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Changes in the European Oil Market. Perspectives for Poland

by Jarosław Ćwiek-Karpowicz and Anna Maria Dyner

Stagnation in European oil refining favours Russian companies interested in downstream investments. Their market position also is going to be improved with the launch of the second part of the Baltic Pipeline System. Although the new pipeline will allow Russia to increase oil exports by sea and to decrease dependence on transit states in Central and Eastern Europe, Poland's bargaining position may not be much worsened due to the increasing chances that Caspian oil will be coming through the Odessa-Brody pipeline.

In the last two months, significant deals were concluded in the European oil market. On 15 October, the state-owned company Rosneft, Russia's biggest oil producer and refiner, agreed to buy PDVSA's stake in a German refining venture for $1.6 billion. On 16 October, Belarusian President Alexander Lukashenko and his Venezuelan counterpart, Hugo Chavez, agreed on an increase in crude oil supplies to 10 million metric tons per year by 2013. Moreover, on 25 October, the Belarusian government reached an agreement with Ukraine to use the Odessa-Brody pipeline for crude oil deliveries from the Pivdenny terminal on the Black Sea to Belarusian refineries. This deal was possible because of the end of crude oil transport through this channel in the reverse by TNK-BP, a Russian private oil company.

Russian Energy Expansion. Rosneft's purchase of refining assets in Germany was a part of Russia's energy strategy aimed at selling to Western markets not only crude oil but also highly processed oil products. The expansion of Russian oil companies in the EU refining sector coincides with that sector's deep stagnation. The economic crisis has reduced the capitalization of many European refineries, mainly due to overcapacity and a decline in demand for oil products, resulting in low margins. Faced with a multitude of challenges, European refineries remain attractive for Russian oil companies suffering from insufficient capacity and seeking refining assets in Europe to boost the value of their crude supplies. In December 2008, Lukoil, the biggest private oil company in Russia, acquired nearly half of the ISAB refinery in Sicily from Italy's ERG and a year later bought 45 percent of the Vlissingen refinery in the Netherlands from Total. In March 2009, Surgutneftegas, a privately-owned company close to the Kremlin, made its debut in Europe: It bought 21 percent of Hungarian MOL from Austria's OMV. Recently, Rosneft's first major asset purchase in Europe allowed the Russian company to gain a 12 percent stake in Germany's largest refinery, Miro in Karlsruhe, about a 19 percent stake in the PCK refinery in Schwedt (which is supplied by Russian oil through the Druzhba pipeline), a 12 percent share of the Bayernoil refinery in Neudstadt and half of the Gelsenkirchen complex. The acquisition increases Rosneft's equity refining capacity by more than 11 million tons a year, gaining an 11-percent share of the German oil-refining market. Moreover, Russian companies' expansion in the EU oil refining market was accelerated by Russian politicians who announced an increase in customs on petroleum products, equalling them with the export duty on crude oil.

In order to provide a direct and cheap supply of crude oil to the EU market, Russian authorities are trying to reduce the country's dependence on transit countries by increasing the importance of their own terminals on the Baltic Sea. The first element of this strategy was the launch of the Baltic Pipeline System (BPS) in December 2001. The project became a commercial success—a new Russian oil terminal in Primorsk reached a capacity of 70 million tons in 2007, which represented at that time one third of the total Russian oil export. In June 2009, Russia began to construct the second trunk line of the system (BPS 2) running from the Unecha junction of the Druzhba pipeline near the Russia-Belarus border to the Ust-Luga terminal on the Gulf of Finland. BPS 2 should be completed by early 2012, while the initial capacity of the pipeline during the first stage will be 30 million tons of oil per year, which later will be upgraded to 50 million tons.

Belarusian Energy Diversification. Apart from intensive activity in the EU refinery market, Russian companies tend to increase their shares in the Belarusian refinery in Mazyr and to take control over the Naftan-Polimir company in Navapolatsk. An agreement signed with Belarus in January 2010 that regulates crude oil delivery issues was aimed at forcing Belarusian authorities to sell their shareholder packages in both enterprises. Although the agreement's unfavourable provisions resulted in a 70 percent decline in Russian crude oil imports and lessened the profitability of both refineries, Belarusian authorities decided not to sell their shares.

The need for maintaining state control over oil companies, which subsidize less profitable sectors of the Belarusian economy, as well as the imminent opening of the BPS 2 pipeline that will bypass the territory of Belarus have forced authorities there to seek other suppliers. In March 2010, Belarus signed a contract with Venezuela for deliveries of 4 million tons of crude oil through the end of 2010, and then prolonged it in October to 2013. In this period, Belarus will be importing 10 million tons of Venezuelan crude oil per year. This required Belarus to launch cooperation with Ukraine, Estonia and Lithuania to receive the shipments of crude oil. Since April, Belarus has imported 880 000 tons on 11 tankers through the Ukrainian port of Odessa, 560 000 tons on seven tankers through the port at Mugga in Estonia and 80 000 tons on one tanker via Klaipeda in Lithuania. In order to minimize transport costs Belarusian authorities started making efforts to replace more expensive rail transport with pipelines. With the declining intensity in exploitation of the Odessa-Brody pipeline by Russian oil companies, Belarusian authorities were able to agree with Ukraine to restore the initially planned direction of oil transport and use the pipeline to transport crude oil from the Pivdenny terminal on the Black Sea to the refinery in Mazyr. Authorities in Minsk are planning to import crude oil from Venezuela through swaps with companies that are operating in the Black Sea region. Acquisition of Caspian (or Russian) crude oil will be beneficial primarily due to lower transportation costs.

Prospects for Poland. In the near future, Russia is going to gain a surplus oil transport capacity, namely due to the BPS 2, which will expand room for it to manoeuvre in conducting its energy-related foreign policy. This situation will change the position of the Naftoport terminal in Gdansk, which will cease to be used by Russia for oil exports. Although the volume of Russian crude oil transported by the Druzhba pipeline to the Central and East European states has decreased in the last few years, it seems unlikely that the whole system will be closed soon. The longest pipeline in Europe certainly will operate; however, Russian companies will be delivering more crude oil to the largest oil refinery in Poland (Plock and Gdansk) and to eastern Germany (Schwedt and Leuna) by tankers using the oil terminals in Gdansk and Rostock.

Although the BPS 2 will weaken the bargaining position of Polish and other Central- and East European refineries against Russian oil suppliers, there is still a chance for a revival of their situation. The return to the original direction of the flow through the Odessa-Brody pipeline not only terminates Russia's monopoly on crude oil supplies to Belarus, but also opens the possibility of bringing Caspian oil to refineries in the Czech Republic, Slovakia and Hungary, and raises the potential for bringing it to refineries in Poland (after a pipeline extension). Access to Caspian oil may increase the competitiveness of Polish oil companies and improve their positions in negotiations with their Russian counterparts, not only on the conditions for the supply of Russian crude oil, but also in terms of a potential for closer cooperation in, for example, oil processing and the distribution of oil products to the European market.