The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

B2B: Russia's Oil & Gas Sector: Avoiding a Toilet Paper Shortage

By Ovanes Oganisyan

October 28, 2013



The MT Conferences section did not involve the reporting or the editorial staff of The Moscow Times.



Ovanes Oganisyan

Analyst
Midlincoln Research

Staking anything at all on success of developing Russia's hydrocarbons sector could lead to a scarcity of toilet paper in Moscow once again.

It's not yet obvious, but developments in the Russian oil & gas sector such as emergence of state oil and gas companies, growing importance of Gazprom and especially of Rosneft could lead to further disbalances in Russian sector economics. What if in 15 years Muscovites will have to cue in lines for toilet paper, just like oil-rich Venezuelans do these days and just like Muscovites had to cue in lines for toilet paper during Andropov's time, at peak of Soviet oil and gas production.

In 1969, the Soviet Union launched Samotlor — huge field in west Siberia with 5 billion tons of reserves. On some accounts, CIA analysts watching Soviet economic development at that time predicted that Russia would make a huge jump in its overall development as Samotlor started producing. They were not aware that the Soviets would soon abandon focus on anything else and would focus mainly on oil and gas. The sector would become a trojan horse for Soviets, who in just 20 years would become another oil exporter alongside Iran, Iraq, Saudi Arabia, Venezuela, Indonesia, etc. ...

At the time, some Soviet policy makers were quite worried about the possibility that the Soviet Union would become an exporter. They were aware of the troubles that faced major oil-exporting countries such as Venezuela, Iran, Iraq and Saudi Arabia. OPEC had already existed since 1960, and exporting countries — OPEC members — were scratching their heads about how to maximize their oil rent.

By 1975, Venezuelan oil minister Juan Pablo Pérez Alfonso, one of the founding fathers of OPEC, called oil "the devil's excrement," saying that "it brings trouble."

He did not refer to the carbon-specific atomic structure, which has 6 electrons, 6 protons

and 6 neutrons (thus bearing the biblical 666 stamp, which some agnostic Soviet communists must have worshipped). He was referring to the trouble that the oil sector creates in an exporter's economy. "Look at this locura — waste, corruption, consumption, our public services falling apart. And debt, debt we shall have for years," Juan Alfonso complained.

Thus, the most cautious Soviets were hinting at problems that reliance on oil and gas could create for Soviet economic experiment. But any of their concerns were addressed with the fact that Soviet Union needed more oil solely for internal use because its other economic sectors needed more energy.

While the growing Soviet economy needed energy, the lobby for Soviet oil and gas exports looked for other ways to maximize oil exports.

The Soviet Union ramped up its oil and gas exports while it tried to face incremental demand in energy needs by building more nuclear electric generation. Soviets were putting in place one or even sometimes two nuclear generating units per year starting from around 1975. The culmination of hectic building of nuclear capacity, that was need in order to address new energy demand and maximize oil and gas exports was Chernobyl.

The origin of Soviet reforms that lead to the development of oil and gas sector go back to 1962 when Soviet economist from Kharkov Evsey Liberman published famous article in Pravda newspaper that highlighted positives for Soviet Union from orienting the economy closer to free market principles. The article was positively highlighted by party central committee and was used by communist bonzes and in particular by Alexey Kosygin to initiate market reforms to create economic system out of Soviet Gulag system that was a slave like system that concentrated solely on investments primarily using slave labor e.g. it was using deferred savings.

With building Avtovaz and launching Samotlor under Kosygin and following some reform of price creating, Soviet Union Gulag system received consumption component as well as net export component and started to look like a more normal economic system, albeit on central planning rather than on supply and demand.

But central planning for an oil exporter just means working out a way to maximize oil rent. The easiest way to grow rent is to grow production. In just 10 years, the Soviet Union's economic system fell victim to the growing importance of oil and gas in its structure. I suspect that it was not the drop in oil prices that killed the Soviet economic structure, it was the overgrown importance of oil and gas sector relative to the other sectors in the economy which created disbalance. Soviets cued in lines for toilet paper downtown Moscow despite oil price was at pick in 1982. Just like Venezuelans are cuing up in lines for toilet paper now when oil price at average maximum levels.

In fact maximization of rent from oil and gas income create more problems and works in hidden mysterious ways to knock down economy.

Dividend rule for State Companies leads to further consolidation of oil and gas sector in Russia.

Take for example introduction of dividend rule for Russian state companies recently. It was

supposed to maximize Russian budget income that can no longer increase its budget revenue from oil and gas taxes as prices plateaued and production stagnated.

But it can be easily imagined that Rosneft will continue its stream of LBOs taking out Surgutneftegas, and Lukoil and even possibly Novatek. Because consolidation of the sector by Rosneft will mean more budget revenue for the state from consolidated state oil company dividends and much less free market in the sector and hence no free market for Russia.

Economic studies are popular with Kharkov academics. In fact the whole concept of the GDP was developed by another man from Soviet Kharkov — Semyon Abramovitch Kuznets, who immigrated to the US after finishing university in Kharkov in the early twenties. Initially, he studied gross product in nominal terms and thought it was the most important measure of comparing national wealth. It is therefore interesting to look at nominal GDP per capita for former Soviet republics in dollars.

The champion here is Estonia, and then the other 2 Baltic republics Latvia and Lithuania which are on par with Russia. Countries which rely on free market and free trade have much more balanced and richer systems then countries that rely on hydrocarbons production. Another example is lagging statistics for per capita nominal wealth of Kazakhstan, Turkmenistan and Azerbaijan despite those countries are producing higher per capita amounts of hydrocarbons.

Higher oil prices are not helping Russians to get any richer than their neighboring former-Soviet Baltic peers Latvia and Lithuania. Those countries don't have any oil and gas resources at all and solely rely on other sectors, free market, competition and increased productivity. Russians remain quite poorer than Estonians in nominal GDP per capita terms.

Maximization of oil and gas rent acts in mysterious ways. Sometimes it leads to wars, to revolutions, dictatorships nationalizations and finally and most importantly — to toilet paper deficits.

The MT Conferences section did not involve the reporting or the editorial staff of The Moscow Times.

Original url:
https://www.themoscowtimes.com/2013/10/28/b2b-russias-oil-gas-sector-avoiding-a-toilet-paper-shortage-a29014