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Rosneft Deal Is All About Taxes

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Russian leadership apparently favors plans to nationalize TNK-BP.

Once state-owned Rosneft buys out BP and the AAR consortium representing four billionaire co-owners of TNK, the government will gain ownership of assets that are too large for it to manage effectively. Nationalizing just one-half of TNK-BP would have carried serious risks, but swallowing the entire company ensures that there will be problems after the deal is completed.

Why would the government nationalize oil companies? I won't bother to discuss the obvious: namely, that many politicians want to gain greater personal wealth and political power through the control of oil resources.

This motive plays an important role, but when it comes to strategic choice of nationalization, there are other important motives at hand, even if they are not explicitly articulated. As 20th-century history shows, the main reason for nationalizing a company is to enable the authorities to more easily collect taxes from the business. Leaders from Vladimir Lenin to Venezuelan President Hugo Chavez have cited a wide range of reasons for wanting to nationalize companies, but the essential factor is that it allows them to guarantee greater

revenues for the federal budget.

The same results, however, could have been achieved by raising taxes. What is the difference between higher tax revenues collected from private companies and the same amount of money collected from state-owned companies? Taxing private companies is even more cost-efficient because it shifts all of the expenses associated with fighting corruption within the company to its private owners. The only difference when someone in a private company steals from the company and when employees of a state-owned company take kickbacks is that the expense in the case of the state company is borne by taxpayers.

Many governments prefer nationalizing companies for the simple reason that their parliaments, tax authorities and police are too weak or incompetent to collect taxes from private companies efficiently. It is therefore no surprise that most oil nationalization has occurred in developing countries. The U.S., Britain, France and the Netherlands, among others, are quite capable of collecting taxes.

What will happen after Rosneft is nationalized? Gazprom offers a good snapshot of what we can expect. The new, larger Rosneft will bring lots of money into the state budget and allow politicians to channel money to major political projects, but this will result in a nearly complete lack of control over the company's strategy to improve investment, efficiency and productivity.

Perhaps it is good for all Russians that the deal will give BP, a private company, 10 to 20 percent ownership in the new Rosneft. As long as BP continues to earn dividends, the owners of Rosneft will also receive dividends — and this includes every Russian citizen, who is automatically a co-owner of any state-owned asset.

With the goal of maximizing profits, BP will do everything in its power to ensure that the company's money is used wisely — something ordinary Russians would never be able to do on their own.

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