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Serbia-Hungary pipeline: a new chapter in energy cooperation

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Serbia has been taking active steps for several months to diversify the sources and directions of crude oil supplies to the country's only operating refinery in Pancevo. Due to sanctions imposed on Russia, the plant is currently unable to import crude oil from that country. However, the government in Belgrade is in favor of building a pipeline linking Serbia and Hungary, through which crude oil would flow only from Russia. The start of construction of the pipeline has primarily an image dimension for Serbia, as it is a step toward independence from crude oil supplies through the Omišalj crude oil terminal and the Adria pipeline. The Hungarian side will definitely benefit more from the construction of the new pipeline.

The essence and purpose of the pipeline. Serbia has one refinery in Pancevo, with a capacity of 96,000 barrels per day (4.8 million tons per year), owned by NIS¹. Crude oil supplies to the refinery are delivered via the Omišalj crude oil terminal (capacity is 600 thousand barrels per day) in Croatia, located on the island of Krk in the Adriatic Sea, and then via the Adria pipeline (transport capacity on this section is about 200 thousand barrels per day). Thus, the guarantor of crude oil supply to the refinery is Croatia through the company JANAF (owner and operator of both the terminal and the pipeline on the territory of the country). As a result of the sanctions, the refinery cannot process crude oil from Russia ("IES Comments," No. 642), as JANAF does not have the capacity to pump such crude oil. Before the outbreak of the war, oil imports from Russia covered about 30% of the refinery's crude requirements, while a large part was imported through the Omišalj crude oil terminal (including from Iraq, from where about 50-60% of the supply came).

There is an agreement in place between the refinery and the Adria pipeline operator to supply Serbia with 6.2 million tons of crude oil through the Omišalj crude oil terminal between January 2023 and December 2024. One of the solutions to help the refinery operate and ensure greater diversification of the directions, but not the sources, of crude oil is Serbia's proposed construction of a pipeline connecting the Serbian and Hungarian pipeline systems (an additional connection of the Adria and Druzhba systems). In early February 2023, Transnafta (Serbia's pipeline operator) announced that it had begun technical talks with the Hungarian side on the construction of the pipeline. The length of the pipeline is expected to be 128 kilometres, and it is to connect the cities of Novi Sad in Serbia and Algyő near Segedin in Hungary. Details of the pipeline's construction are currently unknown, but the Serbian side had previously assumed that the total cost would be about EUR 83 million, of which about EUR 64 million would be on the Serbian side, since the bulk of the 104-kilometer section would be built on Serbian territory.

Serbian side's position. Serbia has been dependent on crude oil supplies for years, as domestic production covers the crude oil needs of the Pancevo refinery by only 20%. Under these conditions, along with the sanctions imposed on Russia, there was concern about the possibility of continuing supplies through the Adria pipeline. Ultimately, the plant does not process crude oil from that country, and thus can continue to use the existing infrastructure. Importantly, a few days before Russia's full-scale aggression, the government in Belgrade came out with an initiative to build a pipeline towards Hungary, and even now, despite the sanctions imposed on Russia, it is not giving up on continuing this project. The source of the commodity, taking into account the specifics of crude oil availability in the region, would be Russia alone. At the same time, the sanctions currently

¹ In contrast, NIS is owned by Gazprom Neft (50%), Gazprom (6.15%), the Serbian government (29.87%) and other shareholders (13.98%).

in force prevent Hungary from acting as a transit country for crude oil supplies from Russia, and thus – if the pipeline were to be built – Russian crude oil could not be transported through it. Thus, from the perspective of the Serbian side, the project has a double significance. First, the purpose of the investment will not be to diversify crude oil supplies, but to try to reduce Croatia's influence on Serbia's energy system. Currently, Serbia is completely dependent on crude oil supplies through a pipeline under the control of the Croatian authorities, with relations between the two countries not being among the best. Secondly, the desire to implement the project may stem from the strategic alliance with Russia and the expectation of a relatively quick end to the Russian-Ukrainian war. Thus, there would then be, at least in theory, the possibility of resuming cooperation with Russia, including at the energy level.

The position of the Hungarian side. Hungary has opposed the imposition of sanctions on the aggressor since the very beginning of the Russian-Ukrainian war, and thus this is one of the common areas of cooperation with Serbia. The agreement on the construction of the pipeline at the political level was signed in October 2022, and the rationale behind the decision on the Hungarian side was to increase energy influence in the region, support Serbia and cooperation with this country in the energy dimension², as well as to serve as a transit state for crude oil supplies to Central Europe. Importantly, the agreement signed by Viktor Orbán and Aleksandar Vučić was supposed to be (and was presented as such) a remedy to "EU sanctions." The effect of these sanctions is that Croatia will not be able to use its existing route for crude oil supplies from Russia (November-December 2022). Under these circumstances, the only solution to ensure alternative supplies of crude oil is to connect the Hungarian and Serbian oil systems.

Conclusions

- In Serbia, there are still signs of the possibility of nationalizing the NIS company, and thus the Pancevo refinery. Such a possibility has been repeatedly mentioned by Aleksandar Vučić. Such a solution is considered rather as a last resort. The option of entrusting MOL of Hungary to act as the refinery operator also comes up in discussions. The debate around the refinery is likely to be accompanied by efforts to provide an alternative route for crude oil supply to the plant.
- Serbia is taking steps primarily to ensure the supply of fuels to the domestic market and, by extension, of crude oil to the Pancevo refinery via the Adria pipeline. The issue raised about the construction of the Serbian-Hungarian pipeline is mainly strategic. The planned infrastructure, due to the potential long duration of its implementation, will enable the supply of crude oil from Russia only after the end of the Russian-Ukrainian war. Both now and in the future – taking into account the existing infrastructure – only crude oil from Russia will be delivered via the pipeline.
- In the event of the nationalization of NIS, the biggest winner could be MOL, which has an extensive network of fuel stations in Serbia (fuel is delivered by river). The company's position in the region would be significantly strengthened if MOL were given the opportunity to serve as the operator of the Pancevo refinery. Then the ability to influence the markets of the Balkan countries and the ability to ensure the availability of fuels – with fluctuating contractual conditions for crude oil (the Adria pipeline or the Druzhba pipeline until the sanctions exceptions are in place) – would be significantly enhanced.
- An important thread in the ongoing work on the construction of the pipeline is the issue of bypassing Croatia. Aleksandar Vučić has repeatedly mentioned that the pipeline would provide an alternative solution to crude oil supplies from the Omišalj crude oil terminal, which would have a real impact on the cost of importing crude oil. However, the construction of the Novi Sad-Algyő pipeline does not represent a quick, viable solution for diversifying the directions of crude oil supplies due to the time required for its construction and the fact that the imported crude oil will only come from Russia.

² Other such examples include the initialling of an agreement in 2022 to store natural gas in Hungary for the benefit of Serbian companies, as well as plans to build a Hungarian-Serbian electricity interconnection by 2028, enabling the supply of electricity from the Paks nuclear power plant in Hungary to Serbia.

- Hungary is trying to look at energy policy in the long term, and therefore hopes that after the end of the Russian-Ukrainian war, EU countries will return to energy cooperation with Russia. Thus, the construction of the pipeline would be beneficial for them in terms of being able to act as a transit state and pump the commodity further south.