Tymoshenko was arrested; with Prime Minister Mykola Azarov in May 2012; Boycott of Yalta Summit and Euro 2012 football championship. Though Ukrainian authority insisted that Summit was postponed not because of political reasons, but because of lack of time to prepare for the Summit, EU diplomat Kocijancic insisted that the future of Association Agreement would be discussed in the future and most probably signed 'not to push Ukraine

660 Khoroshkovskiy, Valerii. Evrointegratsiya: pryskoryty ne mozna zvolikaty. (December 7, 2012). *Dzerkalo tyzhnia*, No. 45, http://dt.ua/POLITICS/evrointegratsiya_priskoriti_ne_mozhna_zvolikati-113464.html, accessed on December 16, 2012.

into Belarus-type isolation⁶⁶¹. Due to the deterioration of the EU-Ukraine relations, on July 19, 2012 DCFTA was initialed, but not signed.

While during summer 2013 Moldova, Armenia and Georgia concluded DCFTA, Ukraine received a new deadline, Summit in November at Vilnius, till which it was obliged to introduce expected reforms. Russian position became more aggressive by launching substantial trade sanctions against Ukraine in July and August 2013. These trade wars were pictured as tools for Ukraine to reject the European bid, hence by the words of Putin's advisor, Sergei Glazyev, 'We are preparing to tighten customs procedures if Ukraine makes the suicidal step to sign the association agreement with the EU'⁶⁶².

5.4. The role of EuroMaidan events on energy politics

November 21, 2013 the President of Ukraine Viktor Yanukovich officially suspended the process leading to signing of Association Agreement with the EU at Vilnius. This step raised concerns of many Ukrainians, who fled to the streets in order to show their disagreement. Meanwhile, Yanukovich not only lost his opportunity to enter the history of independent Ukraine as a glorious Euro-integrator, but also faced a threat to be overthrown unless that step was revised.

In order to analyze what happened during EuroMaidan events, I should concisely summarize the main developments in the energy sector during his presidency. Since 2010 gas price negotiations with Russia did not bring any price reduction and were characterized as failed. Meanwhile though many European countries obtained considerable gas discounts varying from 5 to 30%⁶⁶³, Ukraine remained among the few, who could not reach any agreement. Ukraine was not only left with one of the highest price in Europe, but also with gas debt which as of November 15, 2013 was equal to 1,3 billion USD⁶⁶⁴. Moreover, Russia raised one more problem of unwillingness regardless its obligations to pay for additional amount of gas needed to secure gas transit to Europe. And one more important aspect is that Ukraine signing Association Agreement with the EU would also force Russia to consider Second and Third EU Energy Package.

661 Rettman, Andrew. EU-Ukraine summit 'unlikely' this year. (November 5, 2012). EUobserver, <http://euobserver.com/foreign/118094>, accessed on November 9, 2012.

662 Sterkin, Filipp, Tovkailo, Maksim, and Glikin, Maksim. (2013, August 19). Prichina tamozhennoi voiny s Ukrainoi – bolshaya politika' ['The Reason for the Customs War with Ukraine – Big Politics']. *Vedomosti*.

663 A list of the countries included Austria, France, Germany, Italy, Netherlands, Slovak Republic, and Turkey.

664 Stelmakh, Anastasiya. (2013). The Gas Question in the Context of EuroMaidan events in Ukraine. *Current Politics in Ukraine*, <http://ukraineanalysis.wordpress.com/2013/12/27/the-gas-question-in-the-context-of-euromaidan-events-in-ukraine-2/>, accessed on December 23, 2013.

Yanukovych by freezing European integration played his card and reinvigorated Russia's zeal for price reduction at the expense of European vector. On 17 December, 2013 new Amendment to the January 19, 2009 'Contract for the purchase, delivery, volumes and conditions of natural gas transit for 2019-2029' was signed by Viktor Yanukovych and Vladimir Putin. According to it the price of gas was reduced by Gazprom from more than 400 USD to 268,5 USD per 1000 cm⁶⁶⁵. The roots of such a political decision could have been traced to an earlier period of energy politics. It resembled Kharkiv Accords, when a 100 USD discount was achieved in return for Black Sea Fleet lease extension until 2042. The same time it clearly fitted the 1997 'gas-for-fleet' formula during Massandra Summit, when energy debt was annulled by Russia in exchange for full control over the Black Sea Fleet. These three 'gas in exchange for something' agreements cemented asymmetrically faulty relations between the two countries⁶⁶⁶.

Therefore, suspension of European integration was strongly supported by Russia. This was the moment, when Putin was more prone to show some compliance for the sake of keeping Ukraine in its sphere of control. Numerous visits of the officials from both countries ended up with the meeting of two presidents and signing of over fifteen different agreements.

December meeting was concluded with the gas price reduction equal to 35 %, which gives a fallacious understanding that Ukraine finally eased its economic burden of paying one of the highest prices in Europe. In reality, gas price reduction is a complex issue and should be scrutinized as such. First of all, the reduction came into force since January 2014 and was subjected to quarterly revision. From the first glance, this minor term meant that gas price would be easily revised based on political considerations. This was confirmed by Igor Shuvalov, first Deputy Prime Minister of Russia, who mentioned that the loan was given under the terms that Russia could any time demand its return from Ukrainian government⁶⁶⁷. Second, as declared by Vladimir Putin the gas price reduction was a 'temporary decision' until long-term agreements on gas supplies to Ukraine and the transit of Russian gas to European customers are reached⁶⁶⁸. Third, Ukraine regardless its gradual

665 Stelmakh, Anastasiya. (2013). The Gas Question in the Context of EuroMaidan events in Ukraine. *Current Politics in Ukraine*, <http://ukraineanalysis.wordpress.com/2013/12/27/the-gas-question-in-the-context-of-euromaidan-events-in-ukraine-2/>, accessed on December 23, 2013.

666 Stelmakh, Anastasiya. (2013). The Gas Question in the Context of EuroMaidan events in Ukraine. *Current Politics in Ukraine*, <http://ukraineanalysis.wordpress.com/2013/12/27/the-gas-question-in-the-context-of-euromaidan-events-in-ukraine-2/>, accessed on December 23, 2013.

667 Rosiya vymagatyme vid Ukrayiny vyplaty borgu v razi rozvorotu do EU. December 23, 2013, *Ukrayinska Pravda*, <http://www.pravda.com.ua/news/2013/12/23/7008025/>, accessed on February 27, 2014.

668 Zayavleniya dlya pressy po okonchani zasedaniya Rossiysko-Ukrainskoy mezhsudarstvennoy komissii, 17 December 2013, Moscow, <http://www.kremlin.ru/transcripts/19854>, accessed on February 27, 2014.

decline in gas purchase from Russia (in 2012 – 33 bcm, in 2013 - approximately 27 bcm) still remained one of the top three buyers of gas from Gazprom. As the only reason for the decline of gas purchases was defined as ‘unfair’ and high gas price, one should assume that the full volume of purchases of Russian gas could have been theoretically renewed. Thus as mentioned by Mykhailo Gonchar, even though Ukraine bought 27 bcm of gas paying 10.8 billion USD, next year even under the terms of reduced price by buying full volumes of gas, which was equal to 51 bcm, Ukraine would spend 14 billion USD. Thus Gazprom would be left with an extra profit of 3.2 billion USD from higher volumes of gas sales⁶⁶⁹. To sum up, benefits of price reduction had dubious grounds.

If we come back to the reasons of this decision, Vice Prime Minister Yuriy Boiko stated that it was ‘a fear of losing the Ukrainian market’. He pointed out: ‘Concerning gas ... It became such a great irritant in our relations that negotiations were starting with gas price revision and ending with the same issue. The understanding arrived that Russian colleagues were losing the market, while we were losing the production. The time to meet us half way arrived⁶⁷⁰. As four years of negotiations with Russia did not bring any outcome, this sudden will to accept price decrease should be seen as a side payment for the suspension of European integration.

Historically Massandra Summit Agreement, Kharkiv Accords as well as 17 December 2013 Agreement would prove only one thing that 'there is no free lunch'. Russia always acts pragmatically and will demand more concessions in the future. Gas deal was approved together with a loan of 15 billion USD in installments ending in 2015. This loan is provided by the Fund of National Welfare⁶⁷¹ under 5 % interest rate, which is higher than the one offered by IMF. Just a week before the Gas deal, Yanukovich stated his rejection to raise rates for gas, which was offered by IMF. The reason why Ukrainian government accepted Russian offer with higher interest rate was that the IMF demanded strict implementation of the reforms. Russia in turn would not ask additional questions; on the contrary the current state of shadow economy would be by all means maintained. The real ambitions of Russia were stated by Putin: 'Russia and Ukraine could cooperate more closely also on the international stage by widening the coordination of common positions on urgent

669 Gonchar, Mykhailo. Anshlius po-Putinsky. *Ekonomichna Pravda*, December 5, 2013, <http://www.epravda.com.ua/columns/2013/12/5/407043/>, accessed on February 27, 2014.

670 Boiko 'obiasnil' snizhenie tseny na rossiiskii gaz. *Segodnia*, December 17, 2013, <http://www.segodnya.ua/economics/enews/boyko-obyasnil-snizhenie-ceny-na-rossiyskiy-gaz-483516.html>, accessed on February 27, 2014.

671 The Fund of National Welfare was previously a part of the stabilization Fund, formed by extra profits coming from the oil and gas sector.

global issues⁶⁷². Coordination of foreign policies of both countries seemed very desirable from Putin's position. An expert in Razumkov Center pointed that so-called debt was just a mean to keep Yanukovich under control. As stated by Volodymyr Omelchenko: “Promised 15 billion USD is not a credit, but rather a promise to purchase Euro-bonds. For the beginning it was promised to hand 3 billion USD. In fact, this is exactly the sum of money, which Naftogaz owes for gas. Therefore, in reality Russian Federation allowed restructuring of Naftogaz debts for Gazprom. Further Ukrainian Eurobonds will be purchased part by part depending on the behavior of Ukrainian government. Thus, Putin’s promise of Eurobonds purchase means that he will keep Yanukovich on a short leash. All these negotiations mean that Ukrainian government suspends to be independent subject of international law”⁶⁷³.

Unfortunately, the full terms of the December gas deals have yet to be revealed. This deal though allowed Azarov's government to approve the budget 2014. The same time this deal not only postponed unpopular gas reforms, but also froze the ones that were already in action, such as supply of reverse gas from Europe, energy efficiency etc.

Putin's concessions to decrease gas price for Ukraine were not coinciding with Russian citizens' expectations. Interestingly, according to Levada-Center survey, 56 % of Russians were negative about dropping gas price for Ukraine and 65 % did not support loan provision⁶⁷⁴. This supported the idea that regardless the attitudes of common Russians, Putin pursued his own ideas of keeping Ukraine in Russian sphere of interest.

Another issue that was probably discussed during Gas Deal negotiations was GTS Consortium. Thus, less than a week after Gas Deal was signed an offer to create 50/50 bilateral Consortium to administer Ukrainian GTS was handed to Russia. Vice Prime Minister Boiko mentioned that this cooperation was to be performed on 'equal fraternal terms'. Russian counterpart was to commence GTS negotiations in 2014⁶⁷⁵.

Gas price reduction brought inevitable changes into the energy sector. First changes were announced by Eduard Stavytskyi, Minister of Energy, who said that Ukraine would import natural gas only from Russia due to cheaper price⁶⁷⁶. Therefore, intentions to sign so

672 Putin proponuye schilnishu spivpratsiu z Ukrainoyu u sferi VTS. Interfax-Ukraina, December 17, 2013, <http://ua.interfax.com.ua/news/political/182450.html>, accessed on February 27, 2014.

673 Omelchenko, Volodymyr. Znyzhena tsina rosijskogo gazu dlia Ukrainy dorivniuye seredniy vartosti gazu v Yevropi. *Razumkov Center*, December 20, 2013, http://www.uceps.org/ukr/expert.php?news_id=4422, accessed on February 27, 2014.

674 Evromaidan i sudba Ukrainy v predstavlenii rossiian. December 26, 2013, Levada Center, <http://www.levada.ru/26-12-2013/evromaidan-i-sudba-ukrainy-v-predstavleniyakh-rossiyan>, accessed on February 27, 2014.

675 Stanovaya, Tatiana. (January 8, 2014). Ukraine and Russia: An Expensive ‘Brotherhood’. *Institute of Modern Russia*, <http://imrussia.org/en/russia-and-the-world/637-an-expensive-brotherhood-or-a-ukrainian-bluff>, accessed on February 23, 2016.

676 <http://rian.com.ua/economy/20140225/340316994.html>

long awaited agreement with Slovakia on reverse gas supplies from Europe were erased from the agenda. The EU reaction was quite negative as returning to sole gas supplier decreased Ukraine's security of supply and reduced its competitiveness.

December Gas Deal proved that Ukrainian government was prone to freeze all the reforms in energy sector as energy price was resolving urgent needs of the industry and easing the burden on the budget. Multi-level energy cooperation with the EU was suddenly suspended, which proved a lack of long-term vision for energy sector development⁶⁷⁷.

December Agreement with Russia brought one more interesting development. Soon after the gas price was reduced, Ukrainian president Viktor Yanukovich also stated his criticism towards implementation of the Third Energy Package of the EU. This step indicated that Ukrainian government without fully understanding the nature of the EU legal mechanisms in the energy sector acted opportunistic⁶⁷⁸.

The main outcome of the EuroMaidan events was the flee of the president Viktor Yanukovich to Russia and the appointment of the new interim government headed by Yatseniuk and acting president Olexandr Turchynov. While revolutionary events targetted change of the system, the agreements concluded with his Azarov's government were announced to be revised by Russia. Energy sector appeared to be the first to witness these changes, Kremlin announced that December Agreement was to be revised, and Ukraine should expect gas price increase starting from the second quarter of 2014⁶⁷⁹. Indeed as December Agreement was reached as a result of political concessions from Yanukovich's side (his decision to suspend European integration), 'gas carrot' was given as an expression of Putin's approval of this development.

Yatseniuk's interim government made it clear that Ukraine aimed to decrease its dependency on Russia. On April 28, 2014 Kyiv and Bratislava signed Memorandum on reverse gas supplies from Europe. Slovak operator Eustream declared that the volumes of reverse gas supplies would reach 8 bcm this year, and might be increased to 10 bcm in the near future. Italian operator ENI declared its will to assist Ukraine with reverse gas supplies, which could reach 3 bcm⁶⁸⁰.

677 <http://www.unian.net/politics/857205-tsena-otkaza-na-chto-ukraina-menyayet-evrointegratsiyu.html>

678 Ibid.

679 <http://economics.unian.net/energetics/883069-tsena-importnogo-gaza-dlya-ukrainyi-v-yanvare-sostavila-398.html>

680 General Director ENI. Italy considers the possibility of the gas supply to Ukraine. *Ukrainska Pravda*, <http://ua-energy.org/post/43427>, accessed on April 29, 2014.

5.5. Causal links between domestic politics and international relations under Yanukovych

Moscow's expectations that newly elected Russian-friendly president Viktor Yanukovych will become Russian-dependent in economic and foreign orientations and even totally contrary EU's expert predictions that Yanukovych could become 'Ukraine's Richard Nixon – not because he is corrupt, but because like Nixon he may be able to reposition Ukraine in geopolitical terms'⁶⁸¹ did not come true. Yanukovych followed a 'balanced policy' by playing a card of being a bridge between Russia and the EU.

Domestic level reflected a clash of the interests of various groups. Indeed first two years in power Yanukovych directly allowed certain interest groups (Firtash and Akhmetov) to transcend their interests into political domain. Some of them got ministerial positions and clearly influenced the decision-making process, thus extended their business and nourished closer ties with Russian counterparts. Later with the establishment of his own interest group 'Simya' Yanukovych turned from being a interest groups' mediator to a beneficiary, who attempted to strengthen his own interests and on behalf of his son Oleksandr to enter so lucrative energy business. Domestic level clearly reflected the nature of the president's managerial skills with all the complexity of the conflict of interests. Non-transparent mechanisms prevailed, while private interests overcame long-term national priorities. To fully realize the incentives of Yanukovych as a president the words of leading energy analyst Mykhailo Honchar should be mentioned: "Yanukovych wanted to be both president and number one oligarch. Like all those other guys – Putin, Nazarbayev and Aliyev. Except they had energy and rents to distribute. Ukraine does not"⁶⁸².

Concentration of power and relative economic stability provided Yanukovych with a window of opportunity, when the reforms could have taken place. Energy reform toward market liberalization already brought some first results. According to Leonid Unihovskiy, the Deputy Chairman of the Expert Council on gas industry and gas market, Ukraine already made important steps towards gas liberalization, 'First of all, the Gas Law was adopted. Second, new rules of the access to the Gas Transportation System were also adopted. This creates the necessary fundament for legislative and normative basis to attract

681 Wilson, Andrew. (March 2010). *Dealing with Yanukovych's Ukraine. Policy Brief*. (1) European Council on Foreign Relations, ECFR/31.

682 Op. cit., Wilson, Andrew. (2015). Ukrainian Politics since Independence. In Pikulicka-Wilczewska; Sakwa, Richard. (Eds.). *Ukraine and Russia: People, Politics, Propaganda and Perspectives*: E-International Relations Publishing, UK, <http://www.e-ir.info/wp-content/uploads/2015/03/Ukraine-and-Russia-E-IR.pdf>, accessed on January 13, 2016.

new actors foreign gas traders to Ukrainian market⁶⁸³. In order to finish liberalization of the gas market of Ukraine existing gas price disproportions should have been eliminated. But taken into consideration the complexity of interests in energy sector taken place in parallel with state policies of liberalization, ‘protectionist tendencies favouring big business linked to the president and his political allies have intensified’⁶⁸⁴.

As a result domestic politics indicated concentration of power in one hands and deterioration in democratic standards and high level of corruption. According to the Index of Economic Freedom Ukraine got 163rd position, while World’s Bank’s Doing Business ranking gave Ukraine only 152nd position⁶⁸⁵. Transparency International in 2011 was of no mercy either, therefore Ukraine’s position dropped from 134 to 152. In general Ukrainian anti-corruption law was assessed by international NGO ‘Global Integrity’ and got positive feedback. This NGO insists on great improvements that took place in 2011, especially after the adoption of Law on Access to Public Information (2011) and Law on the Foundations of Prevention and Combating Corruption (2011)⁶⁸⁶. But Ukraine scored poor in actual implementation of this legislation, as pointed by Global integrity projects manager Marco Tomacic ‘Ukraine has adopted many laws to fight corruption, but their implementation level is low’⁶⁸⁷. Indeed corruption remained one of the main obstacles in cooperation with the EU, as pointed by Team Leader of EU-funded Project Kaido-Paul Kranfeldt, when it came to implementation of common projects ‘Ukrainian side was demanding 25 % of project’s budget to be handed to Ukrainian side in cash’, otherwise they would not be interested in participation⁶⁸⁸. This practice could be traced at every level of state machinery, which caused certain projects to be suspended.

International rating of Ukraine’s energy sector performance so far provided us with rather poor results. According to the Global Energy Architecture Performance Index Report

683 Ukraina sushchestvenno prodvinulas v liberalizatsii vnutrennego gazovogo rynku, - ekspert. (December 14, 2012). *RBC-Ukraina*, <http://www.rbc.ua/rus/newslines/show/ukraina-sushchestvenno-prodvinulas-v-liberalizatsii-vnutrennego-14122012130000/>, accessed on December 16, 2012.

684 Matuszak, Slawomir, Sarna, Arkadiusz. (March 2013). From stabilization to stagnation. Viktor Yanukovych’s Reforms. Centre for Eastern Studies. *Point of View*, No. 32, p.41.

685 Heritage Foundation. Index of Economic Freedom 2012. Country Ratings: Ukraine, <http://www.heritage.org/index/country/ukraine>, accessed on November 2, 2012; Doing Business Report 2012, Country: Ukraine, <http://www.doingbusiness.org/reports/global-reports/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB12-Chapters/Country-Tables.pdf>, accessed on November 2, 2012.

686 The Law on the Foundations of Prevention and Combating Corruption contains new principles of corruption prevention; among others, government officials and their close relatives are obliged to declare their income and any expenses that exceed their income and publish it in official press.

687 The report of this NGO is used by IMF and the UN. See, Global Integrity: Ukraine Boasts Strong Anti-Corruption Legislation. (November 14, 2012). Worldwide News Ukraine, <http://wnu-ukraine.com/news/politics/?id=2362>, accessed on November 15, 2012.

688 Interview with Kaido-Paul Kranfeldt, Team Leader, EU-funded project “Capacity Building to State Agency in Energy Efficiency and Energy Saving in Ukraine”, conducted in Kyiv (Ukraine), on 28 May 2013.

2013 Ukraine got 72nd place out of 105 totally assessed countries, which is the lowest place among CIS countries⁶⁸⁹.

Although it would be an overstatement to claim that the entire Ukrainian economy has been divided up among big business, important steps have been made to cement that tendency with Yanukovich's presidency. The position of oligarchs though much more favorable toward closer relations of Russia still follows the tendency, where Ukrainian market is protected by them from dominant Russian presence. Therefore, though Ukrainian oligarchs follow their own business interest, they only situationally happen to strengthen position of Ukraine to resist full integration with Russia, where their interests could be threatened.

International level reflected different situation. Putin-controlled state machinery, where Gazprom serves as an official tool to implement Russian foreign policy aims, pursued its interests even harder with Yanukovich as president. Brighter attempts of Russia were observed reflecting its geopolitical ambitions to dominate over Ukraine, which raised again the questions of Customs Union accession, handover of Ukrainian GTS, merger of Naftogaz and Gazprom etc. as a result Kharkiv Agreement may be listed as a pure success of Russia's diplomacy.

Election of Russian-friendly President Viktor Yanukovich neither brought Ukraine to any new solutions in gas dependency on Russia nor provided temporary gas price reduction. Russian policy will not tend to change in this field and even by means of huge (not always profitable) financial investments into bypass pipelines will be pushed by all means to be implemented using gas leverage on individual European countries and the EU in general.

Eventually the words of Zbigniew Brzezinski '... without Ukraine, Russia ceases to be an empire, but with Ukraine suborned and then subordinated, Russia automatically becomes an empire' reinforce Ukraine's importance, especially in gas sector⁶⁹⁰. Though Russia positioned itself, as the one that wanted to reduce dependency on transit services of Ukraine, Ukraine also appeared to be the biggest consumer of Russian gas. Therefore, the loss of Ukraine as main gas consumer as well as European gas appeals consequently reduced revenues from Russian gas. In order not to lose much more revenues, Russia was already forced to reconsider pricing policy toward Ukraine and EU countries.

689 World Economic Forum. The Global Energy Architecture Performance Index Report 2013. (December, 2012), http://www3.weforum.org/docs/WEF_EN_NewEnergyArchitecturePerformanceIndex_Report_2013.pdf, accessed on December 16, 2012.

690 Brzezinski, Zbigniew. The Premature Partnership. (March/April, 1994). *Foreign Affairs*, 73, No. 2, p. 80.

EU's engagement in the liberalization of Ukraine's energy sector under Yanukovich increased considerably as uncompetitive and corrupt energy market in Ukraine would have led to the lack of transparency and endangered EU's energy security. As described by David Marples and Myroslav Uniat: 'In fact the president seems blandly oblivious of the tightrope he is walking, assuming that in the world of *realpolitik*, it is Ukraine rather than Brussels that holds most of the cards. The Ukrainian leader's logic is that the Kyiv government can operate between the EU and Russia, which are also limited in their bargaining power: Russia, because it needs Ukraine to make the Union work, and the EU because by isolating Ukraine, it would push that country firmly into the Russian orbit'⁶⁹¹. The EU's conditionality that focused on Tymoshenko's arrest did not bring any viable results, as it was treated by Yanukovich as a direct threat to his incumbency.

EU extended the instruments of cooperation in its arsenal with Ukraine at multilateral and bilateral levels, but regardless the wide range of instruments some initiatives (ENP, EaP) seemed to lack commitment not only from the members, but from the EU in the first hand. Undoubtedly full membership in European Energy Community was a huge achievement, which aimed to foster harmonization of energy legislation of Ukraine with the EU. But different expectations from this membership led to a lack of communication and cooperation between the parties under Yanukovich's tenure. Even presidency of Ukraine in Energy Community in 2014 was disrupted by revolutionary events in Ukraine and did not bring any viable outcomes.

Negotiations on the Association Agreement and Deep and Comprehensive Free Trade Agreement could become another focus point of bilateral cooperation, but as Yanukovich's unilateral decision of withdrawal from talks at Vilnius was not accepted by the public, it led to mass protests. Heterogeneous preferences of domestic constituents led to disapproval of Yanukovich's position on non-agreement with the EU at domestic level. Reverberation was clearly observed here when Russia in order to persuade Ukraine not to sign Association Agreement and Deep and Comprehensive Free Trade Agreement offered side-payments such as gas price discount and restructuring of gas debt for Ukraine. Thus again Russia showed great level of will to keep Ukraine far from European reforms, and closer to its own orbit.

Therefore the links between the domestic and international politics under Yanukovich indicate high level of interconnectedness. The nature of domestic politics with

691 Marples, David, Uniat, Myroslav. (February 22, 2013). Out of touch and out of the EU. *KyivPost*, <http://www.kyivpost.com/opinion/op-ed/out-of-touch-and-out-of-the-eu-320791.html>, accessed on February 22, 2013.

more consolidated authoritative power of Yanukovych shaped his preferences towards keeping the energy sector unreformed (as actual implementation of legislation was lacking), enrichment of his own interest group and securing his re-election. International level showed another tendency, where European vector was used as a bargaining chip in negotiations with Russia, while Yanukovych pursued a policy of lower gas price by all means (which led to vast concessions along Kharkiv Agreement). The reforms in compliance with the EU were performed in imitation regime only in order to obtain additional funding, and after December Deal with Russia were totally suspended.

CHAPTER 6

SHIFT IN ENERGY POLITICS IN POST-REVOLUTION PERIOD

6.1. Domestic reform of energy sector and change in energy profile of Ukraine after the developments in Crimea and Donbas

Russian annexation of Crimea and ongoing conflict in Eastern Ukraine had a profound effect not only on country's security, but it has altered the already fragile energy dynamics. This chapter unveils the losses of Ukraine in energy terms and therefore new energy equilibrium as well as points at domestic reform in energy sector and its pitfalls. The aim here is to show how a major crisis in Crimea and Donbas may be utilized by the government in order to implement so needed energy reforms. Regardless promising trend in energy politics domestically, international level possess high volatility, and can be easily reversed by the impact of both domestic and international factors.

Today we talk about Crimea as de facto a part of Russia but in legal terms for Ukraine as a “temporarily occupied territory”, one should point at what it meant for Ukraine in energy terms. It resulted not only in the loss of landmass, but also exclusive maritime zone, which opens access to mineral reserves. Estimated energy reserves in Crimea count for 45 trillion cm of gas, while in comparison shale gas reserves contain only 3,6 trillion cm of gas⁶⁹². These figures seem to be quite important for the energy independency of Ukraine especially when we talk about highly politicized issue of Russia using energy as an instrument to achieve foreign policy goals. While from the perspective of Russia Crimea's energy potential seems as quite a small reward, and nevertheless it still leaves Russia in a victorious position, as high prospective of energy resources in Crimea was by one move erased from the energy equation of Ukraine.

Russian authorities ‘nationalized’ Ukraine's state-owned Chornomornaftogaz, which owns 17 hydrocarbon fields. The activities of this company included 13 offshore platforms and interest in 5 license blocs – Skhidno-Kazantypske in the Sea of Azov, and

692 Stelmakh, Anastasiya. (2014). The Crimean Crisis in Energy Terms. *Current Politics in Ukraine*, <https://ukraineanalysis.wordpress.com/2014/03/27/the-crimean-crisis-in-energy-terms/>, accessed on December 4, 2015.

Odeske, Bezimenne, Subbotina and Palasa in the Black Sea⁶⁹³. Simultaneously a part of national gas transmission network ‘Ukrtransgaz’ in Crimea was also nationalized by Russia.

Undoubtedly the loss of Chornomornaftogaz changed energy balance of Ukraine and vanished prospects of energy shelf extraction. As well as such valuable assets of Chornomornaftogaz as drilling rigs “Petro Godovanets” and “Ukraina” worth of 354 million USD were seized by Russia in March 2014 and in December 2014 removed from its location⁶⁹⁴. With consecutive gas extraction increase in Crimea from 1,05 bcm in 2009 to 1,65 bcm in 2013 and future prospects of extraction of 2,5-3 bcm annually as mentioned in the Strategy of Ukraine, Crimea was holding third place in gas production after the Kharkiv and Poltava regions. But presently the company is under Western sanctions and operates as a ‘state unitary company’ under Russian laws.

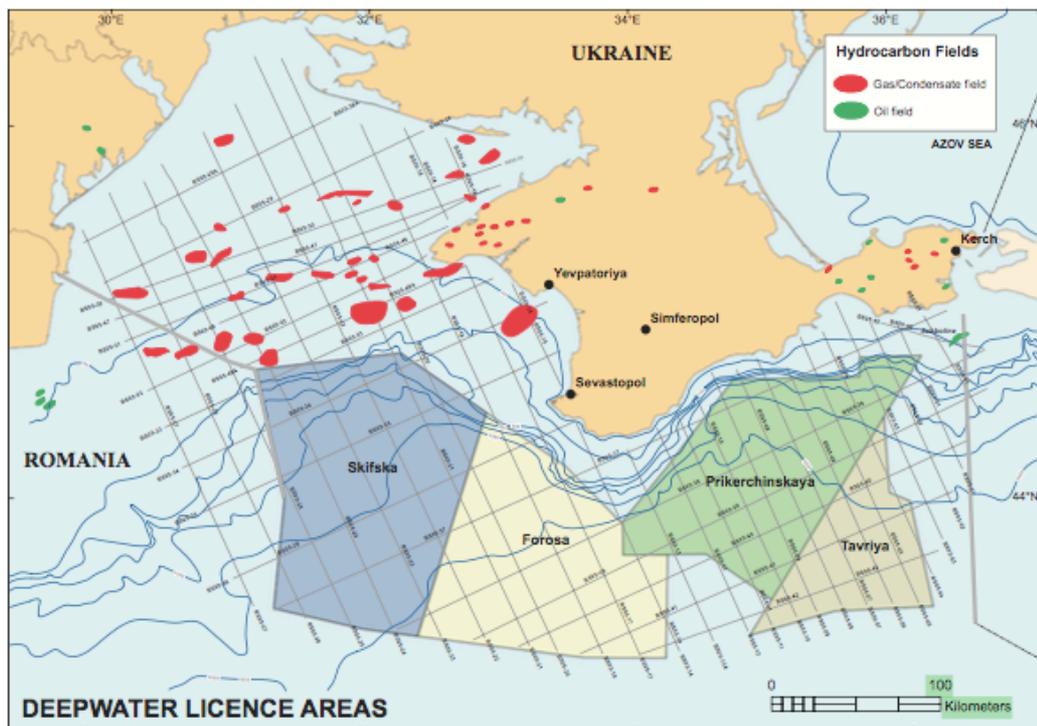


Figure 5. Map. Deepwater Licence Areas in Ukraine.

Source. Viable Opposition. Ukraine’s Oil and Natural Gas Reserves – A Pawn in Geopolitical Chess Game? (March 16, 2014), <http://viableopposition.blogspot.com.tr/2014/03/ukraines-oil-and-natural-gas-reserves.html>

693 Daly, John. (2014). Russia Claims Ukraine’s Black Sea Oil and Gas Bounty. OilPrice, accessed on December 4, 2015, <http://oilprice.com/Energy/General/Russia-Claims-Ukraines-Black-Sea-Oil-And-Gas-Bounty.html>

694 Bugriy, Maksym. (February 17, 2016). Russia Moves to Gain Dominance in the Black Sea. *Eurasia Daily Monitor*. Jamestown Foundation, Vol. 13, Issue 32, http://www.jamestown.org/single/?tx_ttnews%5Btt_news%5D=45103&no_cache=1#.Vtbmb8dYlsM, accessed on March 2, 2016.

Even greater prospects had deepwater energy resources extraction, which raised interest of Vanco Prykerchenska PSA for the development of Prykerchenska block, the PSA of Exxon Mobil, Shell, OVM Petrom, and Nadra Ukrainy Consortium for the development of Skifska block, and the PSA of Eni, Electricite de France, Chornomornaftogaz, and the Water of Ukraine Consortium for Subbotina, Abikha, Mayachna, and Kavkazka blocks⁶⁹⁵. ExxonMobil and Royal Dutch Shell were quite optimistic about prospects of drilling as recent discoveries in the Romanian part of the Black Sea were a good sign of further reserves in Ukrainian part. The inability of these projects to be implemented costs Ukraine 300 billion USD. While Douglas-Westwood energy research group estimated the loss of approximately 117 million barrels of gas production in the next seven years as around 50 offshore wells would have been completed⁶⁹⁶. According to Ukrainian legislation, which considers Crimea as ‘temporarily occupied territory’, these projects will remain frozen for the near future. And though regardless Ukraine’s plans to file lawsuit against Russia to ECHR, Naftogaz also plans to bring Russia to court separately over the offshore deposits lost in Crimea, this may last for years and Russia is unlikely to obey the decisions of the court.

Among other important energy assets in Crimea are the largest solar power plants in Ukraine. Built by Austria-based Activ Solar in 2011, these plants include Perovo power plant (105MWp) and Okhotnikovo power station (82,6 MWp). These solar power plants were part of a national energy project aimed at producing energy from clean sources like the sun. Regardless of their high potential, renewable resources, like solar energy, have never been a priority for Russia and therefore their activity may be suspended.

From the other perspective, ongoing conflict in Eastern Ukraine had serious impact on the energy balance of Ukraine, more precisely on coal mines, which are located in Donbas region. Coal generation out of all energy resources was the only area where Ukraine was self-sufficient. The Anti-Terrorist Operation (ATO) against Russian supported rebels that took place in the Eastern part of Ukraine led to the closure of 60 coal mines, which

695 Bugriy, Maksym. (April 14, 2014). The Cost to Ukraine of Crimea’s Annexation. Eurasia Daily Monitor. *The Jamestown Foundation*, Vol. 11, Issue 70,

http://www.jamestown.org/single/?tx_ttnews%5Bsword%5D=8fd5893941d69d0be3f378576261ae3e&tx_ttnews%5Bexact_search%5D=The%20Cost%20of%20Ukraine%20of%20Crimea%20Annexation&tx_ttnews%5Bcategories_1%5D=6&tx_ttnews%5Btt_news%5D=42227&tx_ttnews%5BbackPid%5D=7&cHash=12fe8de2a7863880973ee3400e107f70#.VmG1t4QxFo4, accessed on December 4, 2015.

696 Cook, Matt. (June 2, 2014). Gassing about Ukraine. *Douglas-Westwood Monday*, <http://www.douglas-westwood.com/wp-content/uploads/2014/06/DW-Monday-2-6-14-Gassing-about-Ukraine.pdf>, accessed on December 4, 2015.

resulted in 22,3 % decrease in coal production⁶⁹⁷. Militants in the occupied territory not only occupied some of the coal mines, they also blocked the delivery of coal to power plants and as reported by OSCE Russia was taking Ukrainian coal to its territory⁶⁹⁸. Shortage of coal failed to be replaced by coal from other countries, like South Africa (due to scandals), and ended up with greater dependence on imported coal from Russia. The problem also lies in the necessity to reequip of thermal generation in order to use all available types of coal.

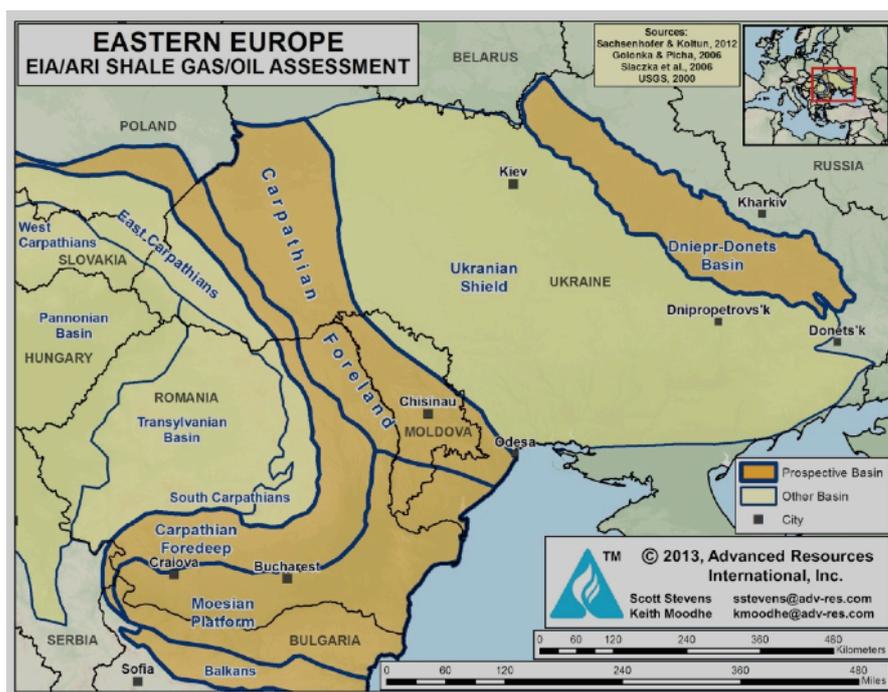


Figure 6. Map. Eastern Europe. Shale gas/oil assessment.

Source. Viable Opposition. Ukraine's Oil and Natural Gas Reserves – A Pawn in Geopolitical Chess Game?, accessed on March 16, 2016, <http://viableopposition.blogspot.com.tr/2014/03/ukraines-oil-and-natural-gas-reserves.html>

The war in the Eastern Ukraine affected the exploration and extraction of shale gas and tight gas reserves in the close-by region of Dniro-Donetsk. Ukraine has Europe's third largest upproved, technically recoverable shale gas reserves after Poland and France. While Dniro-Donetsk basin accounts for 90 % of oil and gas production in Ukraine in more than 140 deposits, 340 bcm of tight gas reserves out of 1,36 trillion cm in the basin are

697 *The Ministry of Energy and Coal Industry of Ukraine.* (February 2, 2015). Statistical Information for January-December 2014. http://mpe.kmu.gov.ua/minugol/control/uk/publish/article?art_id=244984286, accessed on December 4, 2015.

698 Op. cit., Pavlenko, Olena, Antonenko, Anton, Nitsovych, Roman. War in the Energy Sector as a Second Front. (2015). In Pabriks, Artis, Kudors, Andis (Eds). *The War in Ukraine: Lessons for Europe.* The Centre for East European Policy Studies, University of Latvia Press, Riga, p. 93.

technically recoverable⁶⁹⁹, so by 2035 Ukraine could produce 60-70 bcm of gas. Yuzivska field with 4.054 trillion cm of gas reserves was among the first awarded PSA with Shell in January 2013, but ended up with Shell withdrawal in March 2015 from the project due to security situation in the nearby war zone. Therefore, one of the most promising fields of gas and oil extraction in the Eastern part of Ukraine for now is lost in energy terms, which leaves Ukraine with only one more promising field in the Carpathian Foreland Basin in Western Ukraine.

To conclude, annexation of Crimea and war in Donbas cost Ukraine not only thousands of killed and wounded, but also deprived Ukraine of very promising projects on shale gas, deepwater extraction and green energy projects. According to Dragon Capital occupied territories accounted for 2,6 % of Ukraine's territory, 3,3 million people, 10 % of GDP, and 15 % of industrial output⁷⁰⁰. All this loss created harsh economic crisis and made it harder for Ukraine to substitute Russian gas with domestically produced one. But it also offered a window of opportunity for the government to implement so long awaited reforms in energy sector with public support. Therefore, next subchapter covers the question of political structure under Poroshenko and domestic reforms taken.

6.1.1. Political system under Poroshenko

New president of Ukraine Petro Poroshenko entered his presidency based on pro-European integration agenda. He harshly criticized Russia as main aggressor of the events in Crimea and Donbas in all of his speeches. But if we look at the political system under his presidency, some inconsistencies should be mentioned.

Poroshenko-president and Poroshenko-businessman seem to have different priorities, and therefore different interests, when we talk about EU and Russia. Taking anti-Russian stand Poroshenko nevertheless did not give up his business ties with Moscow. A "Chocolate King" still owns confectionary factory "Roshen", and interestingly the products of Roshen produced in Ukraine were banned by Russia, unlike Roshen products manufactured in Lipetsk (Russia).

To understand intentions of the current president it is worth looking at his background. He can hardly be mentioned as new in politics, his political endeavour was tightly connected to last three presidents. Moreover, as a founding member of the Party of

699 U.S. Energy Information Administration. (June 2013) *Technically Recoverable Shale Oil and Shale Gas Resources: An Assessment of 137 Shale Formations in 41 Countries Outside the United States*, <http://www.eia.gov/analysis/studies/worldshalegas/pdf/overview.pdf>, accessed on December 5, 2015.

700 Dragon Capital. (2014). *Ukrainian Economy: Forecasts Revised to Factor in Protracted Military Conflict* (October 2). Kyiv.

Regions, he had direct ties with Yanukovich. His Chief of Staff Borys Lozhkin facilitated the sale of Poroshenko's stake in Ukraine Media Holding to close associate of Yanukovich Sergiy Kurchenko. Therefore, Poroshenko's past ties and current business interests seem unlikely to dismantle the so well established political dynamics of corruption and oligarchization. This also prevented him from bringing corrupt oligarchs and allies of Yanukovich to justice, as Poroshenko's appointees to SBU have doomed ongoing investigations about corruption and murders that took place during Yanukovich's term. The Amnesty International together with the Council of Europe's International Advisory Group and the UN Commission on Human Rights are condemning Ukraine's lack of progress on postrevolutionary justice⁷⁰¹.

Poroshenko's election campaign was based on denouncing corruption as the biggest evil of the society, distancing from Russia and deeper integration with the EU. In his pursuit to limit the influence of previous administration in the new political system, he signed the law "On the purification of Government", which prevented public employees who worked with Yanukovich administration for more than a year from taking positions in the government. This move of lustration was highly supported by the Ukrainian population. In October 2014, together with the National Anti-Corruption Bureau established, Ukrainian government also established the National Agency of Ukraine for Battling Corruption. A list of 2702 cases, which was claimed by officials to include persons charged with corruption, appeared to be fictitious⁷⁰².

The political structure of Ukraine under Poroshenko was a reflection of the ongoing events in Ukraine and outside its borders. Poroshenko ended up with Yatsenyuk, a head of the government, who thanks to his language skills could easily communicate with Western partners, Vitali Klitschko, a mayor of Kyiv and world-known boxer, and Igor Kolomoiskyi, an oligarch and governor of Dnipropetrovsk. Though all of them were strongly pro-European, it could hardly mean the dissolution of corrupted system.

After two years of anniversary of Maidan events, Poroshenko is left with only 17% of support, which appears to be even less than the one Yanukovich had before he was ousted from power. Corruption as a main target of Poroshenko's campaign remains as

701 Op.cit., Kuzio, Taras. (January 7, 2016). Euromaidan Dreams Deferred. *Foreign Affairs*, <https://www.foreignaffairs.com/articles/ukraine/2016-01-07/euromaidan-dreams-deferred>, accessed on January 21, 2016.

702 Kuzio, Taras. (August 25, 2015). President Poroshenko talks big about reform – but he's missing what may be his only chance to break the power of the oligarchs. *Foreign Policy*, <http://foreignpolicy.com/2015/08/25/money-still-rules-ukraine-poroshenko-corruption/>, accessed on January 25, 2016.

widespread as it was before according to 88 % of Ukrainian citizens⁷⁰³. Prosecution of Yanukovich-related allies who strapped Ukraine seems to be excluded from the priorities of the president. Real change in fundamental power dynamics between politicians and businessmen was not altered as well.

It is indeed naïve to expect from Poroshenko-oligarch to seek criminal charges against his former allies and current business partners. As noted by Taras Kuzio, “Poroshenko emerged as an oligarch under a system where presidents dole out protection from the PGO [Prosecutor General Office] and the SBU to friends and patrons; to expect these groups to change their focus toward protecting the people against corruption is an unlikely possibility. In the last 25 years of Ukrainian independence, the PGO has failed to successfully prosecute a single member of the country’s ruling elite. This abysmal track record will not change under Poroshenko”⁷⁰⁴.

In Ukraine regardless two Maidan revolutions old Soviet system remains still alive with all its bureaucracy. Though some of the old establishment are now gathering power to re-gain rent-seeking opportunities, the current government tries to use the time to implement reforms. As stated by Lough and Solonenko, ‘The experience of ousting Viktor Yanukovich’s regime and preserving independence has created a much stronger sense of nationhood than at any previous point in Ukraine’s history of independence, and provides a qualitatively new basis for its efforts to bring about change’⁷⁰⁵. Reforms are being implemented partially due to the pressure from Western institutions, which will be revealed further. But it is important to understand changing role of the oligarchs, the shift in balance and their impact on the energy sector. As Anders Aslund wrote in his book “Ukraine: What Went Wrong and How to Fix It”, if the reforms are to be successful, then “the power of the oligarchs has to be broken”⁷⁰⁶.

6.1.2. Oligarchs after Maidan

Oligarchic system is deeply rooted in Ukrainian state. They continue to participate in politics and lobby their interests in order to preserve or even increase their interests. The

703 Kuzio, Taras. (August 25, 2015). President Poroshenko talks big about reform – but he’s missing what may be his only chance to break the power of the oligarchs. *Foreign Policy*, <http://foreignpolicy.com/2015/08/25/money-still-rules-ukraine-poroshenko-corruption/>, accessed on January 25, 2016.

704 Kuzio, Taras. (January 7, 2016). Euromaidan Dreams Deferred. *Foreign Affairs*, <https://www.foreignaffairs.com/articles/ukraine/2016-01-07/euromaidan-dreams-deferred>, accessed on January 21, 2016.

705 Lough, John, Solonenko, Iryna. (April, 2016). Can Ukraine Achieve a Reform Breakthrough? Chatham House, <https://www.chathamhouse.org/sites/files/chathamhouse/publications/research/2016-04-05-ukraine-reform-breakthrough-lough-sononenko-final2.pdf>, p. 3.

706 Aslund, Anders. (2015). *Ukraine: What Went Wrong and How to Fix It*. Peterson Institute for International Economics, p.18.

elimination of Yanukovich's most expansive 'Family clan' and decline of Firtash and Akhmetov's groups gave chance to other oligarchs (namely Kolomoyskyi) to replace it and to share the power. Taking into consideration harsh economic conditions, political instability and conflict in the Donbas, reshuffle among oligarchic groups during Poroshenko's presidency is unlikely to deprive oligarchs from their power.

Indeed after raise of oligarchs under Kuchma's presidency, the apogee was reached after Orange Revolution, when as a result of rivalry between Yushchenko and Tymoshenko, competition between oligarchic groups became a key mechanisms of policy-making. By providing funding, the interests of oligarchs were represented and lobbied in parliament. Surprisingly, competition between oligarchs ensured pluralism in politics and blocked authoritarian tendencies. With Yanukovich in power, 'family group' quickly expanded its influence. Those close to 'family' Rinat Akhmetov and Dmytro Firtash were able to preserve their positions and even to multiply their assets and power.

Soon after February 2014 elections, when the power in political system shifted from president to parliament, oligarchs found common language with the victors of the Maidan and started providing new management of the country with financial help, access to TV channels etc. After Yanukovich fled to Russia, the EU imposed sanctions against the individuals, who were part of corruption schemes⁷⁰⁷. Not only Yanukovich with his two sons, but also businessman and financial manager Serhiy Kurchenko was also included into the list. Minister for Energy Eduard Stavitsky as well fled abroad. Investigations were launched against them on charges of corruption, fraud and misuse of state assets. Influential oligarchs though stayed out of the list⁷⁰⁸.

The conflict in Donbas and annexation of Crimea clearly showed where oligarchs were standing. With no more than 20 deputies in Opposition Bloc faction, Rinat Akhmetov has no chance of his initiatives to be approved by the parliament. Akhmetov taking silent position ended up with losing great deal of his assets in Donbas, but regained his power by taking over assets in other parts of Ukraine (power generation DTEK, telecommunication Ukrtelekom, agriculture HarvEast). His current 'silent position' confirms that a deal with current government was reached⁷⁰⁹.

⁷⁰⁷ *The Council of the EU*. (March 5, 2014). Regulation concerning restrictive measures directed against certain persons, entities and bodies in view of the situation in Ukraine. No. 208/2014.

⁷⁰⁸ Ibid.

⁷⁰⁹ Kononczuk, Wojciech. (February 16, 2015). Oligarchs after the Maidan. *OSW Commentary*, <http://www.osw.waw.pl/en/wydarzenia/seminar-war-donbas-prospects-ukrainian-economy-and-energy-sector>, accessed on December 17, 2015.

The case of Dmytro Firtash seems more complicated. After Maidan with his close ties with Russia through gas trade, Firtash disappeared from political arena. In March 2014 he was arrested at FBI's request on charges of bribery in Vienna. By paying bail of 155 million EUR he was put under house arrest. Interestingly, money to pay the bail was provided by the Russians, namely billionaire Vasily Anisimov, a head of Putin's favorite Judo Federation⁷¹⁰. Firtash is currently investigated on the scheme of bribing Indian government officials to procure titanium. He still resides in Austria, while his interests in Ukraine are represented by Serhiy Lyovochkin. Control over the largest network of gas distribution companies in Ukraine still brings Firtash great profits to his chemical plants that produce fertilizers.

But as it was revealed by Austrian press in late March 2014, Firtash participated in a meeting with Vitaliy Klitchko and Petro Poroshenko⁷¹¹. Soon after the meeting Klitchko withdrew from the presidential race leaving room for Poroshenko. Therefore, Firtash is suspected to be main sponsor of this campaign in exchange for security guarantees for his assets⁷¹².

Post-Maidan political situation provided another oligarch with unique opportunities of growth. Igor Kolomoyskyi within Privat Group has interests in the sectors of banking (PrivatBank), oil (Ukrnafta), chemical (Dniproazot), mass media (TV channel 1+1) and airlines (MAU). In early period of Yanukovych he had a conflict of interests with inner circle of people close to the President, but later he reached an agreement and till early 2014 lived abroad. Maidan events brought an opportunity for Kolomoyskyi to rise. On 2 March 2014 his candidacy was approved for the position of governor of Dnipropetrovsk oblast, which is a crucial city being adjacent to Donbas. Being native of Dnipropetrovsk and having most of the assets there, it was not a challenge for him to stabilize situation in Dnipropetrovsk. As he assisted in forming and financing volunteer battalions, he soon gained more influence in other regions. Obtaining more support and power brought him to

710 Grey, Stephen, Bergin, Tom, Musaieva, Sevgil. (November, 26, 2014). Special Report – Putin's allies channeled billions to Ukrainian oligarch. REUTERS, accessed on December 15, 2015, <http://uk.reuters.com/article/russia-capitalism-gas-special-report-pix-idUKL3N0TF4QD20141126>

711 Klitschko & Poroshenko geheim mit Firtasch in Wien, <http://www.oe24.at/oesterreich/politik/daniel/Klitschko-Poroshenko-geheim-mit-Firtasch-in-Wien/138157731>, accessed on December 16, 2015.

712 Herszenhorn, David M. (2014, May 6). Brash Ukrainian Mogul Prepares to Fight U.S. Bribery Charges. The New York Times, http://www.nytimes.com/2014/05/07/world/europe/brash-ukrainian-mogul-prepares-to-fight-us-bribery-charges.html?_r=2, accessed on December 16, 2015.

conclusion that he could expand his own business by confiscating assets of other oligarchs (Firtash and Akhmetov), whom he accused of supporting separatism⁷¹³.

The Petro Poroshenko Bloc is clearly influenced by Dmytro Firtash Group through the party of UDAR and Kolomoyskyi Group. Even stronger influence Kolomoyskyi has on the People's Front led by Prime Minister Yatsenyuk. Respectively, Kolomoyskyi's TV station 1+1 was supporting Yatsenyuk during election campaign, while Firtash's Inter channel was backing Poroshenko's Bloc. Opposition Bloc was supported by Rinat Akhmetov and Viktor Medvedchuk, who are representing Russian interests in Ukraine⁷¹⁴.

Post-Maidan political balance proves that even after reshuffle certain Ukrainian oligarchs (Kolomoyskyi and Firtash) remain in power. Poroshenko being an oligarch himself seems unlikely to start de-oligarchisation of the state. Oligarchs continue to have extensive influence on political parties. Government seems too weak to curb their influence taking into account ongoing war in Donbas. Oligarchic groups with vast control in all sectors of economy, with powerful media tools and representation in political parties seem to enjoy their power to influence the public. At most one can expect reducing oligarchs' influence and gradual introduction of the rules within a system.

Poroshenko is maintaining pluralism of oligarchic influences in order to keep balance of forces. The case in January 2015 when Kolomoyskyi was deprived of his control over Ukrnafta proved that Kyiv is sending clear message that the rules are to be obeyed⁷¹⁵. Akhmetov's interests are also endangered by the latest measures taken by the Ministry for Energy and Coal in order to eliminate monopoly in high electricity prices. Firtash Group was also challenged by Naftogaz, who insisted that several chemical companies should be declared bankrupt due to gas debts. All this seems like a lesson orchestrated by the president in order to discipline these oligarchs. Two and a half decades of oligarchs benefitting from state's weakness monopolized key sectors of economy and left them strongly embedded into corruption mechanisms. Therefore, oligarchs will undoubtedly remain important players as long as we observe weak state and corruption in action.

713 Kononczuk, Wojciech. (February 16, 2015). Oligarchs after the Maidan. *OSW Commentary*, <http://www.osw.waw.pl/en/wydarzenia/seminar-war-donbas-prospects-ukrainian-economy-and-energy-sector>, accessed on December 17, 2015.

714 Ibid.

715 In March 2015 Kolomoyskyi refused to pay dividends of 70 million USD to the state budget from Ukrnafta, though government owns 50 % +1 share in the company. He also used battalion fighters in protecting Ukrnafta. All this undermined the legitimacy of Poroshenko and his resignation was unavoidable. For more see, Leshchenko, Serhiy. Sunset and/or sunrise of the Ukrainian oligarchs after the Euromaidan revolution? *Euromaidan Press*, <http://euromaidanpress.com/2015/06/02/sunset-and-or-sunrise-of-the-ukrainian-oligarchs-after-the-euromaidan-revolution/>, accessed on December 21, 2015.

But as noted by Vladimir Socor: ‘For the first time in independent Ukraine, the current political leaders have no corporate or personal interest in the gas business, nor do they depend on interest groups linked to the energy sector’⁷¹⁶. Indeed for the time Poroshenko eliminated so deeply integrated intermediaries, who were the main source of murky deals. The other achievement for now is an attempt to transfer gas business purely into business, rather than handling it personally as a matter of state. These trends regardless still strong positioning of oligarchs in the system, shows that a period of major changes in energy relations started, but the success will mainly depend on the will and persistence of the current government to fully implement the planned reform.

6.1.3. Domestic energy reform

Indeed two and a half decades of independence for energy sector meant numerous plans for reform of Ukraine’s energy sector, but few real steps in practice. Under Poroshenko’s presidency certain real steps toward energy sector reform were observed, which were treated as a sign of so long awaited shift in the energy sector, but so far major obstacles still remain, which preserve the inefficiency of energy sector. Unrest in eastern Ukraine and Crimean annexation undoubtedly sidelined energy reform, but from the other perspectives created a unique opportunity, when due to Russian aggression the public would more easily accept harsh energy reforms. In words of Anders Aslund, “A minor war on national territory could even spur the country to realize that it can no longer continue its old bad ways and has to pursue reinvigorating reform”⁷¹⁷. In this part of the chapter I would like to discuss main achievements and difficulties in energy sector reform, which will lay down the basis for determination of domestic level factors.

After establishing presidential National Reform Council (an advisory body for strategic planning) in July 2014, president Petro Poroshenko presented a document ‘Strategy of Reforms 2020’. Among sixty different reforms mentioned in this document, which are to be implemented simultaneously, energy reform was mentioned as a priority one⁷¹⁸. In the words of Poroshenko ‘military actions should not be used as an excuse for the lack of

716 Socor, Vladimir. (2015). Ukraine Rapidly Dismantling Gazprom’s Supply Monopoly. *Eurasia Daily Monitor*, Vol. 12, Issue 65, http://www.jamestown.org/single/?tx_ttnews%5Btt_news%5D=43764&tx_ttnews%5BbackPid%5D=7&cHash=30ee75ae8f38d8eb4db36cd3339e3ad5#.VoD14jZYm1t, accessed on December 28, 2015.

717 Aslund, Anders. (2015). *Ukraine: What Went Wrong and How to Fix It*. Peterson Institute for International Economics, p.17.

718 President Petro Poroshenko’s speech during the ‘Strategy of Reforms 2020’ conference of 25 September 2014, <http://www.president.gov.ua/news/vistup-prezidenta-ukrayini-na-pres-konferenciyi-strategiya-2-33757>, accessed on December 11, 2015.

reforms’, but rather reforms should become ‘the route of tectonic changes which we must not go through but rather run through, [because] the alternative is total collapse’⁷¹⁹.

Indeed successful implementation of energy reform puts many important things at stake. First of all, only introduction of market prices for gas and improvement of financial standing of Naftogaz will create an opportunity to come closer to end long-lasting economic crisis. With energy efficiency improved, it will be possible to overcome energy dependency easier. The implementation of reform will erase an opportunity for Russia to use energy as political tool or weapon. But the most important reason is that only with transparent energy market one should start elimination of corruption in Ukraine, which still remains the most corrupted country in Europe.

The cornerstone of energy reform is undoubtedly an adoption of a Law on the natural gas market⁷²⁰, which was adopted on April 2015, but came into force on 1 October 2015. Energy reform as a central goal of post-Revolutionary government seems to be a litmus paper to show the ability of current government to reform the most corrupted sector of Ukraine’s economy. This reform not only envisages the adoption of Third Energy Package, but was also among the conditions for Ukraine to receive a loan from IMF.

So far highly corrupted gas market was monopolized by oligarchs, which created a vicious cycle of energy rents. With the new law non-discriminatory access to gas market is to be ensured through principles of free competition with the appropriate level of consumer protection. Main standpoints of the Law were as follows:

- 1) Separation of the activity connected with managing the gas infrastructure from the activity of vertically integrated organizations connected with extraction and supply of natural gas.
- 2) Clear determination of functions of the state and independency of the regulator.
- 3) Stipulation of free price-forming principle at the wholesales and retail natural gas markets.

Indeed as Law foresees the division of Naftogaz, it means that a bunch of secondary laws and executive acts will be needed to transform this huge bureaucratic apparatus into separate entities acting transparently according to market rules. In October 2015 government adopted action plan for launching transformation of Naftogaz into corporation, in return for this European Bank for Reconstruction and Development granted 300 million

719 Ibid; President Poroshenko’s speech during his meeting with representatives of civil society. (July 9, 2014), accessed on December 11, 2015, <http://www.president.gov.ua/news/vijskoviyi-ne-povinni-zavazhati-reformam-prezident-33197>;

720 Press Service of the Ministry of Energy and Coal Industry. (April 10, 2015). Parliament adopted Law ‘On Natural Gas Market’, http://www.kmu.gov.ua/control/en/publish/article?art_id=248086149&cat_id=244314975, accessed on December 10, 2015.

USD for buying gas from Europe⁷²¹. As well acts on improving Naftogaz's financial stability and transparency have been already passed. Naftogaz also managed to regain control over local gas distribution networks (oblgaz), which were previously controlled by oligarchs, among others Firtash.

Second priority of energy market reform was replacement of existing regulator National Energy and Utilities Regulatory Commission with an independent regulator. According to the new law, which is under preparation, this regulator will have extensive competences; including investigative functions, instruments for protecting market competition and imposing fines. Ten secondary pieces of legislation related to the gas market were adopted by the National Energy and Utilities Regulatory Commission and entered into force on October 1. As the Law should comply with EU Directive 2009/73/EC, it is at the same time clashing with the interests of oligarchs, namely DTEK Corporation of Rinat Akhmetov, who owns 30 % of the market. Therefore, one can presume that energy reforms may be hard to implement due to vast resistance of the interest groups⁷²².

Third priority was introduction of market prices for energy ended up with 300 % increase in gas prices for households and 67 % increase for electricity⁷²³. Market level of the prices should be reached in 2017 as mentioned in the Letter of Intent of the Government and the National Bank of Ukraine to the IMF. Along with tariff hikes a system of subsidies was introduced. This is one of the first steps to make gas sector attractive for investors as well as high energy tariffs will eventually stimulate implementation of energy saving and energy efficiency programs.

The energy reforms take place at a snail pace. Indeed simultaneously coal industry reform was launched together with new regulations in electric market. In the history of independent Ukraine the scale of the planned reforms is unprecedented. Reforming key areas of state's operation cannot be an easy task when you are at war with Russia. Another negative factor is the low level of change in political elites. So-called new political leaders are coming from previous state administrations and possess ties with oligarchic groups. All this resulted in initiation of important reforms, which still need to be finalized. Passing laws

721 <http://www.bloomberg.com/news/articles/2015-09-30/ebd-approves-300-million-loan-for-ukraine-winter-gas-purchase>

722 Energy Community. (November 13, 2015). *Energy Community Country Brief. Spotlight on Ukraine*. Issue 2, p. 1, https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/3882284/246BA821D1883943E053C92FA8C081A6.PDF, accessed on March 5, 2016.

723 For the heating period gas tariffs were raised 3 times under the condition of consumption of 200 cm per month, and under the condition of exceeding this volume the price jumped up to 6 times starting from April 2015. For more see, Ukraine raises natural gas price for public. (March 3, 2015). *Ukraine Today*, <http://uatoday.tv/news/ukraine-raises-natural-gas-price-for-public-413105.html>, accessed on December 10, 2015.

is only the beginning of very complicated process, real change will happen, when reforms are implemented.

Energy reform among others is being implemented due to the pressure from international institutions, namely IMF and the EU. Constant pressure of these actors, who clearly stated that unless real reform takes place, financial assistance would be withdrawn, succeeded in breaking resistance from certain political actors reluctant to introduce changes. As noted by DiXi Group, ‘The more international financial organizations set certain reform as a requirement for granting a loan or aid, and the bigger the amount of such aid is, the higher chances to be implemented such a reform has’⁷²⁴. The new Gas Law was adopted as a requirement of the World Bank in order to grant next tranche to the government. However, the pressure of international actors should continue also at implementation stage in order to make changes irreversible. Indeed close monitoring of the implementation should prevent distortion of concepts and values, which are envisaged by the European legislation.

Lack of political will, resistance of certain interest groups, inefficient bureaucratic apparatus lead to the situation when time for reform is wasted and public support for these reforms declines. Success of energy reform sufficiently depends on understanding the core of energy reform and clear message from the government. Current polls show that 68 % of Ukrainians think that their country go in the wrong direction⁷²⁵. Therefore, success of many-folded and vastly intermingled with other sectors of economy as energy sector depends on clear strategic vision and political will, open dialogue with public, civil control and inclusiveness of all actors to participate in discussing reform implementation. As noted by Wojciech Kononczuk: ‘Ultimately, successful implementation of the reform will be a milestone for Ukraine in its attempt to leave the post-Soviet paradigm of how the state, its political elites, its economy and society function’⁷²⁶.

As neatly pointed out by energy expert Edward C. Chow current government so far failed to explain why Ukrainian citizens need energy reform. A lack of political will ends up with an explanation that the International Monetary Fund demands energy reforms, which tends to be rather vague point for common Ukrainians to support pricy energy

724 *DiXi Group*. (2015). Ukraine and Energy Community: On the Road of Reforms. Energy Reforms Coalition, <http://ua-energy.org/post/56990>, accessed on December 15, 2015.

725 Survey conducted by Rating Group Ukraine for IRI in September 2015, http://www.iri.org/sites/default/files/wysiwyg/2014-10-14_survey_of_ukrainian_public_opinion_september_7-21_2015.pdf, accessed on December 15, 2015.

726 Kononczuk, Wojciech. (September 2, 2015). Reform #1. Why Ukraine has to reform its gas sector. *OSW Commentary*, <http://www.osw.waw.pl/en/publikacje/osw-commentary/2015-09-02/reform-1-why-ukraine-has-to-reform-its-gas-sector>, accessed on December 14, 2015.

reforms. A clear vision of modernized Ukrainian economy, improved energy efficiency and an increase in domestic energy production is far from topping the agenda of energy politics in Ukraine. Absence of independent energy regulator together with state-owned energy assets controlled by oligarchs fertilizes so deeply corrupted system, which still lacks transparency and market competition⁷²⁷.

Edward C. Chow continues that it seems hard for an average Ukrainian to understand the necessity of painful economic sacrifices for the sake of energy reform when government is still controlled by different interest groups keeping the reform idle. In current situation conflict in eastern Ukraine should be used as a facilitator of the reform, as Chow puts it ‘a strong impetus for energy reform, not a reason for delay’⁷²⁸.

Reverse flows from Europe will not serve a permanent solution until real reform fixes dysfunctional energy sector. Chow presumes that government needs an honest communication with its nation about challenges and measures taken to address these issues. Indeed increase of public awareness on objectives of the ongoing reforms will accumulate better understanding in a society about the nature of change. Any delay ends up with loss of government’s credibility and strengthening of Russia’s leverage. He sums up rather pessimistically that ‘the impression is left that the Ukrainian energy sector has not changed much at all in spite of agreement by all sides that it needs urgent, fundamental reform’⁷²⁹.

Another achievement of current government is diversification of energy resources. First time diversification of energy supply means real shift in energy balance of Ukraine. As it is forecasted till the end of 2015 Ukraine in total will import 60 % of gas from Europe, though the remaining 40 % will still come from Russia. This trend has several important key points to be mentioned. First of all, indeed for 24 years of independence Ukraine first time buys bigger amounts of gas from another country than Russia, which undoubtedly can be treated as ‘a major accomplishment for Ukraine in its quest to loosen its dependence on direct imports of Russian gas’⁷³⁰.

727 Chow, Edward C. (September 25, 2015). Energy Reform – the clock has struck midnight. *Kyivpost*, <http://www.kyivpost.com/opinion/op-ed/edward-chow-energy-reform-the-clock-has-struck-midnight-398688.html>, accessed on December 7, 2015.

728 Chow, Edward C. (September 25, 2015). Energy Reform – the clock has struck midnight. *Kyivpost*, <http://www.kyivpost.com/opinion/op-ed/edward-chow-energy-reform-the-clock-has-struck-midnight-398688.html>, accessed on December 7, 2015.

729 Chow, Edward C. (September 25, 2015). Energy Reform – the clock has struck midnight. *Kyivpost*, <http://www.kyivpost.com/opinion/op-ed/edward-chow-energy-reform-the-clock-has-struck-midnight-398688.html>, accessed on December 7, 2015.

730 *Ukraine Reform Monitor: August 2015*. Carnegie Endowment for International Peace, <http://carnegieendowment.org/2015/08/19/ukraine-reform-monitor-august-2015/iewe>, accessed on December 10, 2015.

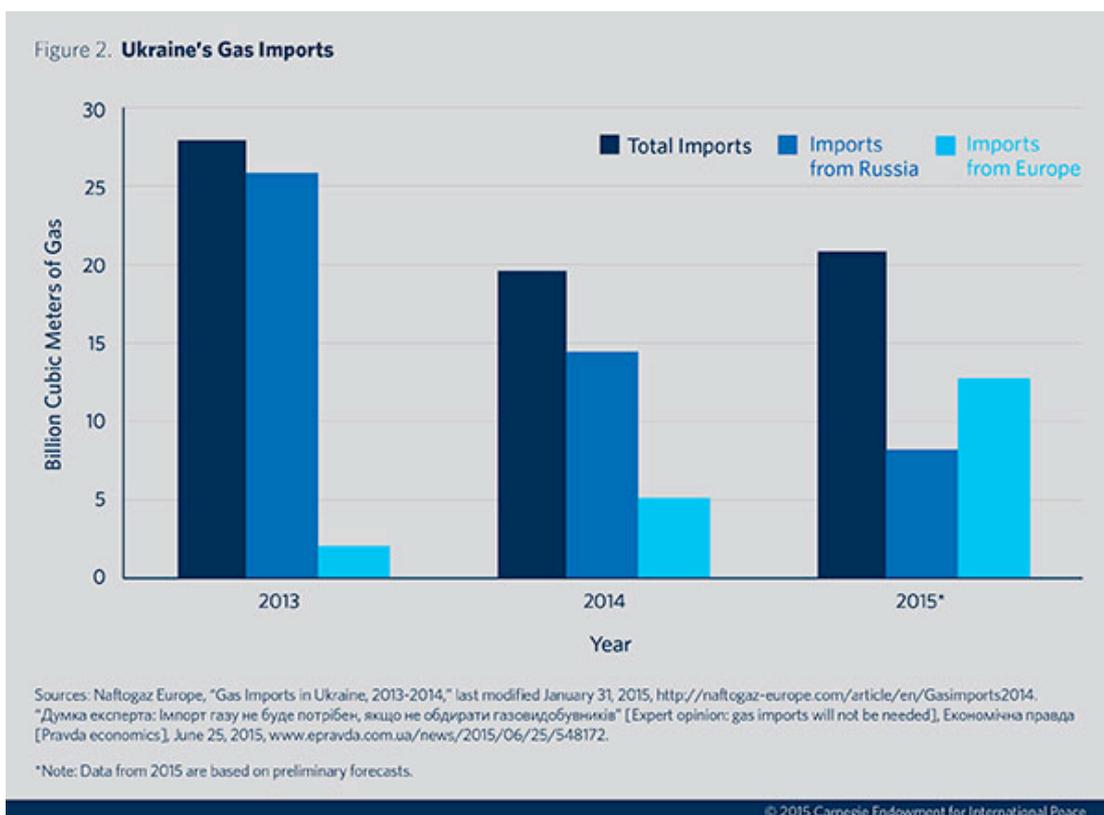


Figure 7. Ukraine's Gas Imports 2013-2015.

Source: Naftogaz Europe. Gas Imports in Ukraine, 2013-2014, <http://www.naftogaz-europe.com/article/en/Gasimports2014>, accessed on 10 March 2016.

Second, though imported gas from Europe still by its origin mostly comes from Russia, but de jure belongs to the EU, which creates geopolitical advantage for Ukraine to eliminate gas as weapon in the hands of Russia. Third, without diminishing the importance of diversification, one should understand that it will not be profitable to replace all the needed quantities of gas by European one as it is quite pricy. In the long term diversification alone will not change anything in energy sector, vast measures on energy efficiency and energy saving should be implemented along with creation of favorable conditions for domestic gas extraction. As Ukrainian economy gets stronger European gas and domestic gas production won't be enough to meet the needs of a rebuilt industrial sector, then Ukraine may again face its vulnerability in gas negotiations with its eastern neighbor.

As mentioned by Anders Aslund, 'Ukraine needs to stop trading gas with Russia in order to clean up corruption'⁷³¹. Indeed with Poroshenko in power there is no publicly

731 Johnson, Keith. (March 10, 2015). Ukraine's 'Courageous' Energy Reforms Meant Erode Russia's Leverage. *Foreign Policy*, <http://foreignpolicy.com/2015/03/10/ukraines-courageous-energy-reforms-meant-to-erode-russias-leverage/>, accessed on December 15, 2015.

available evidence for direct corrupt activities in energy sector, but accusation are still made against those managing energy resources. As stated by Marta Jaroszewicz and Piotr Zochowski: ‘These individuals reap profits mainly from dubious intermediary activities in the field of purchase, sale and the processing of fuels; and from obtaining rebates, licences or loans from the state which they are not entitled to’⁷³². But with current reforms energy sector did face certain changes. The will of president Poroshenko to treat gas only as business needs to be mentioned. It is first time in the history of Ukraine that the leadership neither has any links to energy sector nor participates in highly politicized gas negotiations with Kremlin. Gas matters are strictly given to the Ministry of Energy and Naftogaz to handle, unlike Putin, who is still handling gas trade as a matter of state for Russia⁷³³.

As stated by Anders Aslund “people accept a paradigm shift much more easily than a partial change within the existing paradigm. If one minor liberalization occurs, people ask why that specific liberalization took place. If most sectors are liberalized, people instead ask why the rest have not been liberalized as well, because they have accepted the new liberal paradigm”⁷³⁴. But can reforms really be front-loaded, radical, and comprehensive, while oligarchs are still so powerful and political system balances remain the same? The roll-back is a real threat and sustainability of the reforms indeed depends on real will of the current president to change the system not just some parts of it.

6.2. Deterioration in relations with Russia and suspension of energy supplies

Closer cooperation with the EU and political tensions over annexation of Crimea together with ongoing conflict in Eastern Ukraine were mirrored into energy sector as well. Kremlin was boldly unhappy to see how Ukraine and the EU signed Deep and Comprehensive Free Trade Agreement, and therefore introduced food embargo and other energy-related conditions to threaten Ukraine. Kremlin attempted to politicize energy by all means, but this time Poroshenko altered the conditions, which were empowering Russia to use energy leverage. This was first time in the history of Ukraine, when energy supplies from Russia were cut, because Ukraine did not need it any more. This subchapter shows

732 Jaroszewicz, Marta, Zochowski, Piotr. (May 7, 2015). Combating corruption in Ukraine – the beginning of a long march. *OSW Commentary*, <http://www.osw.waw.pl/en/publikacje/osw-commentary/2015-05-07/combating-corruption-ukraine-beginning-a-long-march>, accessed on December 17, 2015.

733 Socor, Vladimir. (2015). Ukraine Rapidly Dismantling Gazprom’s Supply Monopoly. *Eurasia Daily Monitor*, Vol. 12, Issue 65, http://www.jamestown.org/single/?tx_ttnews%5Btt_news%5D=43764&tx_ttnews%5BbackPid%5D=7&cHash=30ee75ae8f38d8eb4db36cd3339e3ad5#.VnQbszZYm1ss, accessed on December 15, 2015.

734 Aslund, Anders. (2015). *Ukraine: What Went Wrong and How to Fix It*. Peterson Institute for International Economics, p.24.

how uneasy were negotiations between Russia and Ukraine and how important were the ramifications of it. I try to mention additional instruments that were applied by Russia in order to affect Ukraine's position in gas talks. Nevertheless, with firm political will of current president Poroshenko to end gas trade with Russia, the suspension looked rather inevitable because 'nothing is more expensive for Ukraine than cheap Russian gas'⁷³⁵.

From June to December 2014 Gazprom had suspended gas supplies to Ukraine and imposed prepayment conditions for Naftogaz. As a result Ukraine submitted a claim to Arbitration Institute of the Stockholm Chamber of Commerce in June 2014.

On February 19, 2015 Gazprom's CEO Aleksei Miller at the request of the Russian government (as defined by Dmitri Medvedev gas supply was considered to be 'humanitarian aid') decided to supply separatist-controlled areas with gas, stating that their costs would be covered by the prepayments made by Ukraine. This happened soon after due to infrastructural damages gas supply to Donbas was suspended by Ukrainian government. At the same time less gas supply was observed by Kyiv, which was treated as violation of contractual agreements. Russia and Ukraine were again left in the situation when energy supplies were threatened to be suspended, and European partners again were preoccupied with security of gas supplies.

The story of gas supply interruptions was turned by Moscow into re-freezing gas disputes between two countries. According to this scenario Russia was using the situation to show again how unreliable Ukrainian partners are. This would support Russia's argument that Ukraine should be excluded from Europe's transit routes, so that alternative routes (among others Turkish Stream Project) would deserve special attention. But taking into consideration that in the nearest 5 years Ukraine cannot be excluded from being transit country, Moscow rather used its rhetoric to pursue other goals. As at the same time, namely on 25 February 2015 European Commission published its strategy for the introduction of Energy Union, Russia most probably wanted to get bigger leverage within discussions of EU's energy security.

On 1 April 2015 Russia and Ukraine extended the winter package until June. This agreement seemed to be rather beneficial for Ukraine due to several reasons. It not only provided Ukraine with attractive price for gas but also with favorable conditions of purchase. From Moscow's side extension of winter package was treated rather as a concession taking into consideration difficult economic situation.

⁷³⁵ Bielkova, Olga. *In Ukraine's Energy Sector, Failure is not an Option*. Huffingtonpost. April 6, 2015, http://www.huffingtonpost.com/olga-bielkova/in-ukraines-energy-sector_b_7632134.html, accessed online on November 27, 2015.

According to April Agreement the price for gas would not exceed 248 USD per 1000 cm, which appears from the application of formula from 2009 Contract with regard to 100 USD discount granted by Russian government⁷³⁶. Moreover, not only take-or-pay condition was suspended for the second quarter of 2015, but Kyiv was also allowed to buy as much gas as it considered to be needed. And the last winning point was that this agreement did not foresee any additional concessions from Ukraine. Kyiv as well used this situation to pump gas into underground storages. In the period between 1 and 10 April 2015 around 100 million cm of gas was pumped into storages. The same time Ukraine continued to receive reverse gas from Slovakia (up to 30 bcm annually) and Romania. Hence, with a variety of gas suppliers, Ukraine was left with no shortage of gas but rather with a lack of funds to purchase it. The same time question of Russian ‘voluntary‘ supplies of gas to separatist-controlled areas of Donbas was not raised.

Favorable conditions for Ukraine meant concession from Russian side. One of the reasons was Gazprom’s decreased profit, namely in 2014 it decreased by 70 %. Ukrainian share declined drastically from 25 bcm in 2013 to 14,5 bcm in 2014, which decreased Gazprom’s income by around 4-5 billion USD. The same time Gazprom reduced volumes supplied to Europe in order to limit reverse gas supplies to Ukraine, which also resulted in 5-6 billion USD of underpayment and further 400 million USD in discounts to customers as compensation for failing to meet contractual obligations⁷³⁷. Another reason may be about Moscow’s attempt to get more favorable conditions in talks with European Commission about obtaining the right to use fully the extension of the North Stream pipeline. Thirdly, as currently the dispute between Kyiv and Moscow has been ongoing in Arbitration Tribunal in Stockholm since June 2014, it was important for Moscow to show that the provisions of 2009 Agreement were duly carried out.

April Agreement bought time for Kyiv to look for other permanent solutions. Though even President Putin spoke about the need to turn gas cooperation only into purely business based on market prices⁷³⁸, the expectations of Moscow to fully economize energy relations seems quite unlikely. Therefore, Moscow continues the tactics of discrediting Kyiv as a trading partner and looking for another routes to exclude Kyiv from European gas equation.

736 At the time gas price appeared to be 30 USD cheaper than average gas imported via reverse from Slovakia, Poland and Hungary.

737 Bershidsky, Leonid. (January 12, 2016). How Ukraine Weaned Itself Off Russian Gas. *Bloomberg View*, <http://www.bloombergvew.com/articles/2016-01-12/how-ukraine-weaned-itself-off-russian-gas>, accessed on January 21, 2016.

738 Op. cit., Kardas, Szymon, Iwanski, Tadeusz. (April 15, 2015). Gazprom’s tactical concessions to Ukraine. *OSW Analyses*, <http://www.osw.waw.pl/en/publikacje/analyses/2015-04-15/gazproms-tactical-concessions-to-ukraine>, accessed on December 18, 2015.

With the government firm decision to break up with long-standing dependency on Russian energy resources, first step was to change energy supply from Russia to the EU. Yatsenyuk's government managed to decrease the share of Russian gas imports from 92 % in 2014 to 39 % in the first quarter of 2015. Meanwhile, the stake of European supplier increased to 61 % in the first quarter of 2015⁷³⁹.

As a result of failed negotiations, when Ukraine insisted on 200 USD gas price for 1000 cm, Russia offered the continuation of second quarter price, which was 247 USD, Ukraine stopped the purchase of gas from Russia since July 1, 2015. This move was possible due to the drop in overall consumption trends in Ukraine, and especially lower levels for summer months. Minister of Energy and Coal Industry Volodymyr Demchyshyn announced that during a period from August 2014 to July 2015 Ukraine had cut its gas consumption by 20 %. Lower consumption was also caused by loss of energy-hungry territories of Crimea and parts of Eastern Ukraine. So far one cannot say that this decline happened thanks to effective energy-efficiency and energy-saving programs, but rather to a decline in industrial output⁷⁴⁰.

Gas demand in winter period (October 2014-April 2015) was met by mostly national production, imported gas from the EU and gas from the storages. Ukraine imported only 2,67 bcm from Russia at a price 248 USD in line with the so called 'winter package'. Therefore gas import from Russia was suspended on 1 July 2015⁷⁴¹.

But on September 26 as a part of tripartite negotiations an agreement was reached on gas purchases for the winter period. The gas price for the fourth quarter of 2015 was set to 227 USD per 1000 cm⁷⁴². The purchases were to be financed with 300 USD million loan from EBRD. But since 25 November 2015 Ukraine again suspended purchasing gas from Gazprom. While Russia offered the price of 212 USD per 1000 cm of gas from January 2016, Ukraine negotiated 17 contracts with EU-based companies with the gas price ranging

739 Speech of Andriy Kobolyev during *Symposium 'Energy Security in the times of crisis'*. (April 26, 2015). VoxUkraine, <http://voxukraine.org/day-3-energy-security-in-the-times-of-crisis/>, accessed on December 15, 2015.

740 Bershidsky, Leonid. (January 12, 2016). How Ukraine Weaned Itself Off Russian Gas. *Bloomberg View*, <http://www.bloombergview.com/articles/2016-01-12/how-ukraine-weaned-itself-off-russian-gas>, accessed on January 21, 2016.

741 Socor, Vladimir. (2015). Ukraine Rapidly Dismantling Gazprom's Supply Monopoly. *Eurasia Daily Monitor*, Vol. 12, Issue 65, http://www.jamestown.org/single/?tx_ttnews%5Btt_news%5D=43764&tx_ttnews%5BbackPid%5D=7&cHash=30ee75ae8f38d8eb4db36cd3339e3ad5#.VoD14jZYM1t, accessed on December 28, 2015.

742 Gilblom, Kelly. (September 28, 2015). Russia, Ukraine Gas Agreement Warms Europe Amid Widening Glut. *Bloomberg*, <http://www.bloomberg.com/news/articles/2015-09-28/russia-ukraine-gas-agreement-warms-europe-amid-widening-glut>, accessed on December 14, 2015.

between 188 and 211 USD during the period from December 2015 to March 2016⁷⁴³. The price for 1,7 bcm of gas for this period will be paid within EBRD loan.

Russia's unwillingness to revise ten-year gas contract with Ukraine, which expires in 2019, was one of the reasons of gas supply suspension. Last year for the first time Ukraine imported more gas from the EU (10,3 bcm) than from Russia (6,1 bcm)⁷⁴⁴. As gas price for Ukraine under Poroshenko was of utmost importance taking into consideration poor financial capabilities to pay high price for Russian gas, Kyiv finally decided to file a lawsuit against the Russian Federation. It is also quite unprecedented, bearing in mind that Poroshenko's predecessors usually used lawsuit as a bargaining chip, but never treated it as an actual lawful act to protect Ukraine's vulnerable position in Russia's unfair pricing policy. As other European countries won alike lawsuits against Russia, Ukraine's chance to get positive verdict of Stockholm arbitration in 2016 looks quite optimistic. In a search for a fair gas price Ukraine seeks to rectify 6 billion USD of overpayment for gas, which the Russian state monopoly has supplied to Ukraine since 2010. Apart from this lawsuit Ukraine also filed a number of other lawsuits against Russian Federation, including illegal annexation of Crimea and violation of the International Convention for the Suppression of the Financing of Terrorism⁷⁴⁵.

Gazprom's aggressive approach has been changed due to the 70 % loss in revenues; meanwhile Ukraine and Europe got new options to cover their gas needs. One of the options is the supply of the US shale gas starting this year. Meanwhile, Russia dropped threats and focused on more attention to customer needs, namely developing plans of pipeline transporting gas directly to the EU. As First Deputy Energy Minister Alexey Teksler said: "The position of Gazprom and the Russian side is becoming flexible in light of the changing situation, defending our interests but also taking into account the demands of the European side"⁷⁴⁶.

Energy fellow Simone Tagliapietra noted that after events in Crimea and Donbas "gas diversification became a mantra for both the EU and Russia. But Russia needs the EU

743 Naftogaz awarded contracts to five European companies to supply 1,7 bcm within EBRD loan framework. (January 14, 2016). *Naftogaz*, <http://www.naftogaz.com/www/3/nakweben.nsf/0/19A1BF8DA10C5525C2257F3A0043EDA6?OpenDocument&year=2016&month=01&nt=News&>, accessed on January 21, 2016.

744 *Naftogaz Europe*. Ukraine purchased 63 % of its imported gas in Europe in 2015, accessed on June 10, 2016, <http://naftogaz-europe.com/article/en/gasimport2015eng>

745 Naftogaz of Ukraine Submits a Claim to the Stockholm Arbitration Court. (June 16, 2014). *Naftogaz-Europe*, <http://www.naftogaz-europe.com/article/en/rjhtyjkui1>, accessed on January 5, 2016.

746 Mazneva, Elena, Shiryayevskaya, Anna, Gilblom, Kelly. Gazprom is Losing Its Market Muscle. *Bloomberg Businessweek*. (December 23, 2015), <http://www.bloomberg.com/news/articles/2015-12-23/gazprom-is-losing-its-market-muscle>, accessed on January 21, 2016.

gas market as much as – if not more – the EU market needs Russian gas”⁷⁴⁷. The plunge in gas prices increases pressure on Gazprom, whose revenues in 2016 are expected to be lower 16 %⁷⁴⁸. Gas production falls short also due to Ukraine not buying any gas from Russia.

Though Moscow’s position changes as it loses its gas leverage, Kremlin still tries to punish Ukrainian side for European choice. With DCFTA coming into force since January 1, 2016, Russia suspended its free trade agreement with Ukraine on December 16, 2015. Though free trade agreement with Russia lasted since 2011, with DCFTA being signed, Russia warned Ukraine on the ramifications of this act. Another cycle of trade wars started, when on the same day in retaliation for Ukraine joining Western sanctions against Russia, Moscow placed an embargo on Ukrainian food. Kyiv reciprocally banned a range of products imported from Russia. Russia as well banned direct shipment of goods from Ukraine to Kazakhstan through Russia, mentioning that such a transit should be carried only through Belarus. Ukraine though did not officially put any transit restrictions, but was observed to block Russian goods to Moldova. All this pushes Ukraine to look for alternative import/export routes bypassing Russia. One of them includes new “Silk Road”, which would connect southern ports of Ukraine via Black Sea to Georgia, Azerbaijan, across Caspian to Kazakhstan and China, which would operate as of February 2016. Another option is using Belarus as a back door into the Russian market. As imports of goods from Russia fell by 42 % in 2015, Russia’s new trade restrictions will not be that damaging, but would rather push Ukraine into searching for new markets⁷⁴⁹.

To sum up, suspension of gas deliveries by Russia and European direction of Ukraine caused trade wars and transit restrictions. For Russia losing gas leverage appeared to be traumatic, therefore all other instruments were used to punish Ukraine for its European choice. Gas tool is not any more an option to have greater leverage, but it does not mean that Ukraine will not come back to purchasing gas from Russia when industry revives. Relations between Ukraine and Russia remain sensitive, but due to ceasefire in Donbas the hostility in leaders’ rhetoric decreased. Nevertheless until the reform in energy sector is finished and corruption is dismantled, one can hardly say that Russia totally lost its gas leverage.

747 Ibid.

748 Ibid.

749 Varfolomeyev, Oleg. (January 20, 2016). Trade War with Russia Prompts Ukraine to Look for New Markets, Transit Routes. *Eurasia Daily Monitor*, Vol. 13, Issue 13, http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=45002&cHash=9418ac65669d7525dcf35394ee6a354f#.V2D8O1dYm1s, accessed on March 3, 2016.

6.3. Enhanced Ukraine-EU cooperation and IMF involvement

The period of Poroshenko's presidency indicated active engagement of the Western institutions in energy sector reform. Indeed due to the economic crisis and ongoing conflict within the territory of Ukraine, Ukraine appeared to be in a vulnerable position and needed Western financial engagement to keep economy afloat. The EU together with IMF and EBRD agreed on lending Ukraine more money in exchange for actual reform. This positive conditionality together with vulnerable conditions in which the country appeared led to the first real steps in energy reform implementation. The main rhetoric of the reforms was focused on the perspective to meet expectations of the European institutions. So far first main steps were made in the correct direction, but without sending clear message to the people of Ukraine and presenting thorough explanation of the real need for the reform, it is highly probable that the ongoing progress may face roll-back. Therefore, vulnerability of the issue remains and close control of the international institutions over step-by-step reform implementation in Ukraine should continue.

The better outcomes of cooperation with the EU were observed in the situation of closer dialogue between Ukrainian government and European partners. First of all, engagement of experts of the Secretariat of the Energy Community brought best world practices to the table, as a result discussions were transformed into drafting mechanisms, laws and key regulations. World Bank, IMF and the European Commission were the key stakeholders, who developed the Action Plan for the natural gas sector reform in March 2015, which led to the adoption of the Gas Law in April 2015. 'Positive conditionality' with clear deadlines and conditions promotes better reform planning, less wasted time in parliamentary debates and more real steps toward reform⁷⁵⁰.

In transposition to Third Energy Package Trust Fund consisting of the European Commission, the World Bank and the Secretariat of the Energy Community developed an Action plan for the natural gas sector reform. The priorities included adoption of the Gas Law, increase of gas prices for households and thermal power producers, and procurement prices for state-owned extracting companies. Further it was planned to draft law on strengthening the independence of regulator (NEURC) and creation of separate regulatory framework for gas transportation. Further model of unbundling was also planned to be developed and presented. Some of these conditions were identified as requirements under

750 DiXi Group. (2015). *Ukraine and Energy Community: On the Road of Reforms*. Kyiv, Energy Reform Coalition, pp. 12-13, [http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20\(1\).pdf](http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20(1).pdf), accessed on February 1, 2016.

IMF's financing program, therefore were must-to-do for Ukrainian government in order to receive next tranche from IMF⁷⁵¹.

It is important to mention that work on the draft Gas Law was completed by the Working Group in close cooperation with the Secretariat of the Energy Community and as a result Draft Gas Law was presented to government in January 2015. The eagerness of Ukrainian side to develop Gas Law in transposition to Third Energy Package should be mentioned in connection with IMF's financing program as this Law was listed among key requirements for Ukraine. After public discussions the law was approved in general by parliament and on April 30, 2015 signed by the president. Undoubtedly development and adoption of this cornerstone law is a milestone for Ukraine that was made possible thanks to the engagement of all stakeholders. By coming into force from October 1, 2015 it lays down legal, economic and organizational principles of gas market functioning, provides for ensuring non-discriminating access of operators and consumers to the market, creation of a fully operational market based on the principles of free competition and ensuring sufficient consumer protection and security of supplies⁷⁵².

Though Gas Law foresees unbundling of NAK Naftogaz, it does not require changing form of ownership. It is also important to mention that Law provides for transposing a concept of public service obligations as "special obligations to ensure that general public interests are met in the process of natural market operation"⁷⁵³. Such obligations apart from sustainability and accessibility of natural gas will also keep the right of the consumers to choose natural gas supplier and to purchase gas at prices freely defined in contracts. As liberalization of the market will be carried out upon the transitional period (till April 1, 2017), Naftogaz will cease to bear responsibility for the accumulation of gas resources for households, and till October 2018 a supplier of last resort will be elected. The correctness of methodology of assessment and calculation of natural gas retail prices for households were confirmed by a special group consisting of leading audit companies Deloitte, PwC, EY and KPMG⁷⁵⁴.

751 DiXi Group. (2015). *Ukraine and Energy Community: On the Road of Reforms*. Kyiv, Energy Reform Coalition, p. 11, [http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20\(1\).pdf](http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20(1).pdf), accessed on February 1, 2016.

752 DiXi Group. (2015). *Ukraine and Energy Community: On the Road of Reforms*. Kyiv, Energy Reform Coalition, p. 12, [http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20\(1\).pdf](http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20(1).pdf), accessed on February 1, 2016.

753 Ibid, pp. 12-13.

754 NERC. (June 23, 2015). The Working Group checked the correct calculation of natural gas prices for households, <http://www.nerc.gov.ua/?news=4484>, accessed on February 1, 2016.

Thanks to the assistance from the European Commission and the World Bank within Trust Fund contract and in cooperation with the Energy Community Secretariat, Ministry of Energy and NEURC successfully revised and improved gas sector legislation in accordance with the new Law. The European Commission and the World Bank have entered into agreement on establishment of Trust Fund in order to support the modernization of gas transmission system of Ukraine by providing technical aid in amount of 2,5 million EUR⁷⁵⁵. Trust Fund is aimed at assisting Naftogaz and Ministry of Energy and Coal Industry in preparation of restructuring of Naftogaz, support of Urengoy-Pomary-Uzhgorod pipeline reconstruction project, on reconstruction of compressor station ‘Bar’, interconnector construction project between Ukraine and Poland etc⁷⁵⁶.

Another important issue where international actors had a huge role was reform of NAK Naftogaz. Along IMF financing program government is to reduce Naftogaz’s deficit to 3,1 % of GDP. By receiving IMF loan Ukrainian government adopted a “Law Regarding Stabilization of Naftogaz’s Financial Standing”. The law strictly points out payment discipline in gas sector, especially toward heat production and heat supply organizations, provides for advance payments to a guaranteed supplier, a possibility to terminate supplies in case of payment delays or gas off-take above the established thresholds, a possibility to assign claims to third parties, etc. Another Law “On Moratorium of Forced Sale of Property” provided Naftogaz with tools to recover debts from customers and efficient mechanism of influencing enterprises-debtors⁷⁵⁷.

In November 2014 an extraordinary audit of Naftogaz was carried out in order to disclose financial plan and cash flow indicators to improve transparency. On March 27, 2015 Naftogaz published consolidated statements of its group for the years of 2012-2013 in compliance with the International Financial Reporting Standards prepared by Deloitte. A month later around 30 financial statements were published according to which Naftogaz net losses were equal to 85 billion UAH, 71% of which was the loss due to depreciation of Ukrainian hryvnia, the Crimea annexation and war in the Eastern Ukraine, while the rest was the loss due to sale of natural gas to population⁷⁵⁸.

755 Energy Community. Report for 2015. Following the results of monitoring security of natural gas supplies, Kyiv, September 2015, https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/3842350/UKRAINE_Monitoring_security_of_natural_gas_supplies.pdf, accessed on December 21, 2015.

756 <http://www.euointegration.com.ua/news/2014/12/15/7028766/>

757 DiXi Group. (2015). *Ukraine and Energy Community: On the Road of Reforms*. Kyiv, Energy Reform Coalition, p. 16, [http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20\(1\).pdf](http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20(1).pdf), accessed on February 1, 2016.

758 Op. cit., DiXi Group. (2015). *Ukraine and Energy Community: On the Road of Reforms*. Kyiv, Energy Reform Coalition, p. 17, [http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20\(1\).pdf](http://ua-energy.org/upload/files/Light_Dixi_Main_Report_en_2015%20(1).pdf), accessed on February 1, 2016.

Another project related to transposition to European standards was launched by Naftogaz together with PricewaterhouseCoopers (PwC) and Baker & McKenzie lawyers. Financed by EBRD, this project resulted in presentation of the draft Action Plan for reforming Naftogaz's corporate management. The main provisions of the document include alignment of corporate management with the OECD principles, preventing unlawful political inferences, setting up a Supervisory Board and progressive extension of its independence, introducing up-to-date information disclosure, risk management and audit practices, setting up natural gas transportation system operator with separate corporate management structure⁷⁵⁹.

As a result, one thing that improved drastically is transparency of Naftogaz. By launching 'Ukraine's Gas Sector Transparency Initiative', Naftogaz established a website www.naftogaz-europe.com, where all data on import, supply, prices, consumption, transmission and transit can be found. Moreover, information is available in Ukrainian, Russian, English and Hungarian languages. Moreover, participation of Naftogaz in ENTSOG and GSE transparency platforms foresee data on transmission and storages of gas on a daily basis to be published. At the same time, the company joined e-procurements carried out through public system ProZorro. This should be mentioned as significant step toward more transparent activity of Naftogaz. It should be also mentioned that supervision over Naftogaz was transferred from the Ministry of Energy to the Ministry of Economic Development⁷⁶⁰, and at the same time any political or administrative interference into its activity was forbidden. An independent Supervisory Board serves as a guarantor of impartiality⁷⁶¹.

Being a Candidate Country for the Extractive Industries Transparency Initiatives, Ukraine presented its first report covering 2013 on December 4, 2015. This is one more step toward creating greater transparency in oil industry⁷⁶². Undoubtedly it will increase chances of Ukraine to receive larger investments in the field.

The role of the European Commission and the World Bank within the Trust Fund contract proved to increase transparency of Naftogaz, and for the first time in Ukraine's

759 Ibid.

760 Postanova Kabinetu Ministriv pro vdoskonalennia korporatyvnoho upravlinnia publicznego akcionernogo tovarystva 'Natsionalna akcionerna kompaniya 'Naftogaz Ukrainy'', <http://zakon4.rada.gov.ua/laws/show/1002-2015-n?test=4/UMfPEGznhhQXG.ZiUixb/1HI4/os80msh8Ie6>, accessed on May 23, 2016.

761 Dixi Group. (2016). *Ukraine's Gas Sector Reform: A Future Win-Win for Ukraine and Europe*. Policy Brief. p. 4, http://ua-energy.org/upload/files/PolBrief_DiXi_gas%20market%20reform.pdf, accessed on May 29, 2016.

762 <https://eiti.org/ukraine>, accessed on May 28, 2016.

history the financial documents on Naftogaz's performance were prepared in accordance with International Financial Reporting Standards⁷⁶³. The impact of Trust Fund has undoubtedly positive affect in the reform domain, but without clear definition of the government on the reform model, it will not be improved much. To keep "success story" as much fruitful as it was for the last year, clear determination of the government on the reform path is needed.

Another important issue of EU-Ukraine gas cooperation was reverse gas supply from Europe. Due to EU market liberalization and growing number of European interconnections EU's share in the market increased in comparison to Gazprom's in Ukraine. Therefore, European companies can re-sell Russian gas to Ukraine, the ongoing reverse gas trade from Slovakia is a bright example of it. Real progress was made in increasing capacities of gas flows from Europe. After suspension of gas in June 2015 Ukraine had imported 5 bcm from Slovakia, Poland and Hungary. An interconnection agreement between Ukrtransgaz and FGSZ was signed in May 2015⁷⁶⁴. Ukrainian and Polish regulatory authorities and transmission system operators agreed to participate in a pilot project on early implementation of the Capacity Allocation Network Code⁷⁶⁵. Indeed this development became vital for Ukraine in order to replace missing gas from Russia by European one. In political terms, reverse supply from Europe diminished Russian leverage in energy talks with Ukraine and strengthened Ukrainian energy independence. Nevertheless, reverse gas flows from Europe will not replace Russian gas, therefore alternative diversification routes will become a focus of Ukraine's agenda, especially when economy starts to recover.

If we talk about state of compliance the new Gas Law is fully in line with Directive 2009/73/EC and Regulation (EC) 715/2009. Energy Community praised Ukraine as the newest member of the Energy Community for transposing the Third Energy Package in the gas sector. Secretariat as a promoter and interpreter of the EU acquis has been actively assisting in preparation of the primary and secondary legislation. Though adopting the Law is undoubtedly a huge step that lays a ground for further reforms, further adoption and implementation of secondary legislation will suggest an irreversible path of reforms. As the

763 <http://naftogaz-europe.com/article/en/naftogazobnaroduetpredvaritelnyefinrezultatyza2014g>, accessed on May 28, 2016.

764 Information of NAK "Naftogaz" on signing the agreement with Hungarian operator, <http://www.naftogaz.com/www/3/nakweben.nsf/0/AE96AA9D16162AA9C2257E5B004AB86D?OpenDocument&Hig hlight=0,FGSZ>, accessed on May 26, 2016.

765 Energy Community Secretariat. (September 1, 2015). Annual Implementation Report, p. 209, accessed on December 22, 2015, https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/3872267/EnC_IR2015WEB.pdf, accessed on December 22, 2015.

legislative basis for regulator NEURC's performance had not yet transposed the Third Package, it remained the only regulator together with the one in Bosnia and Herzegovina, that lacked jurisdiction over the gas sector. It also lacked independence and was subordinated to the president, who held the right to liquidate it. NEURC also lacked financial independence. All these shortcomings were revised and as a result NEURC was replaced with new regulator National Commission for State Regulation of Energy and Public Utilities of Ukraine (NCSREPUU). New regulator with the Secretary of Energy Community developed the draft law 'On the State Regulation in the Energy Sector', which was approved at the meeting of the Cabinet of Ministers on 25 March 2015⁷⁶⁶.

In February 2014 the Ministry of Energy and Coal Industry of Ukraine and Secretariat of the Energy Community signed Memorandum on their Implementation Partnership. Along this Memorandum both parties agreed to set up an effective implementation mechanism, including the establishment of working groups for amending and drafting legislation to transpose the Energy Community law⁷⁶⁷. On 28 October 2014 the Minister for Energy and Coal Industry of Ukraine signed an order 'About creation of multi-stakeholder working group for development, implementation and monitoring of implementation of reforms in accordance with commitments in the Energy Community Treaty'⁷⁶⁸.

The role of Europe as a negotiator in talks between Russia and Ukraine brought modest results with no crucial damage to Europe. EU's main target was to secure gas flows targeted for European countries in winter period, rather than solving current gas disputed between two neighbors. European Commission acted as negotiator in gas disputes between Ukraine and Russia, which led to the signing of a Protocol for the provision of gas supplies during the winter period on 30 October 2014⁷⁶⁹. As a result Naftogaz transferred 3,1 billion USD to Gazprom for the natural gas received during November-December 2013 and April-June 2014. For 2015 new Addendum #34 to the Contract was signed under similar 'winter package' conditions⁷⁷⁰.

766 Energy Community Secretariat. (September 1, 2015). Annual Implementation Report, p. 209, accessed on December 22, 2015, https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/3872267/EnC_IR2015WEB.pdf, accessed on December 22, 2015.

767 <http://enref.org/wp-content/uploads/2015/01/Memorandum-of-Understanding.pdf>

768 <http://enref.org/en/news/meeting-of-the-group-for-monitoring-of-implementation-of-reforms-in-the-framework-of-the-energy-community-in-updated-composition-was-held-in-the-ministry-of-energy-and-coal-industry/>

769 Binding Protocol regarding the conditions for gas delivery from the Russian Federation to Ukraine for the period from November 2014 until 31st of March 2015, https://ec.europa.eu/energy/sites/ener/files/documents/20141030_trilateral_protocol.pdf, accessed on December 21, 2015.

770 <http://www.naftogaz.com/www/3/nakweben.nsf/0/3E8519F8EB196F8AC2257D86007277F6>

All the above-mentioned active engagement of the European Union was undoubtedly a result of signing and ratification of the Association Agreement (came into force on 1 November 2014) and the provisions of the Deep and Comprehensive Free Trade Agreement (January 2016). Energy provisions are integral part of Association Agreement. With 11 billion EUR of support package European Commission established a Support Group for Ukraine (SGUA)⁷⁷¹. First steps of close cooperation between EU and Ukraine in post-Maidan period unveiled much more higher level of engagement from European side as well as from international financial institutions like IMF and EBRD. The main message from the EU and financial institutions was to keep Ukraine's economy from default by providing tranches only under conditions of transparent and consequent reforms. International institutions taking into consideration previous experience presented more thorough system of control over reform implementation. Under their recommendation a Multi-stakeholder group was formed, which secured inclusiveness of all interest parties and provided a platform for fruitful discussion and further adoption of the developed legislation⁷⁷². All this indicates that the EU together with IMF and EBRD are on the right path of engagement in energy sector reform. Nevertheless the level of engagement should not decrease, as most of the reforms are implemented thanks to engagements of the EU.

Meanwhile the lack of commitment of current government and president to fight corruption led to the resignation of the Minister of Economy Aivaras Abromavicius and deputy Prosecutor General Vitaliy Kasko⁷⁷³. This in turn pushed IMF to postpone the delivery of the third and fourth tranches last year⁷⁷⁴. Therefore, though the basis for the reform has been prepared already, but current political stalemate caused international donors to freeze financial assistance until it is clarified.

Current political situation also endangers the pace of the energy reform as Naftogaz is supposed to receive loans from European Bank of Reconstruction (EBRD) and Development and European Investment Bank (EIB) in order to modernize Urengoy-Pomary-Uzhgorod gas pipeline⁷⁷⁵. Clearly when allegations of corruption are made, all positive

771 http://europa.eu/rapid/press-release_IP-14-413_en.htm

772 EITI Multi-stakeholder groups consists of six representatives each from government, civil society and companies (Shell, TNK, Chevron, Naftogaz, Ukrtransgaz, Ukragazvydobuvannia). See, <https://eiti.org/news-events/ukraine-forms-multi-stakeholder-group>

773 *Ukraine Reform Monitor: February 2016*. Carnegie Endowment for International Peace, <http://carnegieendowment.org/2016/02/19/ukraine-reform-monitor-february-2016/iu83>, accessed on March 2, 2016.

774 Ibid.

775 *Ukraine Reform Monitor: February 2016*. Carnegie Endowment for International Peace, <http://carnegieendowment.org/2016/02/19/ukraine-reform-monitor-february-2016/iu83>, accessed on March 2, 2016.

developments can be easily reversed, which will further erode Ukrainian economy and politics. Energy politics as a top priority area of reform will suffer from the lack of commitment to combat corruption, which will lead to keeping the status quo and bringing Ukraine again to a previous way of doing business in energy domain. Only clear commitment of the current government in reform implementation will eventually have a positive affect not only for the relations between Russia and Ukraine, but will increase the chances of Ukraine through full engagement in the Energy Community to seek for EU's membership in the future.

6.4. Causal links between domestic politics and international relations under Poroshenko

When we look at Poroshenko's presidency it is obvious that political will plays essential role in implementation of energy market reforms. Domestic factors regardless its complexity due to war with Russia rather facilitate the introduction of so necessary reforms. Under the terms of war with Russia over Eastern part of Ukraine and annexation of Crimea, Ukrainian government treated a question of energy dependency on Russia as critical and thus prioritized it within reform agenda.

The role of the current president at domestic level as well as international level is important. After Yanukovich's escape from the country and early elections, the international community warmly supported Poroshenko's candidacy. His presidency brought a unique chance in a volatile situation to implement unpopular reforms, which had been postponed for decades.

The influence of domestic interest groups faced change due to certain reasons. First of all, direct lobbying of energy interests in governmental circles was eliminated. The oligarchs who made fortune during first two decades of independence were sidelined or escaped from the country. The others, who stayed, undoubtedly still affect certain energy domains, but were erased from energy policymaking process. The implementation of the reforms still meets resistance from certain oligarchic groups, but so far is partially managed by the government.

Moreover, the timing of the reform in gas sector was chosen in a quite suitable way. War actions from Russian side provided a unique opportunity to raise awareness of the common citizens to implement reforms even by paying high price for it in order to avoid paying millions of dollars to aggressor with whom Ukraine is at war. Along reform path Ukrainian government lacked a clear explanation for the need of the reforms, thus lacked

direct communication with public, and real steps in the direction of energy-efficiency and energy-saving are still to be taken. With time passing and war turning into frozen conflict, current government has fewer chances to introduce unpopular moves of reform. Therefore, lack of clear dialogue with the public may bring unclear outcomes of the reform.

International level shows that cooperation with international institutions, like IMF, Energy Community, EBRD etc., bears fruit due to, first of all, political will of the current government. As well reforms are being implemented due to clear conditionality presented by the international institutions.

International level brought new balance to the negotiating parties. As Ukraine decided to decrease gas supplies from Russia and to replace it by European ones, Russia lost its leverage. Trying to remove energy issues from being over-politicization, Ukraine defined new rules of negotiations, when rather than chief negotiator, relevant ministers were meeting and discussing the matter of negotiations. Thus, concluding no agreement with Russia was quite beneficial at a time, as Ukraine got more favorable terms of gas supplies from Europe. Russia did not only lose its leverage in negotiations, but also a very important gas consumer, which directly affected the financial well being of Gazprom.

The impact of European partners together with financial institutions like IMF, World Bank, EBRD gave new impetus to implement needed reforms. Such improvements as, development and adoption of primary and secondary legislation, Naftogaz's restructuring and stabilization of its financial standing by IMF etc. established new culture of energy business in Ukraine. Membership in Extractive Industries Transparency Initiatives, ENTSOG, GSE transparency platforms drastically improved transparency of the sector.

Moreover, EU's support for the civil society's involvement in a decision-making process in energy sector made decision-making process more balanced and inclusive, as well as brought greater support for the transposition with the EU's legislation. The impact of the NGOs in terms of raising awareness of the importance of European energy integration should duly mentioned. Frequently, as mentioned by Roman Nitsovych civil society becomes a real promoter for reforms by preparing background information for state institutions on the benefits of the accession in various international organizations, like EITI⁷⁷⁶. It is really crucial, especially as there still exists widespread lack of government's

776 Interview with Roman Nitsovych, Chief Editor of analytical resource "Ukrainska energetyka" (Ukrainian energy) <http://ua-energy.org>, conducted in Kyiv (Ukraine), on 27 May 2013.

understanding of how actual reforms should be implemented⁷⁷⁷. Participation of the representatives of civil society in Multi-stakeholder group under the Ministry of Energy shows a real progress toward opening up the market and greater transparency⁷⁷⁸.

Therefore the interplay of domestic and international factors brought first real steps toward energy sector reform. The outcomes are still in the making and may be easily reversed. The fragility of the situation is managed with active participation of international actors. Negotiations at international level are transferred into tiny but consecutive steps of energy reforms at domestic level. But fragile economic situation and political instability brings always an element of the lack of real advancement. Therefore, though gas imports from Russia first time in the history of Ukraine appeared to be lower than European, the final success of energy reform endeavor lies at the intersection of domestic and international factors. With unified political position inside the country and the support of international organizations, Poroshenko could still fully embrace needed reform.

Undoubtedly, the main problem that has not been eradicated remains corruption. Ukraine still scores poorly in combating corruption, which became an integral part of energy policy making, and tightly ties all the other energy-related sectors. Therefore, without real advance in this field energy sector reform cannot be treated as fully successful.

For the time being it is obvious that the prospects of energy extraction increase inside the country are so far vanished, as Crimea is under Russian occupation and frozen conflict in the Eastern part of Ukraine also erased that area from the list of future shale gas projects. The geopolitical position of Ukraine in energy terms due to these developments changed, and big international companies like Chevron and Shell so far suspended its activity. But nevertheless domestic gas production still looks promising if related legislation is revised in order to attract more investors, including domestic ones.

⁷⁷⁷ Interview with Kaido-Paul Kranfeldt, Team Leader, EU-funded project “Capacity Building to State Agency in Energy Efficiency and Energy Saving in Ukraine”, conducted in Kyiv (Ukraine), on 28 May 2013.

⁷⁷⁸ EITI Multi-stakeholder groups consists of six representatives each from government, civil society and companies (Shell, TNK, Chevron, Naftogaz, Ukrtransgaz, Ukragazvydobuvannia). See, <https://eiti.org/news-events/ukraine-forms-multi-stakeholder-group>

CHAPTER 7

COMPARATIVE ANALYSIS: UKRAINE AND BELARUS

7.1. Domestic level of energy politics in Belarus and Ukraine

Belarus as a landlocked country with 10 million population appeared to be among those countries of post-Soviet block, which happened to vastly rely and depend on Russia⁷⁷⁹. Energy sector was characterized by the inefficient use of the energy sources due to its inexpensiveness during Soviet times, backwardness of the technology and total reluctance to environmental restrictions. Industrial sector instead of improving its efficiency cut its output. Energy consumption dropped by 30 % due to the drop in demand for industrial goods produced in Belarus. Situation was worsened by the limited energy resources and weak legislative and regulatory framework, which turned Belarus into a heavier dependant on only one energy supplier – the Russian Federation. After the collapse of the Soviet Union Belarus was about 90 % dependent on energy imports, and this number has not much decreased in the second decade of its independence. This tendency proves that Belarusian economy due to gradually increasing dependence did not face needed structural reforms⁷⁸⁰.

Belarus is poorly endowed with fossil resources, which in total meet only 16 % of the country's total energy consumption⁷⁸¹. Belarusian oil production amounts approximately 2 million tons per year, and though the reserves in oil are estimated at 55 million tons, its exploration and extraction is difficult and expensive⁷⁸². Other promising resources include peat and forests, which could become main sources of growth in the share of local energy resources in the overall energy balance⁷⁸³. Due to high reliance on gas, 95 percent of electricity production is based on gas. Annual gas imports in average amount around 20

779 Luministe, Taavo. (1998). Ukraine and Belarus: Regime Transitions and State Building After the Collapse of Soviet Union. *Academic Center for Baltic and Russian Studies*, Tartu University, http://www.ut.ee/ABVKeskus/?leht=publikatsioonid&aasta=1998&dok=ukraina_belarus, accessed on February 8, 2013.

780 Balmaceda, Margarita Mercedes, Rosner, Kevin. (2006). *Belarus: Oil, Gas, Transit Pipelines & Russian Foreign Policy*. GMB Publishing Ltd, p. 6.

781 Ibid.

782 Ibid, p. 7.

783 Fedor, Helen. (1995). *Belarus: A Country Study*. Washington: Governmental Publishing Office for the Library of Congress.

billion cm, which corresponds to 2000 cm per head (while in Ukraine this number is 1200 cm)⁷⁸⁴. Dependence on gas will gradually increase unless nuclear power station is built, which is quite unlikely taking into consideration Chernobyl's ramifications. Therefore, gas is forecasted to be of high importance in country's energy mix in the near future.

The role of energy sector is immense as it makes up approximately 30 % of the industrial structure of the country. Belarusian industrial enterprises use a significant share of intermediate imports (mostly energy resources and metals) producing products with low value added. Since 2006 the growth of the foreign trade was negative due to rise in natural gas prices imported from Russia and changing the terms of oil purchase. All this leaves industry highly vulnerable to any changes in energy sector⁷⁸⁵.

Another significant feature of energy sector of Belarus is presented by its transit potential. The capacity of transit gas pipelines in Belarus is 63 billion cm annually. In 1993 Belarus imported 90 % of its fuel from Russia through Druzhba Pipeline and the Northern Lights natural gas pipeline⁷⁸⁶. In 1992 Belarus had 1470 km of pipeline carrying crude oil, 1100 km of pipeline carrying refined products and 1980 km of pipeline carrying natural gas⁷⁸⁷. An important fact is that transit is mainly controlled by Russia and brings around 250 million USD in revenues. Though construction of bypass pipelines reduced attractiveness of Belarus as transit country, it still remains an important transit route for Russian energy resources to Europe.

According to the optimistic prognosis of Pospelova and Kouzmitch till 2020 increasing energy needs will be satisfied by minor gas consumption decrease (from 20.05 in 2010 to 19.45 million tons of oil equivalent in 2020), three times increase of heavy oil consumption and doubled share of the renewables⁷⁸⁸. Therefore, vast gas dependency will remain a core problem of the overall energy balance.

Before the dissolution of the Soviet Union Belarus by occupying less than 1 % of the former Soviet Union produced more than 4 % of its GNP. The country was indeed

784 Götz, Roland. (2007). Ukraine and Belarus: Their Energy Dependence on Russia and their Roles as Transit Countries. In Hamilton, Daniel and Mangott, Gerhard. (Eds.). *The New Eastern Europe: Ukraine, Belarus, Moldova*. Center for Transatlantic Relations, Austrian Institute for International Affairs, pp. 162-163.

785 Gerasimov, Yuri. (2010). Energy sector in Belarus: Focus on wood and peat fuels. Working paper, *Finnish Forest Research Institute*, p. 8, <http://www.metla.fi/julkaisut/workingpapers/2010/mwp171.pdf>, accessed on April 30, 2013.

786 Ibid, p. 165.

787 Fedor, Helen. (1995). *Belarus: A Country Study*. Washington: Governmental Publishing Office for the Library of Congress.

788 Pospelova, T., Kouzmitch, V. (2006). *Renewable Energy Projects in the Republic of Belarus*, <http://www.desire-net.enea.it/documenti/presentazioni/presentazioni%203%20aprile.pdf>, accessed on April 18, 2013.

industrially developed, hence was referred to as USSR's main 'assembly line'⁷⁸⁹. After gaining independence Belarusian economy did not face radical transformations, and continued to be oriented to production especially for the military-industrial complex of Russia.

The transition from a command economy to market took a slow pace and was accompanied by decline in production and inflation. Unlike Ukraine Belarus did not accept liberal approach to transform economy as well as parliamentary democracy was observed in a very limited way. Political system though officially gained the features of presidential republic, still was vastly relying on command approaches of management, and at the same time was based on 'the attempts to ensure the responsiveness of the country'⁷⁹⁰.

Economic rates during 1992-1994 proved a great fall in industrial production by 39 %, sales by 67 % and investment by 54 %⁷⁹¹. Tremendous economic decline (much more deeper than observed in Ukraine the same period) even aggravated when Lukashenka advocated price and wage controls, denounced private property and in more general terms supported a centralized Soviet-style economy.

All the above mentioned together with harsh censorship of mass media and reluctance to the respect of civil rights brought Europe's last dictator to the only in his mind correct decision. First, for membership in Customs Union Belarus obtained reduced prices for gas and oil, while stepping even forward into political integration in 1996 Belarus's debt of 1.2 billion USD was forgiven by Russia⁷⁹². But it was more than just integration, Lukashenka 'tried to transform Belarus into part of the 'Russian myth', culturally, politically, economically, and militarily'⁷⁹³. A preference to join integration project between two Slavic countries, handed Belarus into Russian hands.

789 Belarus was an indivisible part of the Soviet economic system, which largely specialized in the machine-building, light, chemical and petro-chemical industries.

Luministe, Taavo. (1998). Ukraine and Belarus: Regime Transitions and State Building After the Collapse of Soviet Union. *Academic Center for Baltic and Russian Studies*, Tartu University, http://www.ut.ee/ABVKeskus/?leht=publikatsioonid&aasta=1998&dok=ukraina_belarus, accessed on February 8, 2013.

790 Luministe, Taavo. (1998). Ukraine and Belarus: Regime Transitions and State Building After the Collapse of Soviet Union. *Academic Center for Baltic and Russian Studies*, Tartu University, http://www.ut.ee/ABVKeskus/?leht=publikatsioonid&aasta=1998&dok=ukraina_belarus, accessed on February 8, 2013.

791 Ibid.

792 Selivanova, Irina. (1998). Ekonomicheskaia integratsia Rossii i Belorussii i ee vlianie na razvitie narodnogo khoziaistva Belorussii (The Economic Integration of Russia and Belarus and its Influence on the Development of the National Economy of Belarus) in Furman, D. *Belarussia i Rossiia: obshchestvo i gosudarstvo* (Belarus and Russia: society and state). Moscow: Prava cheloveka, pp. 320-321.

793 Op.cit., Moscow Television. (February 15, 1995). Lukashenko on the CIS and the Belovezh Forest Agreements in Brzezinski, Zbigniew. (Ed.). (1997). *Russia and the Commonwealth of Independent States: Documents, Data, and Analysis*, Armonk, NY: M.E.Sharpe, p. 247.

Regardless the opposition voices that Union with Russia meant great sacrifices of Belarus's independence, Lukashenka's understanding of the national interest differed. In his view integration between Belarus and Russia had economic sense: 'The main thing is interest. We have interest in Russia. There is no altruism in the Belarusian president's policy here: it is absolutely in our interest. Yes, as always the opposition criticizes me for this – and not just for this, either – saying that I am selling our interest. You know, I'm an economist, not a photographer. I understand perfectly what interest is. Interest is subject to accounting.'⁷⁹⁴ It was quite apparent that Lukashenka's view of closeness with Russia was based on long-term economic benefits. As a result, as concluded by Rawi Abdelal, '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'⁷⁹⁵.

It is important to understand that unwillingness to exercise independence had been observed even before the collapse of the Soviet Union. Aleksandr Lukashenka was the only one that actually voted against the collapse of the Union during the Belovezh Pushcha Meeting. As he stated it: 'I'm proud of the fact that I cast my vote against the dismemberment of a great state. Time has shown that we committed a grave error'⁷⁹⁶. Belarusian government as defined by Abdelal was interpreting dependence on Russia in neutral way. This dependence was one more reason to reintegrate economically with Russia⁷⁹⁷. Therefore, not surprisingly Belarus never came up with a plan of real economic autonomy from Russia, to the contrary it became even more dependent, when Russia's share of export rose from 42% in 1992 to 65 % in 1998⁷⁹⁸.

Thanks to its strategic location between the Russian Federation and the European Union, Belarus was listed among the most important countries in terms of transit that got special treatment from the Russian Federation. Being an integral part of Soviet pipeline network, Belarus successfully received subsidies from Russia in form of cheap prices for oil, natural gas and electricity. These favorable conditions provided Belarusian economy

794 Op.cit., Moscow Television. (February 15, 1995). Lukashenko on the CIS and the Belovezh Forest Agreements in Brzezinski, Zbigniew. (Ed.). (1997). *Russia and the Commonwealth of Independent States: Documents, Data, and Analysis*, Armonk, NY: M.E.Sharpe, p. 247.

795 Abdelal, Rawi. (2004). Interpreting Interdependence: National Security and the Energy Trade of Russia, Ukraine, and Belarus. In Legvold, R., Wallander, Celeste A. (Eds.). *Swords and Sustenance: The Economics of Security in Belarus and Ukraine*. Cambridge: The MIT Press, p. 112

796 Op.cit., Moscow Television. (February 15, 1995). Lukashenko on the CIS and the Belovezh Forest Agreements in Brzezinski, Zbigniew. (Ed.). (1997). *Russia and the Commonwealth of Independent States: Documents, Data, and Analysis*, Armonk, NY: M.E.Sharpe, p. 247.

797 Abdelal, Rawi. (July, 2002). Interpreting Interdependence. Energy and Security in Ukraine and Belarus. Center for Strategic and International Studies, http://csis.org/files/media/csis/pubs/ruseur_wp_020.pdf, accessed on March 29, 2013.

798 Ibid.

with temporary productivity increase due to several factors. First of all, Belarusian industrial and agricultural exporters together with energy importers obtained a privileged access to Russian markets. Second, state provided export-orientated enterprises with preferential support. Third, governmental policy by controlling the prices and wages achieved temporary advantages for traditional exports⁷⁹⁹.

To sum up, domestic developments proved a policy of no radical changes, when economy was functioning only thanks to low energy prices provided by Russia and vast export of Belarusian products to Russia.

Table 6. Belarus Energy Sector SWOT Analysis.

Strengths	Weaknesses
<ul style="list-style-type: none"> • Location as a transit country • Geographical proximity to its primary energy supplier • Extensive wood resources • Established electricity network • Established gas transmission network • Export refining capacity 	<ul style="list-style-type: none"> • Limited indigenou energy resources • High dependence on imported energy • Very heavy dependence on Russia as a supplier of primary energy • Aging physical infrastructure • Limited oil and gas storage • A weak legislative and regulatory framework • Limited commercial focus
Opportunities	Threats
<ul style="list-style-type: none"> • Increased production of domestic resources (primarily wood) • Diversification of energy supply sources • Expanded transit activities and increased transit revenues • Increased security of domestic supply as a result of expanded storage facilities • Private sector participation 	<ul style="list-style-type: none"> • Disruption in energy supplies from Russia (particularly gas) • Higher energy import costs • Deterioration in service quality • Further deterioration of the domestic infrastructure • Pressures on fiscal revenue streams as a result of explicit and implicit subsidies

Source: World Bank. (2005). Belarus: Window of Opportunity to Enhance Competitiveness and Sustain Economic Growth. A Country Economic Memorandum for the Republic of Belarus. (No. 32346).

799 Abdelal, Rawi. (2004). Interpreting Interdependence: National Security and the Energy Trade of Russia, Ukraine, and Belarus. In Legvold, R., Wallander, Celeste A. (Eds.). *Swords and Sustenance: The Economics of Security in Belarus and Ukraine*. Cambridge: The MIT Press, p. 115.

Regardless its strengths like geographical location, established gas transmission network, export refining capacities, Belarusian government by closer cooperation with Russia mostly undermined existing opportunities like increasing production of domestic resources (like wood and peat) for energy sector's growth. This policy resulted in higher dependence on imported energy resources, lack of investment and establishment of strong authoritative regime.

7.2. Energy dependency on Russia and energy crises in Belarus and Ukraine

Close cooperation between two countries was based on different interpretations of what the motives of cooperation were. Belarus was looking to Russia for a bailout. Moreover, Lukashenka was envisaging the union, when presidents of two countries were acting as equal counterparts. Russia meanwhile was not ready for the vast financial concessions, and the union from Russian perspective was envisaging dominant political role of Russia. Thus, Belarus 'sought primarily to avoid any of the costs associated with independent statehood'⁸⁰⁰, and as a result sided the line of continuity in cooperation with Russia.

Energy relations between two countries reflected the situation of asymmetric interdependence, when Belarus was totally dependent on energy resource supplies from Russia, while Russia was just partially dependent on Belarusian pipeline network. Gradual energy price increase led to the debt's mounting as Belarus lacked financial assets to pay back its debt. This situation levered up Russia's more aggressive behavior in order to reach its foreign policy goals. In 1992 Belarus agreed to the 'zero option' proposed by Russia by renouncing all claims to Soviet assets held abroad⁸⁰¹. A year after when energy debt reached 333 million USD after oil cut off, Belarus waived all customs fees for oil. Starting with 1994 Russia agreed to take 75 % for its energy payment from Belarus in the form of industrial output⁸⁰². In addition, 1994 appeared to be oil market opening for Russian business, Belarus acquiesced in providing Russian oil companies with shares in Belarusian oil refineries and petrochemical plants⁸⁰³.

800 Abdelal, Rawi. (2004). Interpreting Interdependence: National Security and the Energy Trade of Russia, Ukraine, and Belarus. In Legvold, R., Wallander, Celeste A. (Eds.). *Swords and Sustenance: The Economics of Security in Belarus and Ukraine*. Cambridge: The MIT Press, p. 112.

801 Drezner, Daniel. (1999). *The Sanctions Paradox*. Cambridge: Cambridge University Press, p. 156.

802 Belarusian MTZ tractors were sold at the price of 9 000 USD to Russia, while the same tractors were sold to China at the price of 15 000 USD. Therefore, industrial output barter scheme did not solve the energy debt problem.

803 Abdelal, Rawi. (July, 2002). Interpreting Interdependence. Energy and Security in Ukraine and Belarus. Center for Strategic and International Studies, http://csis.org/files/media/isis/pubs/ruseur_wp_020.pdf, accessed on March 29, 2013, p. 3.

In April 1994 after signing a treaty on unifying Belarusian and Russian economies and monetary systems, Belarus looked very open to any kind of compromises and would ‘agree to almost any demands Moscow makes’⁸⁰⁴. The negotiations proved that reaching an agreement is a tough job, when ‘Belarus’s appetites grew larger and larger’ and Russia considered the agreement in the words of Prime Minister Viktor Chernomyrdin a ‘necessity for political reasons’⁸⁰⁵. Prime minister of Belarus Vyacheslav Kebich was one of the proponents of the union with Russia, since ‘it is the only source to satisfy our energy needs. Even if Belarus has enough hard currency, we will fail to purchase oil anywhere but in Russia, since world extraction and sales of oil have long been regulated and controlled by the OPEC’⁸⁰⁶. Lukashenka continued the same path of policy, which further resulted in customs and political integration.

Belarus’s persistence on closer integration with Russia brought fruitful results in economic terms in comparison to other post-Soviet countries. In reality economic collapse was avoided thanks to vast Russia’s assistance, ‘Belarus has received 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’⁸⁰⁷. It became clear ‘that cheap energy prices were an absolute prerequisite for Lukashenka to maintain his Belarusian model’⁸⁰⁸.

Meanwhile, the Belarus’s debt to Russia for oil and natural gas has reached 450 million USD⁸⁰⁹. This was the time, when Russia attempted to gain control over the Belarusian counterpart, Beltransgaz, in exchange for the resumption of gas deliveries took place in 1994. Regardless the Agreement signed with Russia, which stipulated that Gazprom was becoming an owner of the shares in Beltransgaz, the Supreme Soviet of Belarus did not ratify it⁸¹⁰. Therefore first attempt of Russia to enter into ownership rights of Belarusian

804 Zhdanko, Valentin. (March 2, 1994). ‘Bunny’ is ready to compromise. Russian and Belarusian Experts Discuss Details of Unification of the Two Monetary Systems. *Current Digest of the Russian Press*, No. 5, Vol. 46, p. 24.

805 Kolokoltseva, Yelena. (March 23, 1994). Belarus insists on cheap gas from Russia. Talks on Merging ‘Bunny’ and ruble Are Stalled. *Current Digest of the Russian Press*, No. 8, Vol. 46, p. 26.

806 Kebich Stresses Need for Economic Treaty With Russia. (September 14, 1993). ITAR-TASS in FBIS-SOV-93-178, September 16, 1993.

807 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.

808 Lindner, Rainer. (2007). Neighborhood in Flux: EU-Belarus-Russia Prospects for the European Union’s Belarus Policy. In Hamilton, Daniel and Mangott, Gerhard. (Eds). *The New Eastern Europe: Ukraine, Belarus, Moldova*. Washington, DC: Center for Transatlantic Relations, p. 58

809 Fedor, Helen. (1995). *Belarus: A Country Study*. Washington: Governmental Publishing Office for the Library of Congress.

810 Fedor, Helen. (1995). *Belarus: A Country Study*. Washington: Governmental Publishing Office for the Library of Congress.

counterpart miserably failed. But the nature of the future deals reflecting the formula of gas-for-ownership rights became quite apparent.

In January 1995, Belarus and Russia signed an agreement on Customs Union, under which Russia was to deliver 66 % of Belarus's annual amount of crude oil at prices that did not exceed domestic prices; in exchange Belarus would export the products to Russia⁸¹¹. A year after Belarus agreed to waive not only transit fees for oil but as well for natural gas shipped from Russia to Europe in exchange for forgiving further natural gas debts⁸¹².

The same as in other post-Soviet countries Belarus experienced dramatic fell in the oil consumption, but other economic indicators such as high level of exports to Russia kept the economy afloat. The state of absence of any reforms, therefore keeping economy the way it functioned before the Soviet Union collapse, enabled Belarus to freeze economic indicators for a while. Political scientist Daniel Drezner argues that the prices for energy resources, though being increased gradually were still vastly regulated by Russia and kept way below the European prices⁸¹³. By managing gas pricing formula for Belarus, Russia continued to subsidize vast inefficient energy consumption.

Vast Russian engagement in favorable fossil pricing, barter payments and extending ownership in energy sector provided Russia with needed political leverage and Belarus with beneficial terms for trading. But this situation could not have lasted forever as Russian gas exports faced shortages and therefore price changes were to be implemented, especially in case of Belarus, where the prices were still kept at Russian domestic level⁸¹⁴.

In 1997 Gazprom tried to increase the pressure on Belarus in order to get the payments, but Belarus insisted on barter schemes instead. The year after gas intermediaries like Itera and Transnafta started their activity in Belarusian market. This was the period when Belarus paid the lowest price for gas among all the CIS countries, just 30 USD per 1000 cm⁸¹⁵. The ability to get the cheapest gas price in CIS was possible due to the Lukashenka's success of using the leverage of stationing of Russian troops in Belarus and political concessions, which ended in economic cooperation between Belarus and Russia

811 Ibid.

812 Drezner, Daniel. (1999). *The Sanctions Paradox*. Cambridge: Cambridge University Press, p. 157.

813 Between March 1992 and March 1993, the prices for oil increased from 4 USD to 50 USD. By the end of 1994 Belarus was paying 75 USD per ton of oil. See, Drezner, Daniel. (1999). *The Sanctions Paradox*. Cambridge: Cambridge University Press, p. 156.

814 Fedor, Helen. (1995). *Belarus: A Country Study*. Washington: Governmental Publishing Office for the Library of Congress.

815 Götz, Roland. (2007). Ukraine and Belarus: Their Energy Dependence on Russia and their Roles as Transit Countries. In Hamilton, Daniel and Mangott, Gerhard. (Eds.). *The New Eastern Europe: Ukraine, Belarus, Moldova*. Center for Transatlantic Relations, Austrian Institute for International Affairs, pp. 166.

within the Union and Common Economic Space. Another factor of strengthened bargaining position of Lukashenko was the activating of Yamal pipeline in 1999.

Putin coming to power together with the appointment of the new Gazprom's chief Alexei Miller symbolized a new phase in the relations between two countries. A direct wish to possess the shares of Beltransgaz became apparent and raised a wave of discussions. The problematic side of it was inability of two sides to reach the common ground on the value of the 50-percent share in Beltransgaz. While Lukashenko was demanding 5 billion USD, Gazprom was offering only 600 million USD⁸¹⁶. The disputes on Beltransgaz value were intensified by new Gazprom's demands on price increase to 50 USD per 1000 cm. By rejecting those demands, Belarus faced gas cutoffs and siphoned gas intended for Western Europe transit⁸¹⁷.

Belarus purchases gas at considerably low prices created significant risks for energy security. The current situation in energy sector can be characterized by 'the hefty margins that allowed it to finance its investments directly from cash flows and compensate for weaknesses and limitations associated with state ownership and the vertical monopoly structure of the energy companies'⁸¹⁸. In this situation the gas disputes appeared to be unavoidable, so that Belarus experienced it in 2004 and 2006.

Energy crises 2004, 2006

In 2003 Belarus refused to sign new contract with Russia on import of gas due to the 5 years of still valid Gas Agreement, which was signed in 2002. According to 2002 Agreement the price for gas should remain the same level as internal gas price in Russia. But due to total gas cut-off, which took place on 18 of February 2004, Belarus was forced to accept new Agreement. The price increased from 29 USD per 1000 cm to 47 USD⁸¹⁹. The initial purpose of the price increase was Russia's will to gain a control over the Gas Transit

816 Götz, Roland. (2007). Ukraine and Belarus: Their Energy Dependence on Russia and their Roles as Transit Countries. In Hamilton, Daniel and Mangott, Gerhard. (Eds.). *The New Eastern Europe: Ukraine, Belarus, Moldova*. Center for Transatlantic Relations, Austrian Institute for International Affairs, pp. 166.

817 Socor, Vladimir. (May 21, 2007). Gazprom taking over the pipelines in Belarus. Eurasia Daily Monitor. *The Jamestown Foundation*, Vol. 4, Issue 99, http://www.jamestown.org/programs/cdm/single/?tx_ttnews%5Btt_news%5D=32756&tx_ttnews%5BbackPid%5D=171&no_cache=1, accessed on April 25, 2013.

818 Gerasimov, Yuri. (2010). Energy sector in Belarus: Focus on wood and peat fuels. Working paper, *Finnish Forest Research Institute*, <http://www.metla.fi/julkaisut/workingpapers/2010/mwp171.pdf>, accessed on April 30, 2013.

819 Gromadzki, Grzegorz and Kononczuk, Wojciech. (2007). *Energy Game: Ukraine, Moldova and Belarus between the EU and Russia*. Stefan Batory Foundation: Warsaw, p. 24.

System of Belarus. Nevertheless, in 2004 as the value of the GTS was not clearly determined and remained disputed, no additional agreement on GTS was signed.

As Belarus imports nearly all its gas (20-21 bcm) and 90 % of its crude oil from Russia, new conflict between Belarus and Russia was inevitable⁸²⁰. In 2006 new gas conflict between Belarus and Russia emerged. The offered by Russia price for gas reached 200 USD per 1000 cm. As a result of negotiations the price was decreased to 105 USD under the terms that 75 USD per 1000 cm will be paid cash, while 30 USD would be taken as shares of Beltransgaz. As a result 50% of the Beltransgaz shares should be given to Russia within 4 years time⁸²¹. The agreement was signed on 31 of December 2006 and gas cut-off was forestalled.

After 2006 negotiations international community was preoccupied with the serious implications of price increase on Belarus' ability to pay the increased gas bill. Therefore statements about Gazprom's intentions 'to convert such debts to downstream equity' had quite reasonable ground⁸²². In the first quarter of 2008 the gas price jumped to 119 USD per 1000 cm⁸²³ and has been gradually increasing in the forthcoming years. Another financial burden arose from 70 % tax revenues that Belarus needed to pay from refined oil products to Russia⁸²⁴. Further relations between Belarus and Russia worsened due to unpaid gas bills in the first half of 2007.

One should look at energy impasse not only from the perspective of vast dependency of Belarus on Russia, but also from the perspective of fundamentally different interpretations of state union. Lukashenka's different approach to state union raised a wave of opposition from Putin's side, pointing at vast subsidies, provided by Russian counterpart only for year of 2006, which amounted about 6 billion USD⁸²⁵.

After 2006 gas crisis Lukashenka and Putin agreed on 1.5 billion USD loan, which approximately covered the losses after the crisis. In return Belarus agreed to host Russian

820 International Energy Agency. (2007). *Natural Gas Market Review. Security in a Globalising Market to 2015*. France: OECD/IEA, p. 44.

821 Yafimava, Katja, Stern, Jonathan. (January 15, 2007). The 2007 Russia-Belarus Gas Agreement. *Oxford Energy Comment*, <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/01/Jan2007-The2007Russia-BelarusGasAgreement-KatjaYafimavaandJonathanStern-.pdf>

822 International Energy Agency. (2007). *Natural Gas Market Review. Security in a Globalising Market to 2015*. France: OECD/IEA, p. 44.

823 Belarus to buy Russian gas at 119 USD per 1000 cm in 1Q08. (January 1, 2008). *Belarus News and Analysis*, <http://www.data.minsk.by/belarusnews/012008/1.html>, accessed on April 24, 2013.

824 Eckel, Mike. (January 12, 2007). Russia Cuts Duty on Belarus Oil Exports. The Washington Post, http://www.washingtonpost.com/wp-dyn/content/article/2007/01/12/AR2007011202096_pf.html, accessed on May 4, 2015.

825 Minkov, Yakov. (2007). Can the stronghold withstand an economic attack? The challenges and prospects of the Belarusian Economy in the Near Future. *Office for a Democratic Belarus and Association for International Affairs*, Prague, No. 8, p. 20.

tactical nuclear weapons⁸²⁶. In 2011 Belarus transferred last shares of Beltransgaz to Russia's Gazprom and officially lost control over Gas Transit System, instead in 2012 Belarus received gas price in the amount of 164 USD per 1000 cm. As a result, the pipelines of Belarus are officially owned by Gazprom, while the ground is leased long-term⁸²⁷.

7.3. Relations with the EU in energy sector

EU relations with Belarus are still covered by the 1989 Trade and Cooperation Agreement. Although the Partnership and Cooperation Agreement (PCA) and Interim Trade Agreement were signed in 1995, the election of Alyaksandr Lukashenka with further changes to constitution, which enabled him to secure his possible re-election *ad vitam*, led to the suspension of the PCA ratification in 1997 and freeze of the Interim Agreement⁸²⁸. Since then, the relations between Belarus and the EU remain covered by 1989 Agreement, which does not include *acquis* approximation. Moreover, the EU refused to support Belarus' candidacy for membership to the Council of Europe and until today Belarus is a non-member. Apart from it, there is only one more agreement binding Belarus and the EU on trade in textile products dated from 1993.

In 2002-2003 the EU within the 'Wider Europe – New Neighbourhood Strategy' tried to target its Eastern border, where Belarus was considered maybe not a key targeted country, but a 'different partner'⁸²⁹. Therefore, Belarus in the absence of a Partnership and Cooperation Agreement, was defined as a 'subject', but not a recognized partner within the ENP⁸³⁰. It should be mentioned that prior to 2007, Belarus and the EU cooperated within two main programmes, TACIS with the total budget for Belarus of 10 million EUR and European Instrument for Democracy and Human Rights (EIDHR) with a budget of 5 million EUR, which had limited effects due to inflexible funding mechanisms⁸³¹. Among total EU financial assistance during the period 1991-2005, which amounted mere 222

826 Silitiski, Vitali. (December 17, 2007). Belarus-Russia Summit: All is Calm on the Eastern Front. *Belarusian Institute for Strategic Studies*. No. 14, <http://belinstitute.eu/images/stories/documents/blitz20071217belrus.pdf>, accessed on March 15, 2016.

827 http://www.expatica.com/ru/news/Russia-wins-control-of-Belarus-gas-network-for-25-bn_302056.html

828 Bosse, Giselle and Korosteleva-Polglase, Elena. (2009). Changing Belarus? The Limits of EU Governance in Eastern Europe and the Promise of Partnership. *Cooperation and Conflict*, Vol. 44 (2), p. 147.

829 Patten, C. and Solana, J. (September, 2002). *Wider Europe. Letter to the Danish Presidency*. Brussels, p. 3.

830 European Parliament. *ENPI Implementation: the case of Belarus. Briefing Paper*. (July 2008). Directorate-General for External Policies of the Union Directorate B, Policy Department External Policies, EXPO/B/AFET/FWC/2006-10/Lot1/30, p. 4.

831 Bosse, Giselle. (2009). Challenges for EU governance through Neighbourhood Policy and Eastern Partnership: the values/security nexus in EU-Belarus relations. *Contemporary Politics*, Vol. 15, No. 2, June, p. 220-221.

million EUR, only few projects were linked to energy sector and those were mostly focused on the legacy of Chornobyl disaster⁸³².

Between 2004 and 2006 EU started to draft Country Reports and Action Plans with ENP countries, but Belarus appeared to be excluded from the country list. On 21 November 2006, the Commission issued a non-paper entitled 'What the European Union Could Bring to Belarus', which clearly defined EU's 'principled, non-compromising approach'⁸³³. EU was offering full participation in the ENP in return for the adoption of political and economic reforms⁸³⁴. EU's conditionality, which on paper was represented by a list of 12 condition-to-fulfill, was underestimated and finally rejected by the Belarusian government. It is defined by the EU that the absence of ENP Action Plan is 'inhibited by the failure of the country's leadership to undertake democratic reforms'⁸³⁵. As a result, Belarus receives just a limited package of ENPI (2007-2013). EU's conditionality appeared to have no measurable effect due to important factor defined by George Dura, 'Lukashenko would have to democratize Belarusian politics and society, thereby seriously jeopardizing his future as Belarus' president'⁸³⁶.

Energy crisis between Belarus and Russia in 2006 created an illusion that Belarus wished to enhance cooperation with the EU. Belarus introduced the concept of a 'new foreign policy', which was based on two main standpoints⁸³⁷. One stressed the necessity to diversify energy supplies by cooperation with energy-rich countries (Azerbaijan, Iran, Nigeria, Norway and Venezuela) and possible construction of the nuclear plant. And the other pointed the need for closer cooperation with the EU, especially in energy sector. In the interview to 'Welt' Lukashenka claimed that 'if Western energy companies had had stakes in the Belarusian energy transport networks, Russia would never have acted so brutally'⁸³⁸. However one year later this rhetoric, which was used as major irritant towards Russia, evaporated and Belarus 'expressed an interest in developing pragmatic relations with the EU

832 Dura, George. (February, 2008). The EU's Limited response to Belarus' Pseudo 'New Foreign Policy'. *CEPS Foreign Policy Brief*, No. 151, p.2.

833 Bosse, Giselle and Korosteleva-Polglase, Elena. (2009). Changing Belarus? The Limits of EU Governance in Eastern Europe and the Promise of Partnership. *Cooperation and Conflict*, Vol. 44 (2), p. 148.

834 Bosse, G., Korosteleva, E. (March 12-13, 2008). Europeanising Belarus. Paper presented at the 5th Wider Europe Conference. European Parliament, Brussels.

835 European Parliament. *ENPI Implementation: the case of Belarus. Briefing Paper*. (July 2008). Directorate-General for External Policies of the Union Directorate B, Policy Department External Policies, EXPO/B/AFET/FWC/2006-10/Lot1/30, p. 6.

836 Dura, George. (February, 2008). The EU's Limited response to Belarus' Pseudo 'New Foreign Policy'. *CEPS Foreign Policy Brief*, No. 151, p. 6.

837 Ibid, p. 4.

838 Alexander Rahr. (January 25, 2007). Interview with Alexander Lukashenka. *Die Welt*, <http://www.welt.de/print-welt/article711195/Die-Opposition-ist-in-Weissrussland-keineswegs-verboten.html>, accessed on April 24, 2013.

centred on cooperation in certain mutually beneficial areas and based on non-interference in its domestic affairs⁸³⁹. Hence, Russia again headed the agenda.

In June 2007, the EU withdrew Belarus' trade preferences under the Generalised System of Preferences, which reflected a loss of 400 million EUR per year⁸⁴⁰. As part of this policy EU introduced vast sanctions, trade restrictions and visa bans toward Belarus. At the parallel track of EU's policy toward Belarus consequent events proved an intention of both sides to alter the established conditionality. An exception from the EU's conditionality policy was the establishment of the EC Delegation in Belarus in 2008⁸⁴¹. This event took place simultaneously with a contradicting policy of prolonging the travel sanctions against Belarusian officials. Another sign of cooperation was establishment of the Council for Business Cooperation between Belarus and the EU in 2007⁸⁴².

In contrast to previous initiatives the Eastern Partnership Proposal offered a more enhanced model of cooperation with Belarus. EaP kept the conditionality as a vital base of bilateral cooperation, 'as enhancement would take place if and when conditions allow'⁸⁴³. But it also extended the cooperation at the technical and expert levels. Finally as Belarus appeared not to be embraced by any EU multilateral initiative, EaP sought for 'an opportunity for the inclusion of various social groups, such as young people, SMEs and junior officials, in the cooperation with the European Union'⁸⁴⁴. After the EaP was launched in 2009, the new task force was established to foster functional cooperation with Belarus. Belarus was included into multilateral project proposals, including the extension of the Odesa-Brody pipeline to Gdansk with sidelines to Belarusian oil refineries, cooperation on renewable energy sources etc.⁸⁴⁵. This inclusion of Belarus into multilateral cooperation within EaP signaled some progress.

839 Dura, George. (February, 2008). The EU's Limited response to Belarus' Pseudo 'New Foreign Policy'. *CEPS Foreign Policy Brief*, No. 151, p.6.

840 Rettman, Andrew. (December 21, 2006). EU decides to impose mini-trade sanctions on Belarus. *EU Observer*, <http://www.charter97.org/eng/news/2006/12/21/rada>, accessed on April 24, 2013.

841 European Parliament. *ENPI Implementation: the case of Belarus. Briefing Paper*. (July 2008). Directorate-General for External Policies of the Union Directorate B, Policy Department External Policies, EXPO/B/AFET/FWC/2006-10/Lot1/30, p. 13.

842 This non-profit organization was aimed at promotion of economic ties between two counterparts to attract foreign investments. Bosse, Giselle and Korosteleva-Polglase, Elena. (2009). Changing Belarus? The Limits of EU Governance in Eastern Europe and the Promise of Partnership. *Cooperation and Conflict*, Vol. 44 (2), p. 153.

843 *Eastern Partnership. Polish-Swedish Proposal*. (June, 2008). EU Neighbourhood Library. AN ENPI Project, <http://www.enpi-info.eu/library/content/polish-swedish-proposal-eastern-partnership>, accessed on April 19, 2013.

844 Ibid.

845 Bosse, Giselle. (2012). A Partnership with Dictatorship: Explaining the Paradigm Shift in European Union Policy towards Belarus. *Journal of Common Market Studies*, Vol. 50, No. 3, p. 377.

The above-mentioned programs were mostly oriented at the support of the democratic developments in Belarus. Greater focus was observed on mass media independence, human rights, civil society, people-to-people contacts etc. Vast economic programs, including energy issues, appeared to be moved from the top-agenda to technical cooperation due to unwillingness of the Belarusian leadership to raise those problems with the EU and heavy reliance on Russia⁸⁴⁶.

Along EU's initiatives energy transit and diversification cooperation was one of the priorities especially after energy crises with Russia. As a result, Belarus activated contacts not only with the EU, but also with China, Iran, Venezuela and Cuba. Belarus' role as a transit country is crucial for the EU, especially taking into consideration EU's growing dependence on Russian energy. In 2007, when energy cooperation started, Belarus was transiting about 46.7 billion cm of Russian gas through Beltransgaz and Yamal-Europe pipeline, which consisted 20 % of Russian gas to Europe⁸⁴⁷. Gazprom's take-over of 50 % of Beltransgaz coincided with EU's attempts to shape external energy policy. According to the third package of energy liberalization, according to which Commission 'proposes a requirement that third country individuals and countries cannot acquire control over a Community transmission system [...] unless this is permitted by an agreement between the EU and the third country'⁸⁴⁸.

Technical cooperation and apolitical engagement of two sides on issues on mutual interest, including energy, has yielded more cohesive dialogue. Though this cooperation is seen as 'window of opportunity', which indicates possible spillover effects to economic and political cooperation, in case of Belarus this collaboration takes very slow steps in progress. In 2008 the representatives of the European Commission and Belarus met in Minsk to discuss 'technical matters relating to the energy and transport situation in the EU and Belarus'⁸⁴⁹. These meetings discuss the problems of 'shares interests, rather than values'⁸⁵⁰.

846 Dura, George. (February, 2008). The EU's Limited response to Belarus' Pseudo 'New Foreign Policy'. *CEPS Foreign Policy Brief*, No. 151, p. 7.

847 Socor, Vladimir. (May 21, 2007). Gazprom taking over the pipelines in Belarus. Eurasia Daily Monitor. *The Jamestown Foundation*, Vol. 4, Issue 99, http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=32756&tx_ttnews%5BbackPid%5D=171&no_cache=1, accessed on April 25, 2013.

848 *European Commission*. (2007). Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC), No 1775/2005, p. 7.

849 *Commission of the European Communities*. (2008). Belarus: Commission experts in Minsk for technical talks on energy, transport and environment. Press Release, Brussel, 28 January, IP/08/95.

850 Bosse, Giselle. (2009). Challenges for EU governance through Neighbourhood Policy and Eastern Partnership: the values/security nexus in EU-Belarus relations. *Contemporary Politics*, Vol. 15, No. 2, June, p. 222.

Therefore the limitedness of technical cooperation is that it does not foresee approximation, but rather a good will to find a common approach to the problems of mutual interest.

Indeed energy appeared to be an area of mutual interest for both sides. Bilateral meetings of experts took place due to urgency of the topic. This technical cooperation in energy sector could become a stepping-stone towards more enhanced cooperation in other fields in not certain challenges. From the other perspective EU has not yet defined its unanimous position vis-à-vis energy cooperation with Belarus. While some members insist on political dialogue and trade relations with Belarus, the other side insists on ‘non-compromising approach’ of conditionality. An example could be mentioned here about Polish and Lithuanian opposition towards the removal of GSP as it would hurt their economies. While, for instance, after 2004 Russia-Belarus energy crisis EU members (including Poland, Lithuania and Latvia) neglected established ‘conditionality’ toward Belarus and participated in the talks on energy cooperation⁸⁵¹. Moreover, Baltic countries do not support trade embargo as their interests are vested in joint ventures with investments in Belarusian companies.

For EU energy security alerted the necessity of closer cooperation with Belarus due to oil and gas interruptions during 2004-2007. As it was noted within the framework of EaP Commission anticipates ‘finalization of a European Commission-Belarus declaration on energy, as a basis for further development of energy cooperation’⁸⁵². Belarus does realize that EU is an important partner especially in energy sector as it could ‘act as a counter-weight to the influence exerted by Russia’⁸⁵³. But the inability of Belarusian authority to demonstrate its willingness to meet the EU demands on democratic and economic improvements led to lack of the understanding on the common goals of cooperation.

Moreover, EU’s leverage is limited strategically as Belarus has not so far set an ambition of joining the EU. Realizing the limits of being a ‘successful democratizer’ in Belarus, the EU focused on functional cooperation, which is based on shared interests and partnership rather than ‘rule-transfer’⁸⁵⁴. Functional cooperation is not, however a prevailing mode of thinking, and ‘hard’ conditionality and economic sanctions highlight the agenda. As evaluated by Bosse EU’s position by projecting ‘hard’ and ‘soft’ modes of governance

851 Dura, George. (February, 2008). The EU’s Limited response to Belarus’ Pseudo ‘New Foreign Policy’. *CEPS Foreign Policy Brief*, No. 151, p.8.

852 *Commission of the European Communities*. (2008). Eastern Partnership. Communication, Brussels, December 3, COM (2008) 823 final, p. 9.

853 European Parliament. *ENPI Implementation: the case of Belarus. Briefing Paper*. (July 2008). Directorate-General for External Policies of the Union Directorate B, Policy Department External Policies, EXPO/B/AFET/FWC/2006-10/Lot1/30, p. 11.

854 Bosse, Giselle. (2009). Challenges for EU governance through Neighbourhood Policy and Eastern Partnership: the values/security nexus in EU-Belarus relations. *Contemporary Politics*, Vol. 15, No. 2, June, p. 217.

still possesses traditional realist views ‘to protect the supply of energy to the population inside the Union’⁸⁵⁵. By doing so EU separates domestic from international and presents contradictory logics of ‘value/security nexus’, which undermines the efficiency of current initiatives. EU’s approach being torn between idealist values of democracy promotion and realist objective to support ‘state-stability’ lacks an explanation how these two different approaches should be integrated into common EU’s policy. Therefore, the impact of EU policy in Belarus is likely to remain limited taking into consideration ‘the geopolitics and geo-economics’ of Russia’s relations with Belarus and with the EU⁸⁵⁶.

7.4. Commonalities and differences of energy policies in Ukraine and Belarus at domestic and international level

Due to the deficit of local energy resources and inefficient use of gas, Ukraine and Belarus head the rankings of the countries with high rate of energy inefficiency. Energy mix of both countries highly relies on the energy resources imported from Russia. Natural gas consumption has a clear tendency of gradual growth in case of Belarus, while Ukraine’s consumption in the last two years faced more than 20 % decrease, but still remains the major element in energy balance.

Table 7. Natural gas production and consumption in Belarus and Ukraine within selected years.

	<i>1991</i>		<i>2001</i>		<i>2011</i>	
	Gas production (bcm)	Gas consumption (bcm)	Gas production (bcm)	Gas consumption (bcm)	Gas production (bcm)	Gas consumption (bcm)
Belarus	-	14.0	-	15.7	-	18.3
Ukraine	22.1	117.8	16.6	68.8	18.2	53.7

Source: BP. Statistical Review of World Energy 2012, International Energy Agency

Of the two countries, only Ukraine possesses limited gas deposits that satisfy less than third of its gas demand. Ukraine and Belarus also extract small quantities of the crude oil, which is insignificant as they mostly rely on Russian imported oil supplies. Therefore, gas has special place in the energy balance of both countries.

855 Ibid, p. 223.

856 Bosse, Giselle. (September 24, 2012). The EU and Belarus: perpetual tango all over again? *European Policy Centre*.

Metallurgical and chemical sectors are characterized by high natural gas consumption, which far exceeds the average consumption in the EU. The households are also defined as major gas consumers, who due to the lack of energy-saving technologies and high losses of energy, seem to consume gas in very inefficient way.

The other common feature of energy market of both countries is lack of transparency. This lack of transparency is to some extent understandable bearing in mind authoritarian regime of Lukashenka. Yet in Ukraine this problem has chronic roots as since 1994 interchangeably different intermediaries (Itera, EuralTransGas, RosUkrEnergo etc.) were introduced into gas trading business without revealing the ownership structure of those organizations.

Domestic developments in two neighboring countries featured different paths of economic developments. In Belarusian case with one president in power economic growth was built on the rules of state-managed economy, when Russian loans⁸⁵⁷ and vast subsidies kept economy afloat. This resulted in better economic indicators in comparison with other CIS countries after the collapse of the Soviet Union, but at the same time it disabled the substantial need for structural economic reforms. Belarus entered Single Economic Space with Russia and Kazakhstan, but after Russia's accession to the WTO, Belarusian export faced harsh competition. Belarusian producers lacking competitiveness will be sooner or later left no choice but to accept painful reforms with further economic losses in order to keep economy afloat. In Ukraine's case though economy dependent on Russia, but unlike Belarus Ukraine never intended to become a member of closer economic cooperation through SES. Ukraine's dependence on Russia derives from the absence of the structural reforms to transform the industry, which is vastly dependent on natural gas consumption. Russia in case of both countries showed different discounts in prices. As neatly pointed by Rawi Abdelal, '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'⁸⁵⁸.

857 Belarus received 2.5 billion USD from the sale of Beltransgaz to Gazprom in November 2011, 440 million USD loan from the Eurasian Economic Community (EurAsEc) and one billion USD loan from Russia's Sberbank in December 2011. In June 2012, additionally Belarus received 880 million USD as the third tranche of the EurAsEc loan. These measures stabilized economy but only temporary. See, Bosse, Giselle. (September 24, 2012). The EU and Belarus: perpetual tango all over again? *European Policy Centre*.

858 Abdelal, Rawi. (July, 2002). Interpreting Interdependence. Energy and Security in Ukraine and Belarus. Center for Strategic and International Studies, http://csis.org/files/media/isis/pubs/ruseur_wp_020.pdf, accessed on March 29, 2013.

More than two decades of independence Belarus and Ukraine, sandwiched between the EU and Russia, found it extremely difficult to define themselves in energy matters. The lack of efficient energy strategies benefitted the dependency relations with Russia as well as different interest groups. The only thing both countries possess is pipelines network, which they used to counterbalance dependence on Russian energy sources. But in Belarusian case Russia managed to take control of Belarusian energy sector by purchasing the shares of Beltransgaz, while Ukraine so far resisted those attempts⁸⁵⁹.

Two post-Soviet countries like Ukraine and Belarus appeared to face quite different political maneuvers from Russian Federation. To understand why Russia's policy differed that much, one should take a precise look at the domestic developments. Belarus with authoritarian president in power seemed to be much more obedient subordinate rather than Ukraine where policies were changing along with the presidents. Moreover, Ukrainian case proved to be more complicated due to attempts to declare independence from Russia and failed attempts to introduce energy diversification (See, Table 8. Russia's energy policy toward Belarus and Ukraine (1990-2000)).

In energy sector the difference was presented in pricing, barter schemes, and energy asset ownership. While Belarusian authorities successfully negotiated price reduction, which ended in gradual price decrease from 50 USD in 1999 to 20 USD in 2002, in case of Ukraine the prices have been raised gradually⁸⁶⁰. Payment issue was another headache for both authorities as none of them was capable of fully covering energy debts. In the situation when energy debt was mounting 'Belarus has been more forthcoming in offering political and industrial accommodation in exchange for debt cancellation'⁸⁶¹, while in Ukraine any form of GTS management, where Russia will own even a part of the shares, was blocked by the parliament and treated as national security threat. In April 2002 Naftogaz issued Eurobonds worth 1.4 billion USD to restructure its gas debt of 1.34 billion USD to Gazprom until the year of 2013⁸⁶². In the late 1990s – early 2000s Belarus was allowed to continue paying for its gas debt along barter schemes. Therefore, Russian gas supplies produced different policies in two FSU countries, when Belarus even increased the level of dependency on Russian supplies by 'surrendering all gas pipelines and compressor facilities

859 Ibid.

860 Ibid.

861 Myers Jaffe, Amy, and Manning, Robert A. (2001). Russia, Energy, and the West. *Survival*, Vol. 43, No. 2, p. 140.

862 Abdelal, Rawi. (July, 2002). Interpreting Interdependence. Energy and Security in Ukraine and Belarus. Center for Strategic and International Studies, http://csis.org/files/media/isis/pubs/ruseur_wp_020.pdf, accessed on March 29, 2013, p. 14.

to Gazprom⁸⁶³ and Ukraine constantly resisted the efforts to provide Russia with shares in Ukraine's energy infrastructure.

Table 8. Russia's energy policy toward Belarus and Ukraine (1990-2000).

	Belarus	Ukraine
Energy policy tools	Greater energy reliance on Russia	Autonomy (early 1990s) further transformed into a search for energy diversification
Energy dependency	Tool for closer reintegration	Security threat
Russia's energy tools	Lower energy prices; Vast barter schemes; Acquisition of energy assets	Gradual price increase; Limited barter schemes; Rejection of Russian acquisition of energy assets

Source. Adapted from Rawi Abdelal. (2002). Interpreting Interdependence.

Dissimilar domestic politics and distinct leadership peculiarities established two different Russia's approaches toward these countries. As Myers wrote, 'Now that these countries are no longer subsumed within the Soviet Union or the Warsaw Pact, Russia needs to establish more nuanced diplomatic relations with them. So far, Moscow appears to be having some difficulty with this transition, and has resorted to bullying, blackmailing and otherwise interfering in the sovereignty of its neighbours'⁸⁶⁴.

Several shifts in the foreign policy of Belarus to establish closer cooperation with the EU proved to be 'aimed at blackmailing its large eastern neighbour'⁸⁶⁵. First come-back in 1999 targeted the speed up of the negotiations on the Union State Treaty. Pro-European rhetoric vanished with Putin's election and Lukashenka unambiguous prioritization of the Russian factor. Second come-back was observed after the energy crises in 2004, 2006, when Lukashenka declared that 'without intending to join the EU, we offer a mutually beneficial partnership with this strong neighbour ... Belarus is not an enemy of the EU, it is a partner.

863 Korchemkin, Mikhail. (1996). Russia's Oil and Gas Exports to the Former Soviet Union, in Kaminski, Bartolomiej. *Economic Transition in Russia and the New States of Eurasia*. Armonk, N.Y.: M.E. Sharpe, p.133.

864 Myers Jaffe, Amy, and Manning, Robert A. (2001). Russia, Energy, and the West. *Survival*, Vol. 43, No. 2, p. 140.

865 Bosse, Giselle and Korosteleva-Polglase, Elena. (2009). Changing Belarus? The Limits of EU Governance in Eastern Europe and the Promise of Partnership. *Cooperation and Conflict*, Vol. 44 (2), p. 155.

We are ready to cooperate'⁸⁶⁶. In reality, approximation with the EU was never a real intention for the Belarus, rather this policy was used to provoke more progress in cooperation with Russia.

In case of Ukraine EU policy seems to be more productive. Ukraine is a key partner within ENP, EaP and Energy Community. Liberalization of the gas market is on the way, but the need for thorough purge in fuel sector is more than ever needed. Dual approach of the authorities, from one side to meet the EU criteria, but from the other not to loose control of the lucrative sector, brings confusing results. The progress in energy efficiency and energy-saving programs is rather slow, while shale gas appeared to be the only field, which succeeded in attraction foreign investors.

EU seems to be caught between realist approach to prioritize its own energy supply and its idealist policy to democratization. Lacking the clear explanation about the links between two competing logics, EU undermines its own attempts to effectively address both countries in its neighbourhood. EU's double-track policy of 'soft' (through the support of the civil society) and 'hard' governance (through strict conditionality by imposing sanctions, trade restrictions etc.) seemed to have little effect on Lukashenka's government⁸⁶⁷. Familiar duality of approaches is observed in Ukraine's case, when in order to democratize EU introduced conditionality, which is strictly tied to political prisoners. In Yanukovich's case this policy did not bring sufficient results, as Tymoshenko, main political rival of the current government, remained in prison, though Yanukovich pardoned her associate Yuriy Lutsenko.

Energy crises that took place in Ukraine and Belarus possessed common features. First of all, gas crises had direct impact on European countries. The crises included three main actors: Russia as supplier, Ukraine and Belarus as transit countries and EU as buyer. Scenario of the crises maintained the same line: gas supply was first decreased and then fully suspended. Gas cut-offs could not have been averted neither by political nor by law means. The solutions had clearly ad hoc nature. And information about gas crises that circulated in EU countries was lacking comprehensiveness as well as full awareness of the gas flows. But the main development of energy crises lies in raised EU's alertness about the so needed common legislative framework for gas disputes. This pushed EU for more pro-

866 Web-portal of the President of Belarus. Lukashenka's speech delivered at the Meeting with the heads of Belarus's diplomatic missions. Press Release. Minsk. (August 2, 2008). <http://www.president.gov.by/press43744.html#doc>, accessed on April 27, 2013.

867 Bosse, Giselle. (2009). Challenges for EU governance through Neighbourhood Policy and Eastern Partnership: the values/security nexus in EU-Belarus relations. *Contemporary Politics*, Vol. 15, No. 2, June, p. 221.

active position in securing energy supplies in its neighborhood, including Ukraine and to less extend Belarus.

The other positive outcome of energy crises, which Ukraine and Belarus experienced with Russia, is that 'Russia's systematic move towards market prices could be an advantage, because it would lessen the opportunities for Moscow to exploit the resources to achieve its political aims'⁸⁶⁸. Moreover, it would incite these two countries to more proactive diversification policy, vast measures of energy efficiency and energy-saving technology as well as vast structural reforms, which should have been introduced immediately after the collapse of the Soviet Union.

Although political developments after the fall of the Soviet Union raised Ukraine as an independent country, but political elite appeared to be unable to secure the guiding vector of foreign policy, '...they neither won, like Lithuania's nationalists, not lost, like Belarus's, the debate about their country's proper place in the post-cold war world. As a result, Ukraine failed to institutionalize its place in 'Europe', as Lithuania did, or in 'Eurasia', as Belarus did'⁸⁶⁹. For Belarus costs of autonomy seemed to be irrational, therefore any sacrifices in the name of independence were simply disregarded as not worth to endure.

As history shows political loyalty, as in case of Belarus, brings only short-term benefits, which with the time evaporate. In the beginning of 1990s gas and oil in Russian interpretation turned into commodity with strategic meaning, which enabled Russia to possess certain leverage to manipulate its neighbors due to their inability to pay the bills. In the 2000s Kremlin realized that low gas and oil prices for Belarus and Ukraine were not a guarantee of Russia's political control over them. These energy commodities also gained high commercial value, and therefore market prices were introduced gradually. But even Russia's entering into the ownership of Beltransgaz did not suspend energy price growth in Belarus.

Russia cannot cease transportation of oil and gas through Belarus and Ukraine entirely, but by construction of bypass pipelines, Russia tries to eliminate the only strong bargaining chip in the hands of Minsk and Kiev. Belarus remains totally dependent on Russia economically, while Ukraine being a member of the European Energy Community strives for energy independence. Political instability in Ukraine and authoritarian regime in Belarus introduce wide opportunities for manipulation from Russian side.

868 Gromadzki, Grzegorz and Kononczuk, Wojciech. (2007). *Energy Game: Ukraine, Moldova and Belarus between the EU and Russia*. Stefan Batory Foundation: Warsaw, p.18.

869 Abdelal, Rawi. (2001). *National Purpose in the World Economy*. Ithaca, NY: Cornell University Press, p. 103.

Energy appeared to be one more sphere, like foreign policy or security, where the EU is lacking a 'single voice'. The absence of EU's unanimous position in domestic energy matters undermines external energy policy in gas and oil. EU's energy strategy colliding with Kremlin's pragmatic approach brings modest results. Some EU countries prefer to cooperate with Gazprom undermining a single voice of the European Union on the international arena. Driven by national interests the EU states in pursue for cheaper energy resources establish reciprocally beneficial relations with Russia, so as stronger bargaining position of Russia is observed.

CHAPTER 8

CONCLUSION

The overall aim of this Doctoral dissertation was to trace how energy policy of Ukraine has been formed and what was the impact of domestic and international factors on energy politics of Ukraine. By means of empirical and theoretical assessment of energy politics of Ukraine, I aimed at presenting a more sophisticated and scientific explanation of current energy dynamics in relations with Russia and the EU.

Being locked between energy producer Russia and energy consumer EU, Ukraine's energy agenda as key energy transit country has been of immense importance not only regionally but also globally. Price debates, lack of structural reform and diverse geopolitical views of the neighboring countries politicized Ukraine's energy policy objectives. Poroshenko's presidency to certain extent proved first steps in energy market liberalization. Import of energy acquis strategically important for the EU meant much more for the Ukraine. Liberalization of gas and then electricity sector was treated as a positive development, so Ukraine signed Association Agreement and DCFTA. The start of unbundling and further measures on energy diversification and energy efficiency is supposed to contribute to a new shift in strategic energy vision of Ukraine.

Energy relations especially in gas sector will continue to dominate the agenda of Ukraine, the EU and Russia. The efforts introduced by the EU in energy field were accepted by Ukrainian side as efficient, which led to a deeper integration through European Energy Community membership. Energy reforms, which aim at liberalization, are the first needed steps to make energy market more sustainable and transparent in Ukraine. The advantages of EU energy integration already proved to be fruitful for Ukraine, as reverse gas supplies from the EU became possible only because of the adoption of EU's energy acquis. More benefits will be introduced upon the implementation of the further energy acquis in Ukraine.

This thesis makes three key contributions. First, rather than taking snapshots of certain energy crises, it intends to have a more comprehensive approach, which explains the nature of establishment, evolution, continuity and shift of energy politics. Second, it clearly stresses the importance of domestic and international levels, as well as interaction between them. The engagement of the interest groups sheds light on energy decision-making processes. Third, the replication of this research in the cases of other energy-poor countries,

like in case of Belarus, may enrich our understanding on the nature of energy policy making in post-Soviet countries.

Before giving a final analysis on the topic, I would like to elaborate on the main conclusions of this research. Indeed this research attempted to trace the roots of formation, evolution, continuity and shift in energy politics. While formation and shift are self-explanatory, the difference between evolution and continuity deserves to be mentioned. Evolution of energy politics under Yushchenko was understood as a step forward toward European integration without real breaking up with older practices between regime and oligarchs. Continuity under Yanukovich though meant preserving the basis of the energy sector functioning, developed and sustained under Kuchma and Yushchenko⁸⁷⁰, while only certain new aspects were introduced into energy equation.

This research was aiming to raise the importance and complexity of domestic and international factors in energy policy making. Such domestic factors as the nature of political system, role of the leader, political will to introduce reforms, the gap between adoption and implementation of relevant legislation in energy sector, involvement of the interest groups and efficiency of diversification efforts were defined as major factors at domestic level of energy policy making. While energy strategy and foreign policy approaches of the EU and Russia toward Ukraine, engagement of international institutions and their conditionality, affiliations of interest articulators to international actors, economic factors linkage were defined as major factors at international level of energy policy making. The causal links between the factors of domestic and international levels were determined as those that form the nature of energy politics in Ukraine.

In case of the nature of political system, the timeframe of 25 years shows that presidential-parliamentary political system does not bring the changes into the system. Consolidation of power in the hands of the president (like in case of Kuchma and Yanukovich) leads to more authoritative leadership, where power is used, among others, for personal enrichment rather than for the introduction of structural reforms. From the other perspective, parliamentary-presidential political system, though brings more turbulence into political spectrum, but is aimed to preserve more balance and cooperation between the president and the prime minister. The nature of cooperation between the government and the president indicates either pursue for unified direction of reforms (Poroshenko-Yatseniuk) or ends up with totally different approaches towards energy sector management (Yushchenko-Tymoshenko).

⁸⁷⁰ By preservation I mean strengthening of the distribution and redistribution of state assets by means of corruption.

Leadership in energy politics plays quite crucial role. Pro-European or pro-Russian orientation of the president undoubtedly shapes the preferences of the chief executive. But just pro-European orientation does not guarantee reform implementation (like in case with Yushchenko). Rather clear political will to introduce structural reforms by elimination of lucrative intermediaries brings real results, and changes to the existing balance in the well established energy business (Poroshenko's presidency).

Even though reforms in energy sector have been observed during Yushchenko's, Yanukovich's and Poroshenko's presidency, the gap between adoption and implementation decreased only under the latter one. The adoption of legislation was frequently used as a bargaining chip during negotiations with international financial institutions like IMF, EBRD etc. Therefore, as adoption of legislation was a key to obtaining financial assistance, the actual implementation was in many cases neglected by the government. This tendency was altered under Poroshenko, as with more vast engagement of civil society, the monitoring of the implementation is now duly executed.

One of the most essential domestic factors of energy policy making is the involvement of the interest articulators. Indeed, this dissertation shows that oligarchs tend to transcend their influence into decision-making process by securing appointment of their affiliated persons to the high official positions. This practice ensures the lobbying of the interests of the certain interest group in the way that the reforms that may hurt oligarch's interests are suspended and/or the engagement of that oligarch in the interested area of business is favored with governmental support. Weak legislative basis, inefficient bureaucracy and corruption remain the major reasons for the sector's slow development. Elimination of the gas intermediaries that flourished under Kuchma, Yushchenko and Yanukovich undoubtedly indicates the correct step, but will not be sufficient (and moreover may be easily reversed under favorable conditions), if corruption is not eliminated at other levels of state machinery.

Diversification attempts without the allocation of real funds end up with empty declarations. Together with firm support from major actors diversification attempts have the chance of implementation. Diversification projects that are financed by the EU should reflect its initial purpose of construction, and regardless internal political instability the purpose of construction should not be changed, as it happened in case of Odesa-Brody pipeline, which turned to be an anti-diversification tool. Transparency and clear legislative basis as well as close control over commitments' fulfillment should provide more coherence in the energy diversification projects.

And the importance of the reflection of the economic, political, and environmental aspects of strategic documents, like Energy Strategy, is to be mentioned. Energy Strategy should not be pure of political nature (as it happened under Yushchenko) or reflecting the interests of one interest group (like in case of Akhmetov under Yanukovych's presidency), it should be a complex document based on viable economic data that would realistically reflect the development of the sector and make viable forecast of the sector development. The further implementation of primary and secondary legislation should be conducted in compliance with the Energy Strategy.

International factors in its turn define the narratives of the main actors. Energy strategy and foreign policy approaches lay the ground for the (non)cooperation patterns. As pointed out during Yushchenko's tenure energy and foreign policy strategies of Ukraine and Russia were targeting opposite aims, which eventually brought conflict of interests and ended up with two energy crises. Therefore, the timely revision of energy strategy documents is essential as it could secure a necessary shift and prevent crisis in relations.

International actors, especially those, who become a source of import of certain rules and norms in energy market functioning, as in case of the EU, should provide stricter conditionality. Vague conditionality provides with poor results that were observed during Yanukovych's and Yushchenko's tenure. EU's tools to enhance energy cooperation with Ukraine work with different speed and efficiency. Though cooperation with Energy Community undoubtedly has huge benefits for the Ukrainian side, but timely implementation of the legislation is still quite problematic due to the absence of penalties.

The affiliation of certain interest articulators inside Ukraine with international actors, like Russia and EU, proves the unorthodox methods of these countries to influence policy making inside Ukraine. Russian engagement through affiliated companies in Ukraine undoubtedly created strong lobby, which pursues different interests inside Ukraine. Affiliation of the gas intermediaries, like RosUkrEnergo, with the EU clearly indicates the loophole in EU's legislation, which points at a complex transnational nature of corruption.

The causal links between two levels of analysis brings up the complexity of energy politics in post-Soviet countries, like Ukraine. The interaction of these factors and prevalence of the importance of some factors over the others shapes energy politics. The prevalence of cooperation with Russia enabled Kuchma to open up market for Russian companies and handed valuable assets as a side payment for cheaper gas price. The prevalence of internal conflict of interests at domestic level during Yushchenko enabled Moscow to use the situation in the way that the image of reliability of Ukraine as transit

country was shaken. The prevalence of personal preferences of enrichment pushed Yanukovych into Russia's firm hands, whereas European vector was abandoned. The prevalence of domestic constraints (war in Donbas and annexation of Crimea) provided Poroshenko with a necessary impetus to introduce reforms. Without a doubt, this is just a simplification to show the extent of which factors affected the decision-making process more predominantly than the others. Every president as chief negotiator bears a responsibility for the final (un)successful outcome of negotiations. But as shown by this research the preferences of chief negotiator appear to include many components, among which, the affect of the interest articulators due to their transnational nature should be carefully considered.

This study attempted to scrutinize so complex problem of energy policy formation in Ukraine. I tried to scrutinize the topic by application of theoretical interpretations and vast empirical data to show the shifts in continuity and change. This thesis benefitted from the postulates of IR theories, which assisted in a thorough scrutiny of Ukraine's energy relations with the EU and Russia. Realist school explained the evolution of energy relations between Russia and Ukraine from the means of industrial development into political weapon, which was applied to strengthen political leverage of Russia. First decade of Ukraine's independence cemented the firm path of Russian energy resource dependence, when cheaper energy price was exchanged for political concessions.

Liberal perspective introduced efforts of the European Union to shape a common energy area not only for the member states, but also for the neighbourhood. Ukraine was prioritized in that respect due to its important role of being a transit country. Therefore, EU not only facilitated Ukraine's membership in the Energy Community, but also created various initiatives at bilateral and multilateral levels to tackle the problem. The thesis showed that regardless different influences on the energy policy formation and implementation, Ukraine chose the European energy integration over lucrative energy offers of Russia. This choice is treated as a founding stone for further integration, namely signing Free Trade Area Agreement and Association Agreement with the EU. Moreover, even for now Ukraine has already been benefiting from the EU's reverse imports of energy resources as well as export of electricity to the EU.

The application of Putnam's two-level game approach proved to be a fruitful endeavor. It provided me with a suitable framework when two-level negotiations of the chief executive were scrutinized. Two-level approach enabled me to define the win-sets of the presidents, ability to reach and (fail to) implement an agreement, chances for

(in)voluntary defection, size of side payments etc. Double-edged diplomacy in energy politics indicated causal links between two level of analysis. Every chapter includes final analysis on the energy politics from the perspective of causal links between two levels of analysis.

Based on my interviews conducted in Kyiv, European Union plans to deepen integration with Ukraine, which was proved by signing an Association and Free Trade Agreement. Therefore, reforms in energy sector are vital to show Ukraine's willingness to converge on EU standards. The complexity of EU's internal position not only in energy sector, but also in external relations, diminishes EU's external impact. In the absence of unified voice from the EU institutions and governments, the implementation of the conflicting requirements tends to cause certain confusion. This confusion is also misguided by domestic factors in Ukraine, which results in partial implementation of the reforms.

As this thesis is being defended, the government in Ukraine has been changed again, which leads us to new politicians, who promise to commit. Energy sector under Poroshenko first time during the time of Ukraine's independency faced the real shift, when Ukraine ceased from the equation an absolute energy reliance on Russia. 'Kyiv has eliminated gas trading intermediaries with Russia; these were a constant source of non-transparent deals and corruption, and acted as a strong lobby for Russian-Ukrainian integration'⁸⁷¹, but this is just a first step toward real energy independence and sustainable vision of energy sector development. The real reform cycle has just started and will heavily depend not only on political will of the president and his government, but also on the engagement and role of oligarchic groups. International actors by introducing stricter rules of conditionality and offering its financial support will eventually assist Ukraine in making real progress. But being half way on the right path still bears the risk for Ukraine to turn back and rely again on Russia. Therefore, the unconditional instruments that Russia uses to influence Ukraine should be duly considered, which include, first and foremost, Russia-friendly lobbying business groups and murky intermediaries, but no less important are media propaganda, trade restrictions etc.

In a conclusion, I would like to point that further research on the transnational nature of certain interest groups in Ukrainian-Russian cooperation would be a promising academic endeavor. As this area will be the answer to many political decisions at both domestic and international levels.

871 Lough, John, Solonenko, Iryna. (April, 2016). Can Ukraine Achieve a Reform Breakthrough? Chatham House, <https://www.chathamhouse.org/sites/files/chathamhouse/publications/research/2016-04-05-ukraine-reform-breakthrough-lough-sononenko-final2.pdf>, p. 19.

If to consider future prospects of energy sector development in Ukraine further factors should be duly taken into consideration. Current situation with the annexation of Crimea and ongoing war in the Eastern Ukraine changed the chances for energy independence of Ukraine. Indeed, shale deposits that are located in the close-by zone to a conflict in Donbas, and Black Sea shelf and deep-water energy extractions make energy independence a far-reaching dream. As the potential of energy sector has been underestimated since independence, there were few investment projects realized. Nevertheless, under the terms of Crimea coming back to Ukraine, Kyiv will again obtain all the possible tools to develop its own energy resources and reach full energy independence from Russia. For now the only source of potential extraction remains domestic gas extraction, which needs sufficient investment and shale gas deposits in the Western Ukraine, which is not possible without foreign investment. But with the LNG revolution Ukraine may obtain cheaper gas supplies and replace totally Russian gas. Moreover, Ukraine may participate in projects like White Stream in order to utilize its large underground gas storage for European gas supplies⁸⁷².

Regardless the pricing policy for energy resources, Ukraine will need to introduce vast measures on energy efficiency and energy saving together with prioritizing the increase usage of renewable energy. With a more stable economy and less political turbulence Kyiv will again need to satisfy the demands of the industrial complex for affordable energy prices. Therefore, the sooner reforms are introduced the sooner positive outcomes will be reached.

One cannot expect that Russia will cease to use energy as a political tool, but as the vector of European integration in gas sector of Ukraine has already been chosen, Russia will more likely focus on the implementation of alternative pipeline projects to diminish the role of Ukraine as a transit country. The impact of Russia-affiliated interest groups that are still present in Ukraine should not be neglected as their influence reaches far beyond the area of energy politics into high-level decision-making process. Therefore, the more transparent the rules are introduced, the fewer maneuvers these groups will have for rent-seeking and affecting the politics.

The will of the European Union to reach common ground among its members on energy issues will undoubtedly affect Ukraine. Certain countries may continue to follow their national preferences while negotiating with Russia rather than complying with the

872 Interview with Viacheslav Kniazhnytskyi, Former Ambassador of energy security, Ministry of Foreign Affairs, conducted through internet on July 1, 2013.

regulations of Energy Community. This fragility creates loopholes that may cause conflict of interests, which is neatly used by Gazprom. Therefore, fully liberalized energy market will bring eventually more transparency and unified framework of rules. For now Russia already showed its will to establish a parallel set of rules securing its own dominant position, which led to Moscow's withdrawal from Energy Charter Treaty. Energy liberalization will remain an unfavorable development for Russia, and Moscow is expected to create more conditions to confront its finalization. Successful liberalization of Ukraine's energy market does not only mean a more secure gas supplies from Russia, but also it may serve as a model that can be replicated for the countries in transition in post-Soviet area.

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Interviews

Interview with Dirk Buschle, Deputy Director, Energy Community Treaty, conducted in Joensuu (Finland), on 5 March 2013.

Interview with Jim Bown, President of 'Vanco Prykerchenska Ltd', conducted during a Round Table on 'The ways of efficient utilization of Ukrainian Gas Transportation System: reverse, transit and the creation of Eastern-European gas hub' held by the Expert Council on the development of the gas industry and natural gas market' in cooperation with Kyiv International Energy Club 'Q-Club' in Kyiv, conducted in Kyiv (Ukraine) on 3 June 2013.

Interview with Roman Nitsovych, Chief Editor of analytical resource "Ukrainska enerhetyka" (Ukrainian energy) <http://ua-energy.org>, conducted in Kyiv (Ukraine), on 27 May 2013.

Interview with Gennadiy Riabtsev, Deputy Director of Scientific Centre "Psykhya", conducted in Kyiv (Ukraine), on 28 May 2013.

Interview with Mykhailo Gonchar, Director of Energy Programs of Analytical Centre "NOMOS" (www.geostrategy.org.ua), conducted in Kyiv (Ukraine), on 30 May 2013.

Interview with Volodymyr Omelchenko, Director of Energy Programmes of Razumkov Center, conducted in Kyiv (Ukraine), on 30 May 2013.

Interview with Dave Young, Chairman of the Board, European-Ukrainian Energy Agency, conducted in Kyiv (Ukraine), on 31 May 2013.

Interview with Lemlem Said Issa, Resident Twinning advisor to an EU Project 'Support to NERC in the process of implementation of gas legislation in line with the provisions of EnCT', conducted in Kyiv (Ukraine), on 31 May 2013.

Interview with Kaido-Paul Kranfeldt, Team Leader, EU-funded project "Capacity Building to State Agency in Energy Efficiency and Energy Saving in Ukraine", conducted in Kyiv (Ukraine), on 28 May 2013.

Interview with state worker (preferred to stay anonymous), Committee on Fuel and Energy Complex, nuclear policy and security, Parliament of Ukraine, conducted in Kyiv (Ukraine), on 3 June 2013.

- Interview with Jim Bown, President, Head of Representation “Vanco Prykerchenska Ltd”, Conducted in Kyiv (Ukraine), on 3 June 2013.
- Interview with Alla Yeremenko, Editor of the Department of Economic Security of the newspaper “Dzerkalo tyzhnia“ (Mirror of the week), conducted in Kyiv (Ukraine), on 3 June 2013.
- Interview with Walter Tretton, Head of the Energy, Transport and Environment Section of the EU Delegation to Ukraine, conducted in Kyiv (Ukraine), on 3 June 2013.
- Interview with Grygoriy Perepylytsia, Director of the Institute of foreign policy, Diplomatic Academy of Ukraine, conducted in Kyiv (Ukraine), on 4 June 2013.
- Interview with Sergiy Yasynskyi, Counsellor to the Minister of Energy Boyko till February 2013, worked in NAK Nadra Ukraine, conducted in Kyiv (Ukraine), on 5 June 2013.
- Interview with Ildar Gazizullin, Associated Analyst, Energy Policy, International Centre for Policy Studies, Ukrainian Institute of Public Policy (<http://www.icps.com.ua/eng/experts/exp/87.html>), conducted in Kyiv (Ukraine), on 5 June 2013.
- Interview with Dmytro Naumenko, Senior Research Fellow, Center for Economic Studies, Institute for Economic Research and Policy Consulting (<http://www.ier.com.ua>), conducted in Kyiv (Ukraine), on 6 June 2013.
- Interview with Valeriy Tsaplin, Head of the Department of Strategic Planning and energy markets' development, NERC, conducted in Kyiv (Ukraine), on 7 June 2013.
- Interview with Sergii Diachenko, worked in Security Council, Ministry of Energy and Fuel, Deputy Director of Analytical Center, conducted in Kyiv (Ukraine), on 7 June 2013.
- Interview with Viacheslav Kniazhnytskyi, Former Ambassador of energy security, Ministry of Foreign Affairs, conducted through internet on July 1, 2013.
- Interview with Yurii Torlak, First Secretary (Economic issues), Embassy of Ukraine to Turkey, conducted in Ankara (Turkey), on 4 July 2013.

APPENDICES

APPENDIX A. CURRICULUM VITAE

PERSONAL INFORMATION

Surname, Name: Stelmakh, Anastasiya
Nationality: Ukrainian (UA)
Date and Place of Birth: 14 October 1983, Lviv (Ukraine)
Marital Status: Married
Phone: +905066649670
Email: nastunia.lviv@gmail.com

EDUCATION

Degree	Institution	Year of Graduation
MA	International Relations, Ivan Franko National University of Lviv (Ukraine)	2005
BA	International Relations, Ivan Franko National University of Lviv (Ukraine)	2004
High School	Secondary School No. 4 specialized in English, Lviv (Ukraine)	2000

INTERNSHIPS AND FELLOWSHIPS

Year	Place	Enrollment
January – May 2010	Carnegie Research Fellowship Program at Harvard J.F. Kennedy School of Government (USA)	Fellow
July – August 2008	Political Department, The Embassy of Ukraine to the Republic of Turkey	Intern
December 2005	Interdisciplinary Doctoral Studies Program at the Artes Liberales Academy, Warsaw (Poland)	Fellow
March 2005	CIS Department, First Territorial Directorate General, Ministry of Foreign Affairs (Ukraine)	Intern
June 2002	Consulate General of Ukraine in Gdansk (Poland)	Intern

SCHOLARSHIPS

Year	Institution
2010 – 2013	TUBITAK Research Fellowship Program for Foreign Citizens
2010	Carnegie Research Fellowship Program
2008 – 2010	Erasmus Mundus External Cooperation Window Lot 6

FOREIGN LANGUAGES

Ukrainian (Native), English (Advanced), Turkish (Fluent), Polish (Fluent), Russian (Advanced)

PUBLICATIONS

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APPENDIX B

TURKISH SUMMARY / TÜRKÇE ÖZET

Kış ayları yaklaşırken Avrupalı liderlerin gündemi, “Yine gaz kesintileri olacak mı?”, “Ukrayna gaz transitinin güvenliğini sağlayabilecek mi?”, “Rusya enerji kaynaklarını politik bir araç olarak kullanacak mı?” gibi sorularla meşgul olmaya devam etmektedir. Yıllar geçtikçe sorular aynı kalsa dahi, cevaplar konusunda benzer bir şey söylemek mümkün olmamaktadır. Ukrayna gibi eski Sovyet ülkelerinin enerji politikaları, sadece Rusya ya da çevre Avrupa ülkeleri için değil, aynı zamanda uluslararası aktörlerin büyük çoğunluğu tarafından neredeyse otuz yıl boyunca bu sorunun ne denli görmezden gelindiğinin bir göstergesi niteliği taşımasından dolayı son derece büyük bir önem taşımaktadır. Enerjiye olan odaklanmanın yanı sıra bu tez, aynı zamanda en hassas konulardan biri olan ve enerji rantına dayanan yolsuzluk konusuna da değinmektedir. Son zamanlarda ortaya çıkan “Panama Belgeleri”⁸⁷³ tüm dünyada uluslararası gündemi sarsarken bir çok uluslararası lider ve bu liderlerin etki ve güç sahibi ortaklarını da etkilemiştir. Ukrayna bağımsızlığından itibaren yolsuzluğun geliştiği bir ülke olmakla beraber, aynı zamanda iç ve dış politik gelişmelerin karanlık yolsuzluk düzenlemeleri ile nasıl sıkı bir ilişki içinde olduğunun en parlak örneğini de oluşturmaktadır. Bu tez ile Ukrayna’da enerji politikasının oluşumuna ve evrimine ışık tutarak bu alandaki boşluğu doldurmak amaç edinilmiştir. Ukrayna enerji politikasının doğasını anlatırken önemli iç ve dış politika kararları ile bu kararlar üzerindeki çıkar gruplarının etkisini de anlatmak gerekmektedir.

Sovyetler Birliği’nin dağılmasının ardından, eskiden merkezi planlı sosyalist ekonominin bir parçası olan ülkeler bağımsızlıklarını kazanmış olmalarına rağmen ekonomik bağlamda Rusya Federasyonu’na bağımlı bir hal almışlardır. Özellikle enerji kaynaklarına sahip olmak eski Sovyet ülkelerini Rusya’ya tabi hale getirmiştir. Ukrayna da sadece küçük bir fark ile bu ülkeler arasındaki yerini almıştır. Gaz ve petrol boru hatları ağlarına sahip olan Ukrayna, Rusya’dan ithal edilen enerji kaynakları üzerinde müzakere etme ayrıcalığına sahip olmuştur. Enerji kaynaklarını Batı ülkelerine satma amacıyla olan

873 “Panama Belgeleri” Ukrayna örneğinde mevcut başkan Petro Poroshenko’nun sahibi olduğu şekerleme markası “Roshen” ürünlerinin ön satışının yapılandırılması için off-shore şirketler kurma teşebbüsü olduğunu iddia etmektedir. Bu belgelerde adı geçen diğer bir isim ise, bu tezde ismi şüpheli enerji işleri nedeni ile hüküm giymesinden dolayı çokça geçen Pavlo Lazarenko’dur. Poroshenko hakkındaki iddiaların ayrıntıları için bkz., Mylovanov, Tymofiy, Mylovanova, Zoya. (Nisan 5, 2016). *Here is what the ‘Panama Papers’ tell us about the President of Ukraine*. The Washington Post, <https://www.washingtonpost.com/news/monkey-cage/wp/2016/04/05/here-is-what-the-panama-papers-tell-us-about-the-president-of-ukraine/>

Rusya ise kendi ülkesi dışına enerji kaynaklarının nakliyesi bağlamında Ukrayna boru hatlarına her zaman ihtiyaç duymuştur.

Yirmi yıllık bir süreç içinde Ukrayna enerji politikası geliştirilmesinde enerjinin üretimi, tüketimi ve dağıtımı gibi konuların net bir vizyon olmadan duruma bağlı olan bütünlüksüz bir şekilde üstesinden gelmeye çalışmıştır. Kömür ve gaz gibi bazı sektörler geniş destek ve yardımdan yararlanırken yenilenebilir enerji kaynakları gibi diğer sektörler 1990'lı yılların başından itibaren açık bir şekilde önemsiz görülmüşlerdir. Ukrayna, enerji politikası, enerji stratejisi ve enerji ile ilgili hukuksal düzenlemelerin uygunsuzluğu ve uyumsuzluğu neticesinde kaotik durumlarla karşılaşmıştır.

Bu tez 1990'lı yılların başından günümüze kadar olan süreç içerisinde Ukrayna'daki enerji politikalarını ele almaktadır. Bahsi geçen 25 yıllık süre, enerji politikasının oluşumunun başlangıcı, bu politikanın kaotik evrimi ve nihayet olgunlaşma dönemini göstermesi bakımından bilerek seçilmiştir. Enerji alanında karar oluşturma sürecinin ilk yıllarının izlenmesi o dönemdeki kısıtlamaların ve fırsatların neler olduğunu anlamamıza olanak sağlamaktadır. Sonraki dönemler de enerji alanına çeşitli yolsuzluk düzenlemelerinin başlangıcının karmaşıklığını ortaya çıkarmaktadır. Bu durum da enerji alanının belirli çıkar grupları tarafından kontrol edilip istismar edilmesine neden olmuştur. Enerji politikasındaki gerçek dönüşüm ise nihayet mevcut başkanlık döneminde görülmektedir. Gaz piyasası reform gibi bazı alanlarda gerçekleştirilen reformlar enerji alanında olumlu gelişmelerin takip edilmesini beraberinde getirmiştir.

Enerji politikaları dünya çapında en önemli politika alanlarından biri olma özelliğini taşımaktadır. Ulusal ve uluslararası faktörlerin birbirleri ile karşılıklı etkileşimlerinin beraberinde getirdiği kompleks yapı, enerji politikalarının sadece belli bir teorik perspektif ile anlaşılmasını zorlaştırmaktadır. Ayrıca, birbirini bütünleyen bir şekilde farklı teorilerin ve kabul görmüş analitik perspektiflerin kullanımı hakikatte gerekli ve gelecek vaat eden bir araştırma girişimciliği olmuştur. Bu doktora tezi bu yüzden, özünde çok yönlü olan araştırma sorusunu ele alırken önceden kabul görmüş uluslararası ilişkiler teorilerinin sentezi ile Putnam'ın iki-düzeyle analitik yaklaşımının kullanılması ile ele almaktadır.

Enerji kaynakları için rekabetin artış gösterdiği bir dönemde Ukrayna'nın enerji politikası geniş çevre bölgesi için önemini korumaktadır. Enerji politikaları kendi ekonomik limitlerini de aşarak politik yelpazenin içine derin bir şekilde entegre olmuş bulunmaktadır. Dolayısıyla enerji politikası, ekonomi-politik, ekonomi ve uluslararası ilişkileri birbirlerine ağlayan bir alan olmuştur.

Ukrayna gibi eski Sovyet ülkeleri örneklerinde, enerji politikası belli ekonomik sonuçlara ulaşabilmek için bir araç olarak kullanılmaktadır. Bu yüzden bu tez, Ukrayna enerji politikasını iç ve dış politika olmak üzere iki düzeyde analiz ederek açıklamaya çalışmıştır. Ulusal seviye hangi reformların nasıl bir hızla gerçekleştiğini içermektedir. Aynı zamanda, Enerji Stratejisi gibi temel belgeleri de incelemektedir. Ek olarak, enerji alanındaki karar alma sürecindeki hiyerarşiyi de analiz ederek iç politika bağlamında çıkar gruplarının etkisinin ne derece önemli olduğunu ortaya koymaktadır.

Buna ek olarak bu tez, uluslararası düzeyde iki ana aktör olan Avrupa Birliği ve Rusya arasındaki işbirliğini de incelemektedir. Bu tez iki ana aktör ile olan işbirliğini ayrı ayrı incelemesine rağmen birbirleri arasında olan transnasyonal bağlantının varlığını da göz ardı etmemektedir. Fakat konunun detayları gereği bu konunun ayrı bir araştırma konusu olabileceği düşünülmektedir. Uluslararası düzeydeki analiz bizlere iç politikadaki gelişmeler ile bağlantı kurulmasını sağlarken enerji politikasının ulusal ve uluslararası aktörlerin birleştiği alan olma özelliğini de açıklamaktadır.

Bu doktora tezi, tartışmalı enerji politikası konusunu analiz etme hedefiyle Ukrayna örneğinde dış aktör olan AB ve Rusya etkisinin karmaşıklığını da açıklığa kavuşturmuştur. Daha da önemlisi, son yirmi yıllık süreç içerisinde olayların nasıl geliştiği ve bunların bir enerji aktörü olan Ukrayna'nın uluslararası arenadaki rolüne nasıl etki ettiği ve aynı zamanda iç politikadaki gelişmelerin ne derece önemli bir yeri olduğu analiz edilmeye çalışılmıştır.

Daha derin bir çalışma konusu ise AB ile en önemli Doğu komşusu Ukrayna ile arasındaki enerji odaklı ilişkinin incelenmesidir. Her ne kadar Ukrayna Brüksel'in güvenlik yapılanmasında öne çıksa dahi, AB'nin Ukrayna üzerindeki tek taraflı ve ortak duruşu tartışmaya açıktır. Kiev ile olan ilişkilerde net bir AB stratejisinin yokluğuna rağmen, enerji konusu daha derin bir entegrasyon yolunu takip eden, ileriye dönük hedefleri barındırmaktadır. Bu çalışmanın sonuçlarından biri de, enerji entegrasyonunun Ukrayna'yı AB üyesi olma hedefine daha da yakınlaştırdığıdır.

Rusya ile olan ilişkiler farklı bir eğilimi ortaya koymaktadır. Bir yandan Ukrayna'nın ucuz Rus gazına olan bağımlılığı enerji tedarikçisi olan bu ülkeye politik ve ekonomik imtiyazlar sağlaması çerçevesinde bağımlılığı arttırırken, diğer yandan ise Ukrayna üzerinde enerji verimliliği, enerji tasarrufu, alternatif enerji kaynakları gibi enerji reformları konusunda olumlu bir etkisi olmuştur. Rusya bağlantılı çıkar gruplarının ise Ukrayna'yı Rusya ekseninde tutma konusunda önemli bir rolü bulunmaktadır.

Enerji konusunun Ukrayna'nın hem Rusya hem de AB ile olan ilişkilerinde merkez noktada olması bu konunun seçilmesindeki en önemli nedenlerden biri olmuştur. Politika odaklı enerji konusu, bu yüzden Putnam'ın iki-düzeyle yaklaşımı ile ele alınmaktadır.

Bu çalışma, Ukrayna'nın enerji politikasında en çok geniş çapta etkiye sahip olan enerji kaynaklarından biri olan gaz ile sınırlandırılmıştır. Enerji politikası alanındaki diğer enerji kaynaklarına da geniş bir çerçevede değinilerek test edilebilir hipotezler desteklenmeye çalışılmıştır.

Disiplinlerarası bir yaklaşımla hazırlanan bu doktora tezi Dış Politika Analizi, Uluslararası İlişkiler, Uluslararası Ekonomi-Politik ve Karşılaştırmalı Politika alanlarına katkı sunmayı hedeflemektedir. Bu tez ayrıca, yenilikçi bir yaklaşımla Ukrayna enerji politikasını ülkenin dış politikası çerçevesinde sistematik ve bütüncül bir şekilde analiz etmektedir. Bu bağlamda bu tez, Ukrayna'nın dış politika gelişmelerinin geniş bir çerçevede değerlendirilmesi ile enerji alanında karar alma sürecinde ulusal ve uluslararası faktörlerin karşılıklı etkileşimini ele alarak teorik yönden ampirik bir araştırma özelliği taşımaktadır.

Yukarıda sunulan çerçevede, bu araştırma içinde barındırdığı original yaklaşım ve bulgular ile hem akademi hem de karar vericiler için faydalı bilgiler ve analizler içermektedir. Bir yandan, Ukrayna ve uluslararası enerji politika ve stratejilerinde teorik olarak politika-çıkışlı hazırlanması ile tez özelinde ele alınan ülkelerdeki karar vericiler ve paydaşlar için bir çerçeve çizerken, diğer yandan ele alınan analitik yaklaşım ile Uluslararası İlişkiler, Karşılaştırmalı Çalışmalar ve Uluslararası Ekonomi-Politik disiplinlerindeki akademisyenler için eski Sovyet ülkelerindeki yolsuzluk ve daha bir çok bağlantılı diğer araştırma konularını geniş ve detaylı olarak ele alabilmelerine katkıda bulunmaktadır. Aynı zamanda, yapısal argüman, teorik yerleşiklik ve kapsamlı ampirik haritalama neticesinde ulaşılan sonuçlar bu tezin Ukrayna ve Rusya Polisiği, Enerji Politikası ve Jeopolitik, Demokratikleşme Çalışmaları, Çatışma ve İşbirliği Çalışmaları gibi alanların lisans ve lisansüstü programlarında da faydanılabilirliğini ortaya çıkarmaktadır.

Bu çalışma hem iç hem de dış politika gelişmeleri arasındaki bağlantıyı sunmayı hedeflediği için araştırma soruları aşağıdaki gibi ortaya çıkmıştır. Öncelikle siyasal sistemin doğası gereği iç politik faktörler belirlenmiştir. Bunlar; liderlerin rolleri ve reform uygulamalarındaki istekleri, enerji alanındaki düzenlemelerin uyarlanması ve uygulanması arasındaki boşluklar, faiz arkülatörlerinin enerji karar alma sürecindeki dahiliyeti, enerji çeşitlendirme çabaları vb. olmuştur. Bahsedilen bu faktörler, enerji politikasını oluşturan ana faktör ve trendleri belirtebilmek adına bütün devlet başkanlarının dönemlerini kapsayarak detaylı bir şekilde incelenmiştir.

İkinci olarak, enerji politikasının dinamiklerini etkilemesi bakımından uluslararası faktörler üzerinde de durulmuştur. Bunlar arasında; AB ve Rusya'nın Ukrayna'ya karşı enerji odaklı dış politika yaklaşımları ve stratejileri, IMF ve EBRD gibi uluslararası enerji kuruluşlarının etkisi, belirli faiz arkülatörlerinin belirli uluslararası aktörler ile olan ilişkisi, ucuz enerji kaynakları ile ekonomik faktörler arasındaki bağ vb. bulunmaktadır.

İki-düzye analiz yaklaşımı böylelikle hem iç ve dış (ulusal ve uluslararası) enerji politikalarını ayrı bir şekilde değerlendirmeye hem de ikisi arasındaki bağlantı neticesinde enerji konusunu daha detaylı anlamlandırmada yararlı olmuştur. Dolayısıyla, enerji sektöründeki reformların ancak ulusal ve uluslararası fokterler arasındaki karşılıklı ilişkinin netleştirilmesi ile mümkün olacağı düşünülmektedir.

Daha önce de belirtildiği üzere bu tezin ana tartışma konusu, Ukrayna enerji politikasının oluşumu, evrimi ve değişiminin ancak ulusal ve uluslararası politikadaki gelişmelerin birbirleri ile olan ilgisinin açıklanması ile mümkün olacaktır. Enerjiye bağımlı eski bir Sovyet ülkesi olan Ukrayna özelinde bu ilişki devlet katında enerji politikasının oluşumu anlamına gelmektedir. Enerji politikası artık sadece ekonomik alanda bir kaynak olmaktan da ileri bir seviyeye gelerek ulusal ve uluslararası politikanın derin bir parçası haline gelmiştir. Bu durum her ne kadar tezin araştırma safhasını daha da zorlaştırırsa dahi, aynı zamanda Ukrayna gibi eski Sovyet ülkelerinde yaşanan gelişmelere ışık tutup kara kutunun açığa çıkmasına olanak tanıdığı için bir o kadar da gerekli olmuştur.

Putnam'ın iki-düzye yaklaşımı ise, araştırma konusunun Ukrayna özelindeki karmaşıklığını ulusal çıkar gruplarının ve uluslararası gelişmelerin rollerine uygulayabilme imkanı verdiğinden dolayı seçilmiştir. Böylelikle adı geçen yaklaşım çoklu aktörlerin etkisini ve birbirleri ile olan ilişkilerini ortaya çıkarabilmek adına eşsiz bir fırsat sunmaktadır.

Uluslararası ilişkilerin realist ve liberal yaklaşımlarının enerji politikası üzerindeki katkılarının analizi jeopolitikanın ve rantçı teorilerin zayıf ve güçlü yönlerinin açığa çıkmasına katkıda bulunmuştur. Bu yüzden, her görüşün ayrı bir şekilde enerji konusuna değindiğini fakat hiç bir yaklaşımın kendi başına yeterince bu konunun detaylarını açıklamaya yetmediğini söylemek mümkündür. Bu yüzden yukarıda belirtilen uluslararası ilişkiler teorilerinden fayda sağlanırken Putan'ın iki-düzye yaklaşımı ise tamamlayıcı bir alt yapı oluşturmuştur. Böylelikle bu doktora tezi ile enerji politikalarına yenilikçi bir bakış açısı getirerek alandaki bu boşluk doldurulmaya çalışılmıştır.

Ukrayna enerji politiği konusundaki literatürün açıklanmasına geçmeden önce bir noktayı netleştirmek gerekmektedir. Enerji konuları akademik literatürde genellikle

enerjinin hem ticari amaçlarla safi bir mal hem de bir dış politika aracı olarak stratejik amaçlar doğrultusunda kullanılıyor olması bakımından sürekli çetrefilli bir şekilde ele alınmaktadır.⁸⁷⁴ Bu yüzden enerji politikası, ülke ekonomisinin rekabet gücü, iç pazar kapasitesi ve ulusal gücünü belirlediği için bir ülke adına stratejik önem taşımaktadır. Ukrayna gibi enerji konusunda aşırı şekilde dışa bağımlı ülkeler açısından enerjinin kullanılabilirliği ülkenin iç ve dış politika konularında ciddi bir etkisi bulunmaktadır. Boru hatları ağları ile stratejik bir transit ülke konumunda olan Ukrayna, coğrafi olarak kilitlenmiş ve aynı zamanda Rusya enerji kaynaklarına tabi hale gelmiştir. Her ne kadar enerji konusunun politik bir hale gelmesi yadsınmazken bu doktora çalışmasında gerçekleştirilen kaynak taraması ile Ukrayna enerji politikası konusundaki temel eğilim ile birlikte bu konudaki sınırlılıkların da belirlenmesi hedeflenmiştir. Literatürdeki mevcut trendin eksik noktalarını çıkış noktası alan eleştirel bakış açısı temelinde, bu çalışmanın yenilikçi bir yaklaşım ile literatürdeki boşluğu doldurmaya katkı yapması sonuç bölümünde planlanmıştır.

Çeşitli birincil ve ikincil mevzuatların yanı sıra kaynaklar, kitaplar, dergiler, resmi raporlar, mülakatlar ve diğer konu ile ilgili olan araştırma makalelerini içermektedir. Bu tezin yazım aşamasında ise, Polonya Batory Vakfı, Ukrayna Uluslararası Politika Çalışmaları Merkezi, Ukrayna DiXi Grup, Ukrayna NOMOS Merkezi, Polonya Doğu Çalışmaları Merkezi, Ukrayna Razumkov Merkezi, Birleşik Devletler Stefan Global Witness gibi bir çok strateji kuruluşunun analizlerinden de yararlanılmıştır. Şunu da belirtmek gerekir ki, bu konuda, özellikle 1990-2000 yılları arasındaki dönem üzerine yazılmış İngilizce kaynaklar son derece azdır. Dolayısıyla kaynakların bir çoğu Rusça ya da Ukraynaca olmuştur. 1996 yılına kadar olan dönem üzerine yazılmış kaynaklar Foreign Broadcast Information Service (FBIS) aracılığı ile çevrilmiştir.

Ukrayna enerji politikası konusunu ele alan literatür kısmen sınırlıdır. Bir çoğu ana araştırma perspektifini iki ana aktörden birine odaklanarak çizmiştir. Örneğin; Prange-Gstöhl, Umbach, Wolczuk, Youngs gibi düşünürler Ukrayna enerji politikasına Avrupa'nın enerji güvenliği penceresinden bakmaktadır.⁸⁷⁵ Bunun yanı sıra Abdelal, Andres, Kofman, Loudermilk, D'Anieri gibi yazarlar ise konuyu Rusya'nın enerji politikasının güven(siz)liği

874 Westphal, Kirsten. (2006). Energy Policy between Multilateral Governance and Geopolitics: Whither Europe? *European Energy Policy*, Vol. 4, p. 59.

875 See, Prange-Gstöhl, Heiko. (2009). Enlarging the EU's internal energy market: Why would third countries accept EU rule export? *Energy Policy*, Vol. 37; Umbach, Frank. (2011). Ukraine's Energy Security Challenges: Implications for the EU. In T. Kuzio, D. Hamilton (Eds.). *Open Ukraine. Changing Course towards a European Future*. (95). Washington, DC: Center for Transatlantic Relations; Wolczuk, Kataryna. (2009). Implementation without Coordination: The Impact of EU Conditionality on Ukraine under the European Neighbourhood Policy. *Europe-Asia Studies*, Vol. 61, No. 2, March, pp. 187-211; Youngs, Richard. (2007). *Europe's External Energy Policy: Between geopolitics and the Market*. CEPS Working Document, No. 278, November.

perspektinden ele almaktadır⁸⁷⁶. Ukrayna özelinde ise enerji konusu, Ukrayna'nın bu konudaki iki aktör olan AB ve Rusya ile olan ilişkilere sıkıştırılmıştır. Bu yüzden Ukrayna enerji sektöründeki ana odak noktası AB ya da Rusya'nın çıkarları olagelmıştır. Dolayısıyla, çoğunlukla enerji güvenliği ve jeopolitik ile ilgilenen Rusya-AB odaklı yaklaşımların ise bu konuda Ukrayna iç politikasındaki gelişmeleri ve bu gelişmelerin ülkenin diğer aktör ile olan ilişkisini göz ardı ettiği gözlemlenmiştir.

Schmidtke ve Yekelchik gibi diğer araştırmacılar Ukrayna, AB ve Rusya arasındaki ilişkilere ve bu üçülke arasındaki işbirliğine değinmektedirler.⁸⁷⁷ Malygina, Pavlenko, Antonenko, Nitsovyeh, Pirani, Stern, Yafımava ise çalışmalarda gazın uluslararası politikada önemli bir araç olduğunu savunmaktadır.⁸⁷⁸ Diğer çalışmaların büyük çoğunluğu (genellikle analizler ve raporlar) Ukrayna ve Rusya arasındaki gaz krizlerine odaklanmıştır. Bazı araştırmacıların gaz kesintileri ve tekel enerji politikası bağlamında Rusya'yı suçladığı görülürke⁸⁷⁹, diğer yazarlar ise Ukrayna'nın bağımsızlığını kazanmasının ardından uluslararası politikada güç mücadelesinin bir kurbanı olduğunu savunmaktadır⁸⁸⁰. Diğer akademisyenler ise, Ukrayna'nın gaz transit sisteminin öyle eski, yıkık dökük ve yolsuzlaşmış olduğunu savunurlar ki onlara göre bu durum hem Ukrayna hem de Rusya'ya anlaşma ve yolsuzluk yapma konusunda ayrıcalık tanımaktadır.⁸⁸¹ Daha da fazlası, AB'nin gaz krizlerinin yönetilmesindeki aciz rolü de ciddi bir şekilde Smith, Schmidtke ve

876 Abdelal, Rawi. (2004). Interpreting Interdependence: National Security and the Energy Trade of Russia, Ukraine, and Belarus. In Legvold, R., Wallander, Celeste A. (Eds.). *Swords and Sustenance: The Economics of Security in Belarus and Ukraine*. Cambridge: The MIT Press; Andres, R.B., Kofman, M., Loudermilk, M.J. (2011). Solutions for Russian-Ukrainian Gas Brinkmanship. *Journal of Energy Security*, 15 March; D'Anieri, Paul. (1999). *Economic Interdependence in Ukrainian-Russian Relations*. Albany: SUNY Press.

877 Schmidtke, O., Yekelchik, S. (Eds.) (2008). *Europe's Last Frontier? Belarus, Moldova, and Ukraine between Russia and the European Union*. New York: Palgrave Macmillan.

878 Malygina, Katerina. (2010). Ukrainian-Russian Gas Relations After the 2009 Conflict: The Current Situation and Future Prospects, *Russian Analytical Digest*, No. 75, 16 March; Pavlenko, Olena, Antonenko, Anton, Nitsovyeh, Roman. War in the Energy Sector as a Second Front. (2015). In Pabriks, Artis, Kudors, Andis (Eds). *The War in Ukraine: Lessons for Europe*. The Centre for East European Policy Studies, University of Latvia Press, Riga; Pirani, S., Stern, J., Yafımava, K. (June, 2010). The April 2010 Russo-Ukrainian gas agreement and its implications for Europe. *The Oxford Institute for Energy Studies*, p. 8, http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/05/NG_42.pdf, accessed October 6, 2012; Smith Stegen, Karen. (2011). Deconstructing the 'energy weapon': Russia's threat to Europe as case study. *Energy Policy*, No. 39.

879 Stern, Jonathan. (2010). The new security environment for European gas: worsening geopolitics and increasing global competition for LNG. In Lévêque, François; Glachant, Jean-Michel; Barquín, Julián; Hirschhausen, Christian von; Holz, Franziska; Nuttall, William J. (Eds.) *Security of Energy Supply in Europe: Natural Gas, Nuclear and Hydrogen*. Edward Elgar Publishing Ltd.: UK, 2010; Smith, Keith C. (2004). *Russian energy politics in the Baltics, Poland, and Ukraine: a new stealth imperialism?* Washington, D.C.: Center for Strategic and International Studies; Perovic, Jeronim. (2007). Russia's Energy Policy: Should Europe Worry? *Russian Analytical Digest*, 3 April, No. 18; Malygina, Katerina. (2010). Ukrainian-Russian Gas Relations After the 2009 Conflict: The Current Situation and Future Prospects, *Russian Analytical Digest*, No. 75, 16 March.

880 Kuzio, Taras. (March 7, 2008). Ukrainian Politics, Energy and Corruption under Kuchma and Yushenko. How the Gas Issue Plays in Ukrainian Politics and How Ukrainian Politicians Play the Gas Issue. Paper presented at Harvard University.

881 Andres, R.B., Kofman, M., Loudermilk, M.J. (2011). Solutions for Russian-Ukrainian Gas Brinkmanship. *Journal of Energy Security*, 15 March, p. 2.

Yekelchik tarafından eleştirilmektedir.⁸⁸² Fakat, 2005 yılında patlak veren ilk gaz krizinin de aynı zamanda AB'yi enerji politika revizyonu yapmak ve Ukrayna'yı bu bağlamda önceliklendirmek zorunda bıraktığını da göz ardı etmemek gerekmektedir.

Taras Kuzio, Richard B. Andres, Michael Kofman and Micah J. Loudermilk gibi akademisyenler gaz krizleri teşviklerinin “politik” olduğunu yeniden tasdik etmektedirler.⁸⁸³ Katerina Malygina ise Rus enerji şirketi Gazprom tarafından algılanan iki ana nedenini işaret etmektedir. “Birincisi, Ukrayna'nın güvenilir bir transit ülke imajı vurgulanarak Kuzey ve Güney Akım boru hatları gibi alternatifler için desteğin arttırılmaya çalışılması olmuştur. İkincisi ise, Avrupa'nın ilgisinin Gazprom'un mali problemlerinden sapmasına ve AB ve IMF'nin Ukrayna'ya gaz borcunu ödeyebilmesi için mali destek vermeye itmesidir⁸⁸⁴.

Ukrayna'nın enerji politikasındaki iç politikanın etkisini ele alan sadece bir kaç çalışmaya rastlanmaktadır.⁸⁸⁵ Fakat bu kaynaklar da, genellikle uluslararası düzeyde karar alma sürecindeki ilişkilerinden ziyade sadece oligark grupların enerji kaynakları ticaretindeki⁸⁸⁶ rant miktarları ile sınırlı kalmıştır.

882 Smith, Keith C. (2004). *Russian energy politics in the Baltics, Poland, and Ukraine: a new stealth imperialism?* Washington, D.C.: Center for Strategic and International Studies; Schmidtke, O., Yekelchik, S. (Eds.) (2008). *Europe's Last Frontier? Belarus, Moldova, and Ukraine between Russia and the European Union*. New York: Palgrave Macmillan.

883 Kuzio, Taras. (March 7, 2008). Ukrainian Politics, Energy and Corruption under Kuchma and Yuschenko. How the Gas Issue Plays in Ukrainian Politics and How Ukrainian Politicians Play the Gas Issue. Paper presented at Harvard University; Andres, R.B., Kofman, M., Loudermilk, M.J. (2011). Solutions for Russian-Ukrainian Gas Brinkmanship. *Journal of Energy Security*, 15 March.

884 Malygina, Katerina. (2010). Ukrainian-Russian Gas Relations After the 2009 Conflict: The Current Situation and Future Prospects, *Russian Analytical Digest*, No. 75, 16 March, p. 6.

885 Balmaceda, Margarita M. (1998). Gas, Oil and the Linkages between Domestic and Foreign Policies: The Case of Ukraine. *Europe-Asia Studies*, Vol. 50, No. 2; Balmaceda, Margarita M. (2008). The Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's power, oligarchs' profits and Ukraine's missing energy policy, 1995 – 2006. Routledge: London; Balmaceda, Margarita M. (2013). *Politics of Energy Dependency: Ukraine, Belarus and Lithuania Between Domestic Oligarchs and Russian Pressure, 1992-2012*. University of Toronto Press; D'Anieri, P.J. (2007). Understanding Ukrainian Politics: Power, Politics, and Institutional Design. Armonk, NY, USA: M.E. Sharpe, Inc.; Korduban, Pavel. (May 12, 2010). Ukraine Wary of Putin's Proposal to Merge National Gas Companies. *Eurasia Daily Monitor*, Vol. 7, Issue 92; Matuszak, Slawomir. The Oligarchic Democracy. The influence of Business Groups on Ukrainian Politics. *OSW Studies*, No. 42, September 2012, p. 41-42, http://www.osw.waw.pl/sites/default/files/Prace_42_EN.pdf, accessed on November 1, 2012; Matuszak, Slawomir, Sama, Arkadiusz. (March 2013). From stabilization to stagnation. Viktor Yanukovich's Reforms. Centre for Eastern Studies. *Point of View*, No. 32; Pirani, Simon. (June, 2007). Ukraine's Gas Sector. *The Oxford Institute for Energy Studies*, p. 23, <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG21-UkrainesGasSector-SimonPirani-2007.pdf>, accessed on October 14, 2015; Puglisi, R. (2003). The Rise of the Ukrainian Oligarchs. *Democratization*, Vol. 10, No. 3, Autumn.

886 Kapliuk, Ekaterina. Rassledovanie: obogashchenie Aleksandra Yanukovicha. (October 23, 2012). *Forbes.ua*, <http://forbes.ua/business/1340389-rassledovanie-obogashchenie-aleksandra-yanukovicha>, accessed October 30, 2012; Kuzio, Taras. (January 16, 2013). Ukraine Sliding From Oligarchy to Cronyism. *Eurasia Daily Monitor*, Vol. 10, Issue 8; Leshchenko, Serhiy. (January 11, 2013). Sorkin appointed to NBU. Family finished squeezing oligarchs. *Ukrainska Pravda*, <http://www.pravda.com.ua/articles/2013/01/11/6981269/>, accessed on March 17, 2013; Leshchenko, Serhiy. Sunset and/or sunrise of the Ukrainian oligarchs after the Euromaidan revolution? *Euromaidan Press*, <http://euromaidanpress.com/2015/06/02/sunset-and-or-sunrise-of-the-ukrainian-oligarchs-after-the-euromaidan-revolution/>, accessed on December 21, 2015; Matuszak, Slawomir. The Oligarchic Democracy. The influence of Business Groups on Ukrainian Politics. *OSW Studies*, No. 42, September 2012, p. 41-42, http://www.osw.waw.pl/sites/default/files/Prace_42_EN.pdf, accessed on November 1, 2012

Margarita Balmaceda'nın ilk kitabı Ukrayna-Rusya ilişkilerindeki enerji bağımlılığını ve yolsuzluk konularını incelemektedir. Kendisinin son kitabı, "Politika ve Enerji Bağımlılığı: Oligarklar ve Rus Baskısı arasında Ukrayna, Belarus ve Litvanya, 1992-2012" üç eski Sovyet ülkesi arasında derinlemesine bir karşılaştırma yaparak iç politikada etkili olan oligarklar ve Rusya Federasyonu ile olan ilişkileri ele alması bakımından önemlidir.⁸⁸⁷

Ukrayna enerji politikası konusuna kısmi bir bakış açısı ile yaklaşan çalışmalar da mevcuttur. Bazıları enerji sübvansiyonlarının karmaşıklığı ve bunun sektör üzerindeki etkisini incelerken⁸⁸⁸ diğerleri ise enerji sektöründeki yeniden yapılanmaya dikkat çekmektedir⁸⁸⁹. Bir kaç yazar ise Ukrayna'nın gelecekteki enerji talebini tahmin etmeye çalışmıştır⁸⁹⁰.

Ukrayna'nın enerji sektörü üzerinde dış etkiler ile iç politik gelişmeleri harmanlayan ve bu noktada tarihsel bir arka plan çizen çalışmaların da mevcudiyetini vurgulayarak sonuçlandırmak yerinde olacaktır. En önemli katkılardan birisi ise Simon Pirani'nin, 2006 yılına kadar olan dönemdeki gelişmeleri gaz transiti, gaz tüketimi ve gaz arzı olmak üzere 3 başlık çerçevesinde incelediği çalışmasıdır⁸⁹¹.

Ana akım kaynaklar Ukrayna ve Rusya arasındaki ilişkileri açıklarken genellikle realist çerçeveden yararlanmışlardır. Liberal yaklaşım ise daha çok enerji alanında Avrupa ve komşu çevre ülkeleri ile olan işbirliğini ele almak için kullanılmıştır. "Capture state" kavramı çıkar gruplarının etkisi aracılığıyla iç politikada yaşanan engellerin etkisini de önemli bir ölçüde karşılamaktadır. Fakat genellikle bu etki iç politika düzeyinde kalarak ileri bir uluslararası düzeyde etki sağlamamaktadır.

Enerji politikaları konusu hali hazırda, önemlerini de göz önünde tutarak, uluslararası ilişkiler teorilerinden sadece realist ve liberal akım çerçevesinde dar bir çerçevede ele alınmaktadır. Şüphesiz ki, bu konudaki araştırma azlığı araştırma için güvenilir veriyi içeren şeffaflık ve enerji ile ilgili koulardaki gizlilik konularındaki problem ile açıklanabilir.

887 Balmaceda, Margarita M. (2013). *Politics of Energy Dependency: Ukraine, Belarus and Lithuania Between Domestic Oligarchs and Russian Pressure, 1992-2012*. University of Toronto Press.

888 Krasnov, G. V., Brada, J. C. (1997). Implicit subsidies in Russian-Ukrainian energy trade. *Europe-Asia Studies*, 49(5), pp. 825–843.

889 Von Hirschhausen, C., Vincentz, V. (2000). Energy policy and structural reform. *Eastern European Economies*. January-February, No. 38 (1).

890 Horn, Manfred. (1999). Energy Demand until 2010 in Ukraine. *Energy Policy*, 27, pp. 713-726.

891 Pirani, Simon. (June, 2007). Ukraine's Gas Sector. *The Oxford Institute for Energy Studies*, <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG21-UkrainesGasSector-SimonPirani-2007.pdf>, accessed on October 14, 2015;

Araştırmanın sonuçlarına ulaşabilmek için bu tezin yazpısı niteliksel yaklaşım çerçevesinde şekillenmiştir. Niceliksel yaklaşımdan ise resmi verilerin toplanması aşamasında faydalanılmıştır.

Bu çalışmada genellikle niteliksel araştırma metodolojisinden faydalanılmıştır. Niteliksel araştırmanın hedeflerine ulaşabilmek için yapısal ve fonksiyonel analizi içeren bütüncül bir yaklaşım izlenmiştir. Fakat, paralel olarak sebep-sonuç ilişkisini inceleyebilmek için bireyci yaklaşım dikkatli bir şekilde sebep-sonuç analizi ile uygulanmıştır.

Açıklayıcı yaklaşımın uygulanması için geleneksel betimleyici pozitivist yaklaşımında ötesinde bir uygulama izlenmiştir. Açıklayıcı yaklaşım neden Ukrayna enerji politikasının çeşitli sebep-sonuç ilişkilerine dayalı belirli bir şekilde oluştuğu sorunsalını içermektedir.

Tarihsel yaklaşımın kullanılması ise, enerji politikası evrimindeki devamlılığı ve değişimi takip etmeye olanak sağlamıştır. Bu yüzden, Ukrayna'nın bağımsızlığından günümüze kadar olan dönemler ayrılarak Kravchuk, Kuchma, Yushchenko, Yanukovych ve Poroshenko başkanlık süreleri ayrı bölümlerde incelenmiştir.

Bu çalışmada uygulanan bir diğer teori de karşılaştırmalı örnek araştırma metodudur. Böylelikle enerji politikası oluşturma fenomeni araştırılırken doğasında olan sistematik karşılaştırma⁸⁹² ile ampirik inceleme Belarus örneğine uygulanmıştır. Belarus'u karşılaştırma yapılan en uygun diğer bir ülke olarak seçmenin bir kaç sebebi bulunmaktadır. İlk olarak, bir Sovyet sistemi parçası olan Belarus bağımsızlığını kazandıktan sonra kendi boru hattı ağına sahip olmuştur. İkinci olarak, enerji üretimindeki zayıf göstergeler ve Rusya ile çok sıkı olan ekonomik bağlar Belarus'u ağırlıkla enerji konusunda Rusya'ya bağlı kılmıştır. Belarus ve Rusya arasında entegrasyon birliklerinin kurulması da Belarus'u bir transit ülke haline getirirken, Rusya ise ana enerji tedarikçisi olmaya devam etmiştir. Üçüncü olarak, enerji bir çok kez Belarus ve Rusya arasında bir dış politika malzemesi olarak gündeme getirilmiştir. Belarus ve Ukrayna'nın karşılaştırılabilirlik özellikleri her iki ülkenin de ortak Sovyet tarihi mirasına sahip olması ve demokratikleşme dalgalarının ardından enerji politikalarını AB ile daha yakın işbirliği çerçevesinde şekillendirme şanslarının olmasındandır. Diğer yandan, Ukrayna ve Belarus'un enerji dinamikleri ve iç politikalarındaki farklılıklar ile AB ile olan aynı olmayan dış politikaları enerji sektörü gelişimi bağlamında önemli farklılıkları da ortaya çıkarmaktadır. Uygulanan tüm metodlar,

892 Kaarbo, Juliet, Beasley, Ryan K. (1999). A Practical Guide to the Comparative Case Study Method in Political Psychology. *Political Psychology*, Vol. 20, No. 2, p. 372.

Rusya Federasyonu'na olan karşılıklı bağımlılığı da göz önünde bulundurarak, iki ülkeyi ilgilendiren enerji oyunundaki farklılıkları ve benzerlikleri daha derin bir incelemeye olanak sağlamaktadır. Bu yüzden, Belarus karşılaştırmalı örneği bu tezin test edilebilir hipotezlerini tekrar onaylamaktadır.

Gözlem yapma, belge analizi ve mülakatları içeren saha araştırması niteliksel veri toplama metodlarından bazılarıdır. Bu çalışmada daha çok sonucusu kullanılmıştır. Belirli soru ve cevaplar yerine serbest akışın olduğu görüşmeler gerçekleştirilmiştir⁸⁹³. Yüz yüze esnek bir konuşma dahilinde gerçekleştirilen görüşmeler, 2013 yılı içinde konferanslarda ve kişisel randevularla oluşturulmuştur. Basılmış materyallerden oluşan ikinci tür kaynakların incelenmesi sonrasında oluşan sonuçlardan sonar Mayıs-Haziran 2013 tarihleri arasında Kiev'de (Ukrayna) saha araştırması gerçekleştirilmiştir.

Saha araştırması esnasında bazı zorluklarla da karşılaşmıştır. Örneğin, görüşme yapılan kişilerin kariyerlerini etkileyeceği düşüncesi ile sorulara yanıt vermek istememesi ya da kendi isimlerinin referans olarak gösterilmemesi, cevapların kayıt altına alınmaması gibi çekincelerin yanı sıra, verilebilecek cevaplardan ziyade saha çalışmasının soruları ve tez konusu ile daha yakından ilgilenme gibi zorluklar gözlemlenmiştir. Özetlemek gerekirse, üst makamları ekonomik ve politik olarak ilgilendiren enerji konularının araştırılmasında o ülkenin bir vatandaşı olarak bile sorun yaşadığımı belirtmek isterim. Sonuç olarak enerji konusunun hala hassasiyetler ve gizlilik içerdiğini ve bu yüzden karar vericilere ulaşmanın zor olduğunu söylemek mümkündür.

Ukrayna'da enerji politikalarının dinamiklerinin altında yatanları daha iyi anlayabilmek adına görüşmeler, Parlamento (Verkhovna Rada) üyeleri, AB Komisyonu temsilcileri, politika uzmanları, akademisyenler, gazeteciler ve yabancı misyon temsilcileri ile gerçekleştirilmiştir. Bu görüşmeler, araştırmanın erken bulgularının test edilmesinde ve tezin hipotezinin analizinin keskinleştirilmesini sağlamıştır. Ulusal perspektifin yanı sıra, AB ve yabancı misyon temsilcilikler ile gerçekleştirilen görüşmeler AB-Ukrayna enerji ilişkilerinin, yanlış bilgilerin ve çatışma alanlarının daha iyi anlaşılmasına imkan tanımıştır.

Yapısal bağamda bu tez sekiz bölümden oluşmaktadır. Brinci bölüm kapsam ve hedefler, araştırma sorusu, kaynak taraması, argüman ve metodolojiden oluşmakta ve tezin yapısı ile son bulmaktadır.

Girişten sonraki 2. *Bölümde*, uluslararası ilişkilerin iki ana akım teorisi olan realizm ve liberalizm açıklanarak tezin teorik çerçevesi çizilmektedir. Neorealist çerçeve Ukrayna ve Rusya Federasyonu arasındaki ilişkiyi anlatırken kullanılmıştır. Burada enerji gücünün

893 Douglas, J.D. (1976). *Investigative social research: Individual and team field research*. Beverly Hills, California: Sage Publications, p.15.

nasıl da bir dış politika aracına dönüştüğünün altı çizilmektedir. Enerji tedarikçisi Rusya ve enerji tüketicisi ve transit bir ülke olan Ukrayna arasındaki ilişki asimetrik karşılıklı bağımlılığı içeren bir ilişkiyi betimlemektedir. Bu karşılıklı bağımlılık, Ukrayna'nın enerji sektörü reformlarını genişletmekteki isteksizliği ve ekonomide karaborsanın oluşması ile birlikte derinleşmektedir. Neoliberal teori ise, AB ile olan yakın enerji işbirliğinin aciliyetinden bahsedilirken kullanılmıştır. AB'nin kendi kurumsal avantajını Ukrayna'da enerji sektörü reformlarını tatbik etmek için kullandığı görülmektedir. Ukrayna'nın enerji sektöründeki şeffaflığın önemi Rusya-Ukrayna arasında iki kez yaşanan gaz savaşından sonra vurgulanmaya başlanmıştır. Jeopolitiği ve rant-arayan teorileri açıklayan kısımlar ise daha çok sınırlamalar dahilinde değinilmiştir. Rant-arayan teori, capture-state literatürünün bir parçası olarak enerji sektöründeki yolsuzluğu politik sistem içerisinde anlamamıza yardımcı olmaktadır. Özetlemek gerekirse yukarıda bahsedilen teoriler enerji politikalarının bir kısmını açığa kavuşturmakla birlikte bütüncül bir şekilde tek başına açıklamaya yetmemektedir. Bu yüzden Putnam'ın iki-düzey yaklaşımı tez argümanı tamamlayıcı şekilde açıklaması için kullanılmıştır.

Tezin odak noktası ile paralel bir şekilde, 3. *Bölüm* 1991-2010 yılları arasında Ukrayna'nın enerji politikasındaki dinamikleri ele almaktadır. Leonid Kravchuk ve Leonid Kuchma başkanlığı dönemleri Rusya'nın Ukrayna üzerindeki etkisinin ne derece büyük olduğunun ve bunun aksine AB etkisinin ise o derece zayıf olduğunu açığa kavuşturmaktadır.

4. *Bölüm*, Başkan Viktor Yushchenko dönemindeki enerji politikası alanındaki gelişmeleri analiz etmektedir. İç politikada Tymoshenko ve Yushchenko arasında yaşanan anlaşmazlık enerji sektöründe bir çıkmazı beraberinde getirmiştir. Avrupa yanlısı başkan katı bir şekilde Rusya'nın enerji tepkisi ile karşılaşmış ve 2006 ve 2009 yıllarında iki kez gaz krizi yaşanmıştır. Güncellenmiş Ukrayna 2030 Enerji Stratejisi ve Enerji Komitesinin tam üyesi olabilmek için gerekli olan reformların başlatılması Avrupa modeli enerji reformlarının adaptasyonunun ilk adımları olarak sembolize edilmiştir.

5. *Bölüm*, Viktor Yanukovych'in başkanlık dönemindeki enerji politikalarını ele almaktadır. Başkanlığının ilk üç yılı AB-Ukrayna ilişkilerinde adeta bir mihenk taşı olmuştur. Bu bölüm Rusya yanlısı bir devlet başkanının, her ne kadar Avrupa entegrasyona öykünmüş olmasına rağmen, Ukrayna'nın Avrupa Enerji Topluluğu'na tam üye olabilmesi için gerekli hazırlıkları tamamladığını ele almaktadır. Rusya ile olan ilişkilerde, Rusya yanlısı Yanukovych başkanlığının ilk yılında "donanma için gaz" anlaşması olarak bilinen Kharkiv Anlaşması'nı imzalamıştır. Bunun karşılığında hükümet düzeyinde ve

Ukrayna'daki Rus yanlısı oluşumlar düzeyinde daha agresif bir Rus politikası izlenmeye başlanmıştır. Ukrayna'nın cevapsız kalması Rusya'yı daha da cesaretlendirmiş ve buna karşılık olarak AB'nin dış enerji politikası çerçevesinde Ukrayna stratejik ülke olarak nitelendirilmiştir. Çeşitli ikili ve çoklu araçlarla AB Ukrayna'yı Avrupa ortak enerji pazarına dahil etme amacını sürdürmüştür. Enerji Ortaklığı'na üye olmak ise enerji piyasası liberalleşmesinde önemli bir adım olarak görülmüştür.

6. *Bölüm* Euro-Maidan olaylarından sonraki en güncel dönemi ele almaktadır. Kırım'ın ilhakı ve Donbas'daki savaştan sonra Ukrayna'nın değişen enerji profili enerji alanında süratli reformların yapılmasına neden olmuştur. Uzun zaman beklenen enerji vergileri ile gaz arzının çeşitlendirilmesindeki artış ile birlikte yirmi yıldır durmuş olan enerji dinamiklerini değiştirmiştir. Her ne kadar net bir enerji reform yolu izlenmiş olsa dahi, belirli çıkar gruplarının halen enerji alanındaki etkisi bu alanın şeffaf ve kanunlara uygun olmasının önüne geçmiştir. İç ve dış politikadaki yakın bağlantı, uluslararası kuruluşların yakın gözlem yapması ve politik istek ile birlikte mevcut hükümetin gerekli enerji reformlarını hayata geçirebileceğine işaret etmektedir.

7. *Bölümde* Belarus örneğinde karşılaştırmalı vaka analizi çalışması gerçekleştirilmiştir. Eski bir SSCB ülkesi olan Belarus'un Rusya'nın gaz ihracatından en çok fayda sağlayan ülke olduğu görülmektedir. Sovyetler döneminde Belarus ve Ukrayna kendilerine hızlı endüstriyel planlamayı gerçekleştirmeyi mümkün kılacak uygun fiyata gaz satın alıyorlardı. Bağımsızlıklarını kazandıktan sonra iç politikalarındaki değişimler Rusya ile daha farklı bir ilişki düzeyini beraberinde getirmiştir. Belarus örneği, Belarus'un transit ülke olmayı kabul etmesi çerçevesinde gaz kozunun Rusya tarafından kazanıldığıının en belirgin yansıması olmuştur. Lukashenko'nun dış politika öncelikleri Rus yeni-empyrialistlerinin hırsını beslemiş ve böylece Belarus tek ekonomik alan olan Gümrük Birliği'ne girmiştir.

Bu tez üç ana katkıyı sunmaktadır. Birincisi, güncel enerji krizinin analizi yerine daha bütüncül bir yaklaşımla enerji formasyonunun, evriminin, gelişiminin ve değişiminin doğasını analiz etmektedir. İkincisi, iç ve dış politikanın ayrı ayrı önem ve etkisi ile birlikte birbirleri arasındaki ilişkiye vurgu yapmaktadır. Çıkar gruplarının müdahil olması enerji alanında karar verme sürecindeki etkiyi açığa çıkarmıştır. Üçüncüsü, bu tezin diğer enerji bakımından fakir olan Belarus gibi ülkeler özelinde eski Sovyet ülkelerindeki enerji politika belirleme süreçlerinin daha iyi anlaşılmasına katkı sağlaması olmuştur.

Özellikle gaz sektöründeki enerji ilişkileri gelecekte Ukrayna, AB ve Rusya'nın gündemini domine etmeye devam edecek gibi gözükmektedir. AB tarafından enerji alanında

ortaya konan çabalar Ukrayna tarafından etkili olarak kabul edilmektedir ve bu durum Avrupa Enerji Topluluğu üyeliği aracılığı ile daha derin bir işbirliğine yol açmaktadır. Liberalleşmeyi amaç edinen enerji reformları Ukrayna'daki enerji pazarının daha istikrarlı ve şeffaf olması için atılması gereken ilk adımlardır. AB enerji entegrasyonunun avantajları, AB tarafında gelen gaz arzının ancak AB müktesebatının kabulü ile mümkün olmasıyla birlikte, şimdiden Ukrayna için verimli olmaya başlamıştır. Ukrayna'nın AB müktesebatını daha da fazla uygulamaya başlaması ile birlikte daha da fazla avantaj elde edileceğini söylemek yanlış olmayacaktır.

Bu araştırma konusunun ana sonuçlarına baktığımız zaman öncelikle enerji politikalarında oluşum, evrim, devamlılık ve değişim konularının temelini analiz edildiğini söylemek gerekmektedir. Oluşum ve değişim her ne kadar kendini açıklayabilen bir niteliğe sahip iken, evrim ve devamlılık kısmı ayrıca ele alınmalıdır. Yushchenko dönemindeki enerji politikasının evrimi esasen rejim ve oligarklar arasındaki geleneksel uygulamaları kırmadan Avrupa entegrasyonu çabalarının bir ileri adımı olmuştur. Yanukovych dönemindeki devamlılık, her ne kadar Kuchma ve Yushchenko⁸⁹⁴ döneminde geliştirilen ve sağlanan enerji sektörünün işleyişinin temel taşlarının korunmasını içerse de, enerji dengesine sadece yeni bir kaç boyut kazandırılabilmiştir.

Daha önce de belirtildiği üzere bu araştırma enerji politikası oluşturma sürecinde ulusal ve uluslararası faktörlerin önemini ve karmaşıklığı ele almaktadır.

Siyasal sistemlerin doğası gereği 25 yıllık başkanlık ve parlamenter sistem çok da değişikliği beraberinde getirmemiştir. Kuchma ve Yanukovych dönemindeki gibi başkanlık sistemlerinde güçlerin tek bir elde birleşmesi gücün yapısal reformlar yerine bireysel zenginleşme için kullanıldığı daha otoriter liderliğe yol açmıştır. Diğer yandan, bu tarz bir sistem her ne kadar politik yaşama daha fazla kargaşa getirirse de başkan ve başbakan arasındaki denge ve işbirliğini korumayı amaçlamaktadır. Hükümet ile başkan arasındaki işbirliğinin doğası reformlar yönünde birleşme olduğu kadar (Poroshenko-Yatseniuk) enerji sektörüne tamamen birbirinden farklı yaklaşımlara da (Yushchenko-Tymoshenko) neden olabilir.

Enerji politikalarının belirlenmesi sürecinde liderlik çok kritik bir rol oynamaktadır. Bir başkanın Avrupa yanlısı ya da Rusya yanlısı olması hiç şüphesiz ki yönetimin önceliklerinin şekillenmesini değiştirmektedir. Ayrıca belirtmek gerekir ki, sadece Avrupa yanlısı olmak da, Yushchenko örneğinde olduğu gibi, reformların kabul edilip uygulanacağı anlamına gelmemektedir. Bu durumun yerine, net siyasi istek yapısal reformların kar amacı

894 Korunma konusu ile bahsedilen devlet varlıklarının yolsuzluk aracılığı ile dağıtım ve yeniden dağıtımudur.

güden araçların eliminasyonu ile uygulanmasında sonuç ve son derece gelişmiş enerji içinde mevcut dengeye değişiklik getirebilecektir. (Poroshenko'nun başkanlık dönemi).

Her ne kadar enerji sektöründe Yushchenko, Yanukovych ve Poroshenko dönemlerinde reformlar görülse dahi, kanunlaştırma ve uygulama arasındaki boşluk sadece son başkanlık döneminde azalma eğilimi göstermiştir. Yasal düzenlemelerin kanunlaştırılması IMF, EBRD gibi uluslararası finansal kurumlarla olan müzakerelerde pazarlık kozu olarak kullanılmıştır. Bu yüzden, düzenlemenin kanunlaştırılması mali yardım alabilmek için önemli bir şarttır ve bir çok durumda hükümetler tarafından reddedilmiştir. Bu eğilim, sivil toplumun daha geniş bir çerçevede dahil olması ve uygulamanın daha yakın izlenmesi çerçevesinde Poroshenko başkanlığı döneminde değişiklik göstermiştir.

Enerji politikası oluşturma konusunda en önemli ulusal faktörlerden biri de faiz artikülatörlerinin bu sürece dahil olmalarıdır. Gerçekten de bu tez, oligarkların yakın iletişimde oldukları kişileri yüksek pozisyonlara getirme yöntemi ile karar alma süreçlerini etkileme eğiliminde olduğunu göstermektedir. Bu uygulama bazı çıkar gruplarının menfaatlerinin korunmasına yönelik lobicilik faaliyetlerini içermektedir. Böylelikle gerçekleştirilen reformların çıkar grupların menfaatlerinin etkilenmemesi ya da yeni alınan kararların çıkar gruplarının menfaatlerine uygun olması hedeflenmektedir. Kuchma, Yushchenko ve Yanukovych dönemlerinde ortaya çıkan gaz sektöründeki araçların elimine edilmesi hiç şüphesiz ki doğru bir adımdır, fakat yolsuzluk tüm devlet kademesinde elimine edilmeden bu adımlar tam olarak sonuç vermeyecek, dahası çıkar gruplarının manüpülasyonuna açık hale gelecektir.

Enerji kaynaklarını çeşitlendirme çabaları gerçek fonların tahsisi olmadan sadece içi boş bildirimlerden ileri gidememektedir. Ana aktörlerden gelen ciddi destek ile birlikte çeşitlendirme çabaları uygulama alanı bulabilmiştir. AB tarafından desteklenen bu çeşitlendirme projeleri birincil önceliği olan inşa etme amacını taşımaktadır. İç politikadaki istikrarsızlığa rağmen inşa etme amacının değişmemesi gerekmektedir ki Odesa-Brody boru hattı örneği çeşitlendirme karşıtı bir araca dönüşüvermiştir. Şeffaflık ve açık hukuki temeller taahütlerin yerine getirilmesindeki yakın kontrol ve takip enerji çeşitlendirme projelerinde daha fazla uyum sağlayacaktır.

Bunun yanı sıra, Enerji Stratejileri gibi belgelerde yer alan ekonomik, politik ve çevresel boyutların yansımalarının önemi de belirtilmelidir. Enerji Stratejisi ne Yushchenko döneminde olduğu gibi sadece politik doğayı yansıtmalıdır, ne de Yanukovych başkanlığı döneminde Akhmetov örneğinde olduğu gibi sadece çıkar gruplarının menfaatlerini yansıtmalıdır. Bu strateji, gerçekçi bir şekilde sektörün gelişimine yön verecek ve buna

yönelik öngörülerde bulunabilecek tutarlı ekonomik verilere dayanarak belirlenmelidir. Sonraki aşamada birincil ve ikincil mevzuatların uygulanması da yine bu Enerji Stratejisi ile uyumlu olmalıdır.

Buna karşılık uluslararası faktörler ana aktörlerin içeriğini tanımlamaktadır. Enerji stratejisi ve dış politika yaklaşımları işbirliği (ya da işbiriksiz) modellerinin yolunu oluşturmaktadır. Daha önce de belirtildiği üzere Yushchenko'nun başkanlık döneminde Ukrayna ve Rusya'nın sürdürdüğü enerji ve dış politikaları karşıt hedefleri sonrasında çıkar çatışmasına ve iki enerji krizine neden olmuştur. Bu yüzden, zamanında yapılan enerji strateji belgeleri gerekli değişimlerin yapılmasını sağlayacağı ve muhtemel krizlerin önüne geçebileceği için önemlidir.

AB örneğinde olduğu gibi enerji piyasasının işleminde belirli norm ve kuralların ithal kaynağı olan uluslararası aktörler daha da katı koşullar getirmelidirler. Belirsiz koşulluluk hali Yanukovych ve Yushchenko dönemlerinde gözlemlendiği gibi yetersiz sonuçlara neden olmaktadır. AB'nin Ukrayna ile olan enerji arttırımı işbirliğinin hızı ve verimliliği değişiklik göstermektedir. Her ne kadar Enerji Topluluğu ile olan işbirliği Ukrayna açısından yararlı olsa da, yönetmeliklerin caydırıcı ceza olmamasında dolayı zamanında uygulanmaması halen ciddi bir problemdir.

Ukrayna içindeki bazı çıkar gruplarının AB ve Rusya gibi uluslararası aktörler ile olan bağlantısı, bu ülkelerin Ukrayna içinde politika belirleme sürecine alılmışın dışında metodlar ile etki ettiğinin bir göstergesidir. Ukrayna içindeki bağlantılı şirketler aracılığı ile hiç şüphesi ki Rusya farklı çıkarlar peşinde koşan güçlü bir lobi oluşturmuştur. RosUkrEnerg gibi gaz araçlarının AB ile olan bağlantıları, açıkça AB yasal düzenlemeleri içinde bir boşluk oluşturarak kompleks bir uluslararası yolsuzluğa da işaret edebilmektedir.

İki-düzeyleli nedensel ilişki analizi Ukrayna gibi eski Sovyet ülkelerindeki enerji politikalarının karmaşıklığını açıklayabilmektedir. Bu faktörler arasındaki ilişkiler bazı faktörlerin diğerleri üzerindeki etkisinin önemi enerji politikasını şekillendirmektedir. Rusya ile olan işbirliğinin devamı Kuchma'nın enerji marketini Rus şirketlerine açması ve değerli varlıkları daha uygun fiyat için değiş tokuş yapmasına olanak sağlamıştır. Yushchenko dönemindeki ulusal düzeydeki iç çıkar çatışmalarının devamlılığı Moskova'yı Ukrayna'nın transit ülke imajının sarsılması yönünde kullanmasına olanak sağlamıştır. Kişisel zenginleşmenin sürmesi ise Yanukovych'i Rusya'ya yakınlaştırırken Avrupa vektörünün terk edilmesini beraberinde getirmiştir. Donbas'daki savaş ve Kırım'ın ilhakı gibi İç politikadaki kısıtlamaların devamı Poroshenko için reformların hayata geçirilmesi bağlamında itici güç olmuştur. Hiç şüphesiz ki, bu sadece hangi faktörlerin diğerlerinden

daha fazla karar alma sürecini domine ettiğinin basit bir göstergesidir. Her başkan başmüzakereci olarak müzakerelilerin olumlu ya da olumsuz sonuçlarındna sorumludur. Fakat bu çalışmada da belirtildiği gibi başmüzakerecinin tercihlerinde bir çok bileşen bulunmaktadır. Bu bileşenlerden biri de faiz arkitütatörlerinin ve çıkar gruplarının etkisidir ve bu etki de uluslararası özelliğinden dolayı dikkatlice göz önünde bulundurulmalıdır.

Putnam'ın iki-düzeyle oyun yaklaşımı ise başarılı bir çaba olarak değerlendirilmektedir. Bu yaklaşım ile yöneticilerin ve karar vericilerin iki düzeyli müzakerelerinin derinlemesine incelenmesi olanaklı olmuştur. Aynı zamanda bu yaklaşım, bir liderin bir anlaşmayı uygulamasındaki başarısı ya da başarısızlığını, bir anlaşmadan gönüllü ya da zorla çekilmesini, ödemeleri, kazanımları ve kayıpları gibi konuları açıklamaktadır. Enerji politikaalarındaki çift taraflı diplomasi de iki-düzeyle analizine işaret etmektedir. Böylelikle her bölümün sonunda iki-düzeyle yaklaşımı analizi çerçevesinde enerji politikaları analiz edilmektedir.

Kiev'de gerçekleştirilen görüşmelere dayanarak Avrupa Birliği'nin Ukrayna ile olan entegrasyon sürecini daha da derinleştirme planlarının olduğunu söylemek yanlış olmayacaktır. Serbest Ticaret ve Ortaklık Antlaşması imzalanması da bu amacın bir göstergesidir. Bu yüzden, enerji sektöründe gerçekleştirilecek olan reformlar Ukrayna'nın AB standartlarına yaklaşma isteğinin en hayati noktasıdır. AB'nin sadece enerji alanında değil de aynı zamanda dış ilişkilerinde de mevcut olan karmaşık iç yapısı, AB'nin dış ilişkilerdeki etkisini azaltmaktadır. AB kurumları ve hükümetlerinin birleşik ve ortak bir yaklaşım belirleyememeleri, çatışan isteklerin uygulanmasının belli kargaşaya dönüşmesine neden olmaktadır. Bu kargaşa da Ukrayna'daki iç faktörler tarafından yanlış algılanmakta ve ilgili reformların sadece kısmi bir şekilde uygulanmasını beraberinde getirmektedir.

Bu tezin sunum ve savunma aşamasında Ukrayna'da tekrar bir hükümet değişikliği meydana gelmiştir. Bu değişiklik neticesinde yeni taahütlerde bulunan yeni politikacılar iktidara gelmiştir. Ukrayna'da enerji sektörü, bağımsızlıktan günümüze kadar olan dönemde ilk defa Poroshenko döneminde mutlak Rusya'ya bağımlılık ekseninden çıkarak gerçek bir değişim yaşamıştır. Kiev, Rusya ile sürekli bir şekilde şeffaf olmayan anlaşmalar yapan ve yolsuzluklara neden olan, güçlü bir şekilde Rusya-Ukrayna⁸⁹⁵ bütünleşmesi lobisi yapan gaz ticareti araçlarını elimine etmiştir. Fakat tüm bu yapılanlar gerçek bir enerji bağımsızlığı ve enerji sektörünün kalıcı bir vizyona sahip olabilmesi için atılmış ilk adımlardır. Gerçek reform döngüsü yeni başlamıştır ve şimdilik sadece ağırlıklı olarak devlet başkanı ya da

895 Lough, John, Solonenko, Iryna. (April, 2016). Can Ukraine Achieve a Reform Breakthrough? Chatham House, <https://www.chathamhouse.org/sites/files/chathamhouse/publications/research/2016-04-05-ukraine-reform-breakthrough-lough-sononenko-final2.pdf>, p. 19.

hükümetin politika isteğine değil aynı zamanda bazı oligark ve çıkar gruplarının dahiliyetine göre de şekillenmektedir. Uluslararası aktörler, daha katı koşullar getirerek ve mali yardımlar sunarak en nihayetinde Ukrayna örneğinde gerçek ilerlemenin sağlanmasına yardımcı olacaktır. Fakat yolun yarısından dönüp de Ukrayna'nın tekrar Rusya'ya bağımlı hale gelme riski de halihazırda mevcuttur. Bu sebeple, Rusya'nın Ukrayna'yı etkilemek için kullandığı, en önemlilerinden biri Rusya yanlısı lobi, iş grupları ve farklı amaç ve çıkarlar taşıyan araçlar olurken yine basın propagandası ve ticari kısıtlamalar gibi koşulsuz araçlar da yine göz önünde bulundurulmalıdır.

Sonuç olarak, Ukrayna-Rusya ilişkilerinde belirli çıkar gruplarının uluslararası boyutunun ayrı bir akademik çalışmanın konusu olabileceği değerlendirilmektedir. Çünkü bu alan ulusal ve uluslararası düzeyde verilen bir çok politik kararın cevaplanmasına yardımcı olacaktır.

Ukrayna'daki enerji sektöründeki gelişmelerin geleceği hakkında diğer faktörleri de göz önünde bulundurmak gerekmektedir. Kırım'ın ilhakı ve hali hazırda Ukrayna'nın doğusunda devam eden savaş Ukrayna'nın enerji bağımsızlığı konusundaki olanaklarını değiştirmiştir. Dahası, Donbas yakınında çatışmalardan etkilenen petrol yatakları ve Karadeniz'in sığ ve derin sularındaki enerji çıkarımları ise enerji bağımsızlığını uzak bir rüya haline getirmektedir. Bağımsızlıktan itibaren enerji sektöründeki potansiyeli önemsiz görüldüğü için sadece çok az bir miktarda yatırım projesinin farkına varılmıştır. Yine de, Kırım'ın tekrar Ukrayna toprak parçası haline gelmesi durumunda Kiev tekrar kendi enerji kaynaklarını geliştirme ve Rusya'dan tamamen bağımsız olma araçlarına erişebilecektir. Halihazırda muhtemel potansiyel çıkarım ulusal gaz çıkarımıdır ve bu alanda ciddi yatırımlara ve Ukrayna'nın batısında petrol yataklarına ihtiyaç vardır. Bu da dış yatırım imkanı olmadan pek mümkün değildir. Fakat LNG devrimi ile Ukrayna ucuz gaz sahibi olabilir ve Rus gazını tamamen bir başka alternatif ile değiştirebilir. Enerji kaynaklarının pahalı politikalarına rağmen Ukrayna halen enerji verimliliği konusunda çeşitli önlemler getirmek ve yenilenebilir enerjinin kullanımını artırıcı önlemler almak durumundadır. Daha istikrarlı bir ekonomi ve daha az politik kargaşa ile Kiev satın alınabilir enerji için endüstriyel yapıların talebini karşılayabilecektir. Bu yüzden, reformlar ne kadar erken getirilirse o kadar erken pozitif sonuçlar elde edilmeye başlanacaktır.

Rusya'nın ise enerjiyi politik bir araç olarak kullanmaktan vazgeçeceğini beklememek gerekmektedir. Fakat Ukrayna'nın gaz alanında Avrupa istikametini çoktan seçtiğini de görmek gerekmektedir. Rusya'nın ise Ukrayna'nın transit ülke etkisini aza indirebilmek adına daha çok alternatif boru hatlarının uygulanmasına odaklanacağını

beklemek gerekmektedir. Halen Ukrayna'da mevcut olan Rusya ile bağlantılı çıkar gruplarının etkisi gözardı edilmemelidir. Bu grupların etkisi sadece enerji alanı ile sınırlı olmayıp karar verme sürecinde etkili olan yüksek pozisyonları da kapsamaktadır. Bu sebeple, ne kadar çok şeffaf düzenlemeler getirildikçe çıkar gruplarının rant arayan ve politikayı etkilemeye çalışan hareket alanları o kadar kısıtlanmış olacaktır.

Avrupa Birliği'nin enerji konusunda kendi üyeleri arasında ortak bir temele ulaşma isteği şüphesiz ki Ukrayna'yı da etkilemektedir. Bazı ülkeler, Enerji Topluluğu'nun düzenlemelerine uyumlu olmaktansa Rusya ile müzakere etmeyi tercih etmektedirler. Bu kırılganlık Gazprom tarafından düzenli bir şekilde kullanılan çıkar çatışmalarına varan boşluklar doğrubilmektedir. Bu yüzden, tamamen liberalleşmiş enerji pazarı en nihayetinde daha şeffaf ve birleşik çerçeveye oturmuş kuralları beraberinde getirecektir. Şimdilik Rusya'nın kendi dominant pozisyonunu korumak adına Enerji Şartı Antlaşması'ndan Moskova'nın çekilmesi ile sonuçlanan paralel kurallar bütünü oluşturma niyetinde olduğu görülmektedir. Enerji liberalleşmesi Rusya için aleyhte bir gelişme olarak kalmaya devam edecektir ve Moskova'nın bu durumun tamamlanmasına karşı daha fazla koşullar oluşturması beklenmektedir. Ukrayna enerjisi pazarının başarılı bir şekilde liberalleşmesi Rusya'dan daha güvenli gaz arzının yanı sıra, aynı zamanda eski Sovyet bölgesinde transit durumunda olan diğer ülkeler için de bir model olarak görülüp uygulanma alanı genişletilebilir.

APPENDIX C

TEZ FOTOKOPİSİ İZİN FORMU

ENSTİTÜ

Fen Bilimleri Enstitüsü

Sosyal Bilimler Enstitüsü

Uygulamalı Matematik Enstitüsü

Enformatik Enstitüsü

Deniz Bilimleri Enstitüsü

YAZARIN

Soyadı : STELMAKH

Adı : ANASTASIYA

Bölümü : ULUSLARARASI İLİŞKİLER

TEZİN ADI: ENERGY POLITICS OF UKRAINE: DOMESTIC AND INTERNATIONAL DIMENSIONS

TEZİN TÜRÜ : Yüksek Lisans Doktora

1. Tezimin tamamından kaynak gösterilmek şartıyla fotokopi alınabilir.
2. Tezimin içindekiler sayfası, özet, indeks sayfalarından ve/veya bir bölümünden kaynak gösterilmek şartıyla fotokopi alınabilir.
3. Tezimden bir (1) yıl süreyle fotokopi alınamaz.

TEZİN KÜTÜPHANEYE TESLİM TARİHİ:

Yazarın imzası: