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Łukasz Lewkowicz, Michał Paszkowski

Slovakia: the game about crude oil supplies from Russia

In Slovakia, a debate has been going on for a long time about the possible imposition on crude oil supply embargo from Russia by the European Union countries. The Slovak government hopes to obtain an appropriate derogation period from these provisions. Technological and infrastructural reasons are indicated as the problem. The project of introducing a special tax on crude oil imports, the purpose of which is to obtain funds from Slovnaft, is highly controversial.

Deliveries and processing of crude oil in a refinery. There is one refinery in Slovakia in Bratislava (throughput of 124,000 barrels per day), which is owned by Slovnaft (a subsidiary of the MOL Group). Currently, the supplies of crude oil to the refinery are carried out only via the Druzhba pipeline, and thus only Russia crude oil (Urals grade) is processed there. Over the years, no other grades were processed in the refinery, and the renovation and modernization works were aimed at increasing the depth of processing. As a result, along with this process, the range of grades, which the plant is currently able to process, it is still more profitable to use crude oil from Russia for this process. Thus, the Bratislava refinery is one of the most modern plants in Central Europe with a high level of the Nelson complexity index (11.5 points). Although the refinery is able to process other (alternative to Urals) grades, it focuses on processing crude oil from Russia, as the yield of the products is the most favorable.

In the context of supplies from alternative sources, it is possible to import crude oil to the plant through the Adria pipeline (400,000 barrels per day in Croatia and 280,000 barrels per day in Hungary) and Šahy-Százhalombatta (120,000 barrels per day), the reloading capacity of which is optimal for this plant (the expansion of the Šahy-Százhalombatta connection took place in 2015, and the ability to diversify sources and directions of supplies which was tested in 2019 during the oil crisis due to the high level of organic chlorides in crude oil from Russia). Thus, the refinery has technological and infrastructural possibilities enabling the import of other types of crude oil.

Despite this, Slovakia asked the EU for a three-year waiver from the embargo on oil imports from Russia. According to Deputy Prime Minister and Minister of Economy Richard Sulík (SaS), Slovakia, like Hungary and the Czech Republic, is in a special situation because, unlike other EU countries, it is not possible to immediately change oil suppliers. According to the deputy prime minister, the problem is the insufficient capacity of the Adria pipeline, and the change of technology at the Slovnaft refinery, related to the supply of a different type of crude oil, will require time and financial outlays. Prime Minister Eduard Heger (OĽaNO), who is a supporter of EU unity in the field of energy sanctions against Russia, proposed shortening the derogation period for Slovakia to two years. However, representatives of the government coalition with SaS and Sme Rodina are sceptical about this proposal and emphasize that Slovnaft will not be technically able to cut itself off from Russian oil at this time.

New oil tax from Russia. On May 18, 2022, the Slovak government approved the adoption of a special tax that will be applied to the Bratislava refinery (now the bill will be processed in parliament). It was an original proposal made by Deputy Prime Minister and Minister of Finance Igor Matovič (OĽaNO). The tax rate is to be 30% and will be calculated on the basis of the total volume of processed crude oil and the spread between Urals (Russia) and Brent (UK) grades. The new law is to be temporary and is expected to last until 2024 (or until the big difference between the purchase price and the reference price disappears). It is assumed that the state budget will receive approximately EUR 300 million from the new levy. Deputy Prime Minister Matovič wants to allocate the money thus obtained to finance the so-called anti-inflationary package. In his opinion, Slovnaft will not increase fuel prices after the introduction of additional taxation, and if it did, the state would introduce additional regulations. Moreover, he is convinced that the remaining parties of the government coalition will not oppose the adoption of the new tax in parliament.

The SaS party responsible for economic issues, however, does not agree with the current legislative proposal adopted by the government. Deputy Prime Minister Richard Sulík, along with other members of the

government, on the recommendation of the SaS, were sceptical about the proposal to introduce a new tax, as they believe it will increase fuel prices at stations. At the same time, they did not exercise their right of veto and did not block Igor Matovič's proposal at the stage of inter-ministerial consultations. Richard Sulík, however, did not rule out the veto of the bill on the new tax in parliament.

Advantages and disadvantages of such a solution. According to experts, the introduction of the new tax will have several advantages over the embargo on oil supplies from Russia. It is argued that there will be no immediate supply disruption with potentially negative effects on the Slovak economy and that this will also increase Slovnaft's incentive to seek new suppliers. At the same time, Russia's budgetary revenues will decrease as the Russian side will have to offer its crude oil at an even greater discount in order to remain competitive. In addition, the funds obtained from the new tax can be used, apart from supporting the anti-inflationary package, for some special fund for the reconstruction of Ukraine or for a quick transformation of the energy sector.

There are also noticeable threats related to the adoption of the said tax by the government. The new levy raises primarily legal doubts. In a competitive EU market, introducing a tax for just one company seems illegal and the EU institutions may be reluctant to do so. The second serious problem is the local nature of the new tax solutions. The tax on one refinery will have minimal impact on Russian crude oil exports to EU countries. Taxation of oil from Russia would be effective if it were adopted at EU level.

Conclusions:

• The refinery in Bratislava has adequate technological and infrastructural capabilities enabling the construction of a diversified structure of crude oil supplies. However, for unknown reasons, the government (probably based on the position of Slovnaft / MOL Group that the refinery in Bratislava requires further modernization works and the construction of additional infrastructure connections) indicates the need for a transitional period for importing crude oil from Russia. Taking into account the emerging price discount for the Urals grade, the Bratislava refinery, and thus the MOL Group, would be in an extremely favorable market position. At the same time, the competitiveness of the fuel market in Central Europe would be upset, and PKN ORLEN S.A. would lose the most.

• The project to introduce special taxation on the Bratislava refinery is extremely controversial. According to the draft act, the funds obtained from the tax will not be allocated to the energy transformation, replenishment of strategic reserves or the development of air defence or the reconstruction of Ukraine, but only to finance the government's new social packages. This tendency may lead to devastation of public finances in the future. The new tax may also result in a shortage of Slovnaft funds for further modernization of the Bratislava refinery.

• The introduction of this type of special tax may affect the perception of Slovakia as a country hostile to foreign investors. Under these circumstances, each company could be selectively taxed by the authorities. Taking into account the location of Slovakia in the vicinity of the ongoing military conflict, this may result in a lack of new foreign investments in the longer term or the withdrawal of foreign companies already operating in this country.