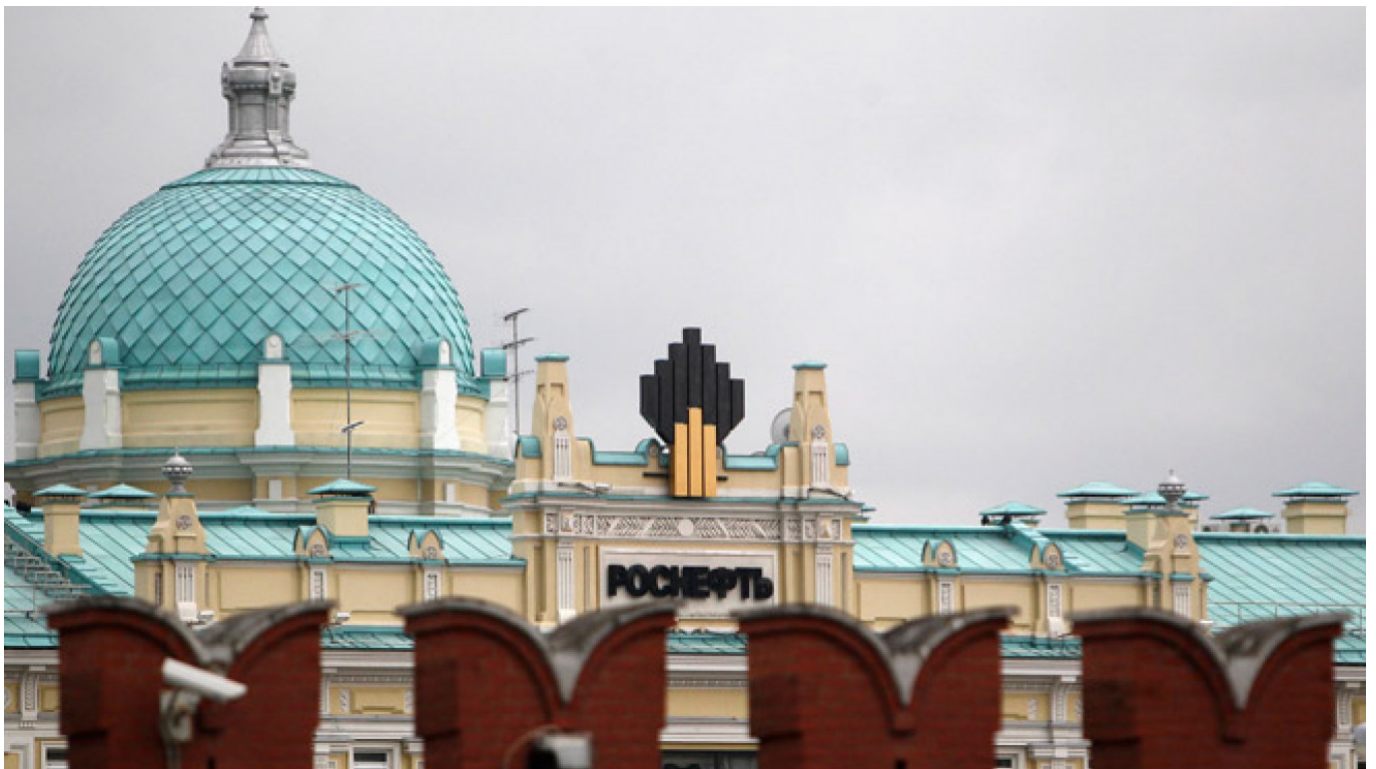


Rosneft Should Extract Russia's Oil, Not Its Cash

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Last week's biggest economic sensation was the news that Rosneft, one of the largest oil companies in the world, had appealed to the Russian government for help. One of their requests, for example, was a soft loan of 1.5 trillion rubles (\$40 billion).

Both the scale and the nature of this request are a bit surprising. First of all, the amount is greater than the federal budget for public health and education combined. And secondly, to an outside observer, the very idea of a nationalized oil company looking for help from the government seems odd.

After all, what was the point of nationalizing Yukos and handing its immense resources to Rosneft (if we don't get into a discussion about personal financial or political gain)?

History shows that the governments of developing countries get more money from nationalized companies than through taxation of private corporations. Governments of developed countries face this problem to a lesser degree; they are more successful at collecting taxes.

But what is the point of nationalization — a difficult and costly process — if as a result the government doesn't have the opportunity to access additional funds from the company in times of need (by lowering the salaries of managers and reducing investment programs, for example) and instead finds itself in the role of a lending institution?

Aside from this specific problem, there is a more general problem with a government lending money to state companies.

Imagine that BP or Exxon borrowed money from the Russian government and then was to repay the loan. The lender would be able to get something in return for its money: collateral (if there was any) or part of the company's assets (shares, perhaps). The fact that the lender will get part of the borrower's assets if the latter doesn't repay the loan is good motivation to do so.

But what will happen if Rosneft doesn't repay its loan to the government? What can the state take if this happens? Nothing, because it already owns the company almost completely. So there is no motivating factor in this case to repay the loan.

But even this "general difficulty" isn't the last or even biggest problem with Rosneft's call for help from the state. The request itself is a sign of the company's effectiveness and stability, and a bad one.

The sanctions causing Rosneft difficulties in managing its own debts are simply part of the world that a large oil company must operate in. For Exxon and BP, dealing with political risks, both within the countries where they work and geopolitically as well, has long been a main, if not the primary, management task.

If Rosneft can't handle its debt in the changing political situation, it means that the company is not optimally structured or appropriately prepared for operating in the market. It's not inconceivable that its size ("the biggest oil company in the world") is excessive.

If so, we should expect proposals from Rosneft as to which assets will be sold off and which expenses will be reduced so that the company can continue to be what it should: an effective and stable cash cow for our country.

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