Russia’s National Oil Champion Goes Global

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THE ISSUE

- In 2014 Russia’s national oil champion, Rosneft, was hit by the twin shocks of a global oil price collapse and Western economic sanctions. The company has surprised many in overcoming these constraints and by aggressively expanding its international business.

- Led by Igor Sechin, close associate of Vladimir Putin, Rosneft has begun to venture into the Middle East, Latin America, and Asia. The motivations behind a number of these projects extend beyond a purely commercial basis and are often directly supportive of Russian foreign policy.

- The rapid rise of Rosneft’s international business bears close watching in the context of the overall policy toward Russia.

*The Kremlin is reflected in the polished company plate of the state-controlled Russian oil giant Rosneft at the entrance of the headquarters in Moscow, on May 17, 2011. DMITRY KOSTYUKOV/AFP/Getty Images*
fter the Soviet Union collapsed and Russia was roiled by political and economic chaos, many state-owned assets were privatized based on political connections and corrupt practices. The oil sector was a particularly attractive, but by no means the only, target for these privatizations. By the end of the 1990s, almost all of Russia’s oil production was privately owned. In spite of continued nontransparency, the oil sector began to resemble a competitive market with private investors introducing Western technology, financial accounting, and operating and management practices. It also started to attract major foreign investments. The remaining state oil assets were managed by a sleepy state enterprise named Rosneft that, in spite of its name (Russian Oil), produced less than 5 percent of Russia’s oil.

Today, majority state-owned Rosneft produces almost half of Russia’s oil. Its daily oil production of 4.6 million barrels, according to its last reported quarterly results, is double that of the world’s largest oil company by market capitalization, ExxonMobil, which last reported daily liquids production of 2.3 million barrels. Rosneft’s rapid rise coincided with the rule of Vladimir Putin, who first became president of Russia in 2000. Its production increases were built largely on the backs of controversial acquisitions of assets previously held by private companies such as Yukos, TNK-BP, and Bashneft. Rosneft’s acquisition spree accelerated after Putin’s close associate and Russia’s then-deputy prime minister Igor Sechin became chairman of its board of directors in 2004. Sechin left government in 2012 to take over as Rosneft’s chief executive officer. Rosneft’s board of directors is now chaired by former German chancellor Gerhard Schroeder.

Rosneft’s transformation as Russia’s national oil champion is consistent with Putin’s policy of regaining state control over the commanding heights of the Russian economy, which is more reliant on oil income today than the Soviet Union ever was. Rosneft is Russia’s largest taxpayer and contributed a quarter of government revenue in 2014. Until recently, Rosneft concentrated mainly on consolidating its dominance over the domestic oil patch. It is also Russia’s leading refiner and is increasing natural gas production for direct sales to domestic gas users, producing 67 billion cubic meters in 2016.

In 2014, Russia was hit by the twin shocks of a global oil price collapse and Western economic sanctions enacted after its aggression against Ukraine in the Donbas region and annexation of Crimea. These developments affected Rosneft severely since it involved the value of the commodity it produces and sells and restricted Rosneft’s access to international financing when it was heavily indebted from the aforementioned acquisitions. A normal company might hunker down, repair its balance sheet, and wait for external conditions to improve. Instead Rosneft has done the exact opposite and expanded its international business aggressively.

As part of the 2014 U.S.-led sanction efforts, Igor Sechin, as the leading figure of Russia’s largest petroleum company and his having “shown utter loyalty to Vladimir Putin,” was directly sanctioned. Further Russian sanctions enacted by Congress in 2017 called on the U.S. Department of the Treasury to submit a detailed report on senior political figures, oligarchs, and parastatal entities as determined by their “closeness to the Russian regime and their net worth.” While the unclassified version of the report released to Congress on January 29 included Igor Sechin, the report was poorly received and largely regarded as nothing more than a “rich list” by Russian experts. However, the report also contains classified annexes, including a list of parastatal entities and supporting analysis, which by definition would have included Rosneft.

Although Rosneft’s rapid international expansion is too recent to assess definitely, this paper describes some of Rosneft’s overseas ventures and explores possible motivations, economic and political, behind them.

**IN AMERICA’S BACKYARD**

It is natural for an oil company of Rosneft’s size to diversify overseas in order to spread its geologic, operational, market, and political risks. Some American companies derive a significant portion of their earnings from outside the United States. However, a national oil company also serves national interests, not just its own commercial interests. Some of Rosneft’s international activities started in service to Russian foreign policy, for example, the $4 billion arms-for-oil deal with Venezuela under then-president Hugo Chavez in 2006. Unlike China, Russia and Rosneft do not need oil to supply their domestic market but they know how to dispose of it in order to facilitate the sale of Russian armaments and to advance foreign policy objectives.

With the economic and political turmoil under current president Nicolas Maduro, China and its companies, which are major benefactors of Venezuela, appear to be trying to reduce their financial exposure and have even reached out to Venezuela’s political opposition. By contrast, Rosneft is seizing the opportunity created by Venezuela’s economic implosion to increase its investments. It already holds major stakes in numerous upstream projects and is
looking to acquire more. According to Reuters, Russia and Rosneft have supplied $17 billion in loans and credit lines to Venezuela since 2006. Rosneft alone has made more than $5.7 billion in prepayments to Venezuelan state oil company PdVSA. It even accepted as collateral 49.9 percent of PdVSA’s equity in its U.S. subsidiary Citgo, although it has reportedly sought to exchange that collateral for additional upstream positions in Venezuela. It is reported that Rosneft has been reselling 13 percent of Venezuela’s oil.

These actions are hard to explain on a purely commercial basis. As attractive as Venezuelan oilfields may be, the expected return on investment would have to be astronomical for an average company to justify bearing additional risks in this country. The future of such long-term investments is uncertain under a post-Maduro government. Unlike other international corporations, including Chinese parastatal companies, Rosneft’s approach is the opposite of spreading risks, with an appetite that appears not only to be commercially motivated but supportive of Russian foreign policy. With Venezuela descending further into chaos, and other international actors backing away from the country, the Russian government and Rosneft have helped the Maduro government avoid default and in so doing have assisted Maduro’s regime survival efforts.

Similarly, Rosneft started shipping oil to Cuba in 2017, the first significant supplies from Russia since the end of the Soviet Union. In December 2017, Igor Sechin met in Havana with Cuban president Raul Castro to discuss increased supplies of crude oil and petroleum products and cooperation in oil and gas projects in Cuba, including upgrading the Cienfuegos refinery. Rosneft stepped in and replaced PdVSA for subsidizing the cash-short Cuban economy with fuel at a time when the Trump administration has halted the U.S. rapprochement with Cuba that started under President Obama.

In Brazil, Rosneft assumed a 45 percent stake in 21 oil and gas exploration blocks in the Amazon’s Solimoes river basin when it acquired TNK-BP in 2013. These are the sort of noncore assets a company would typically sell after a major merger in order to pare down debt, lower costs, and concentrate on taking advantage of synergies to improve profitability in core assets. Instead Rosneft moved to acquire the other 55 percent stake in these licenses from Brazilian company PetroRio and drilled its first exploratory well in February 2017. Venturing abroad to spread country risks makes sense for a private company; however, there are different considerations for Russia’s national oil company that was busy consolidating operations at home after major acquisitions of Yukos and TNK-BP. Perhaps this can be explained partly by Sechin’s personal fondness for Lusophone countries as he is a fluent Portuguese speaker from his time serving the Soviet Union in Mozambique and Angola. (In 2015, Rosneft formed a consortium to explore in Mozambique, which was awarded three offshore blocks and negotiations are ongoing to finalize concession agreements.)

While some of Rosneft’s investment activities in Latin America provide potential rewards for the company as an oil producer and trader, in many cases the rationale appears to extend beyond just the commerciality of these projects. This is most notably demonstrated by its activities in Venezuela and Cuba. In particular, its increased level of economic engagement and political support for the Maduro government has seen the Kremlin directly embrace a government that the United States opposes in its own backyard. Such a strategy was long ago deployed by the Soviet Union in backing Cuba, another country that Russia is showing renewed interest in, with Rosneft also supporting these efforts as of late.
war and the fight against the Islamic State. Less noticed perhaps has been the commercial inroads Rosneft has made in the Middle East and North Africa.

We had written elsewhere about the growing cooperation, in spite of political differences, between Saudi Arabia and Russia. This was necessitated partly by the urgent need, after oil prices collapsed in July 2014, to coordinate production cuts by the largest oil producing countries (other than the United States), under an Organization of the Petroleum Exporting Countries (OPEC)/non-OPEC agreement. This relationship was cemented by the unprecedented visit by Saudi Arabia’s King Salman to Russia in October 2017 and the announcement of a $1 billion joint fund for energy investments. In January 2018, Saudi Arabia’s oil minister Khalid Al-Falih said its oil alliance with Russia will last for “decades and generations.” Rosneft, as Russia’s largest producer, has to bear the brunt of the required cuts to bring Russia to full compliance with the deal.

This, however, does not stop Russia from playing on the other side of the Persian Gulf. One month after King Salman visited Russia, President Putin paid a visit to Iran, during which the National Iranian Oil Company (NIOC) and Rosneft signed a partnership agreement on “strategic projects” worth up to $30 billion. Sechin indicated that specific contracts for developing several oil and gas fields will be finalized within a year and would also involve Rosneft as the off-taker in Russia’s oil-for-goods deal with Iran amounting to 100 thousand barrels per day. Meanwhile Russia has gained access to an Iranian air base and appears to be seeking naval access as well.

The Trump administration is threatening to reimpose sanctions against Iran and Western oil companies are approaching new oil deals with caution, much to the frustration of Iran. NIOC has been unable to develop many of the giant fields discovered in the past two decades, including the underdeveloped onshore southwestern area of Arvandan (west of the Karoun River near the Iraqi border) with fields such as Azadegan and the oil layer of the offshore super-giant South Pars gas field. Iran is desperately seeking outside technical and financial resources to develop its hydrocarbon resources. The lack of competition from Western companies gives Russian (and Asian) companies the upper hand in negotiations.

Relationships that begin out of expediency by seemingly strange bedfellows can sometimes grow into more permanent alliances. During Putin’s visit to Tehran in November 2017, Supreme Leader Ayatollah Ali Khamenei told the Russian president that their cooperation in the Middle East could isolate the United States.

In Iraq, Rosneft has pursued opportunities in both the north and south of the divided country. It inherited several oil licenses in southern Iraq, controlled by the central government in Bagdad, from Bashneft after acquiring the company in 2016. Meanwhile, Rosneft signed an agreement with the Kurdistan Regional Government (KRG) to prepay for more than $1 billion-worth of Kurdish oil and lifted its first cargo in April 2017. In the same month, Rosneft began drilling its first exploratory well in Block 12 in the Najaf and Muthanna provinces of southern Iraq.

In September 2017, just before the Kurdistan independence referendum, KRG and Rosneft reached agreement to build a natural gas export pipeline to Turkey, a deal believed to be worth more than $1 billion. The pipeline, with a capacity of 30 billion cubic meters a year, is supposed to be completed by 2019 and commence exports in 2020. After the controversial independence referendum, the Iraqi central government seized previously Kurdish-controlled Kirkuk, including its famed oilfield, and surrounding areas in mid-October. As Iraqi forces rolled into Kirkuk, it was announced that Rosneft had taken a 60 percent controlling stake in the Kurdistan pipeline that feeds into the Kirkuk-Ceyhan pipeline to Turkey and agreed to boost its capacity from 600 to 950 thousand barrels per day. In November, the Iraqi government announced a
tender for a new export pipeline to carry crude oil from the recently seized Kirkuk oilfield to Turkey. Iraqi oil minister Jabar al-Luaibi announced that the pipeline will have a capacity of 300 thousand barrels per day and that dialogue had opened with Rosneft to build it. While none of these difficult pipeline projects may be completed anytime soon, they once again demonstrate Rosneft’s eagerness to become a key player in the reconstruction of the oil and gas industry and to build its political influence in a strategically located region between Syria, Turkey, and Iran. These projects would also solidify Russia’s position as the preeminent energy supplier to Turkey, a NATO ally with whom the United States has had its difficulties recently. Turkey was once closely aligned with Western energy interests in the broader region, including the Caspian. However, Russia is the largest supplier of oil and gas to Turkey and state-owned Rosatom is building Turkey’s first nuclear power plant.

Russia has proved willing to deal simultaneously with opposing sides in a conflict. This is also true in the case of Libya, where it is renewing a previously strong relationship when the country was ruled by Colonel Gadhafi, whose overthrow by Western powers in 2011 is seen by Putin as a betrayal of Russia’s initial cooperation in the U.N. Security Council.

In February 2017, Rosneft signed a crude offtake agreement with Libya’s National Oil Corporation. Russia has increased its support of the commander of the Libyan National Army, Khalifa Haftar, who aligns with the Tobruk-based government in the east. Russia also maintains connections with other Libyan factions, including the Tripoli-based Government of National Accord (GNA) in the west and publicly endorses U.N. efforts to find a peaceful resolution to unite the country. However, Russian foreign minister Lavrov has stipulated that the GNA is not a legitimate actor without the backing of the Tobruk-based government.

In the past, Russia’s activities in Libya were underpinned by multibillion-dollar arms sales paid by oil revenue. Russia sought but failed to build a naval base in Libya under Gadhafi, but its fleet did gain port access to Benghazi. Maintaining its naval base in Syria is a primary objective of Russia’s involvement in its civil war and reentry in Libya would allow Russia to extend its naval presence to the central Mediterranean, where Russia’s lone aircraft carrier recently visited. For Rosneft, Libya holds Africa’s largest oil reserves and enjoys low-cost production. It is also well placed to supply Europe with natural gas through the existing Green Stream pipeline to Italy. There would seem to be a propitious match between Russia’s military interest and Rosneft’s commercial ones.

Another one of Russia’s traditional friends in North Africa and the Middle East is Egypt, the largest Arab country by population. In March 2017, a trading arm of Rosneft signed an agreement to supply 10 cargoes of internationally sourced liquefied natural gas to Egypt. It also purchased Egyptian crude oil for the first time. In October, Rosneft acquired a 30 percent equity stake in the ENI-discovered gas field, Zohr, off the Mediterranean shore of Egypt at a price of $1.125 billion and plans to invest another $2 billion in the next three years to bring the field into production at a rate up to 29 billion cubic meters per year. Russia has increased its military cooperation with Egypt, while U.S. relations with the country have become more circumspect. Rosatom has also concluded a $30 billion agreement to construct a nuclear power plant in Egypt.

Russia at large in the Middle East has demonstrated a striking ability to exert its influence beyond existing alliances that transcend the prevailing divisions in the region by adopting a multivector approach. This is evidenced by Russia’s engagement with various factions in Libya, investment deals made with both the central Iraqi and Kurdistan regional governments, and by maintaining ties with Iran while simultaneously improving those with Sunni Arab Gulf states, such as Saudi Arabia. Russia’s increased involvement in the Middle East has not only come in the
form of military force, as most notably demonstrated by its involvement in Syria, but also economically through the likes of Rosneft’s activities in countries that are desperate for investment in their oil and gas sectors, to help restore and build in many cases the lifeblood of their economies.

IN THE HEART OF OIL DEMAND GROWTH

Rosneft’s ambitions are not limited to upstream exploration and production, but also in downstream refining and marketing. Naturally this focuses on the world’s largest oil importer, China. Rosneft’s direct relationship with China grew from a crude supply deal signed in 2009 for repayment of a $25 billion Chinese loan to build the East Siberia Pacific Ocean pipeline, Russia’s first real attempt to diversify away from dependence on the European market. With the inauguration of the initial line to the Chinese border in 2011 and its extension to the Pacific port of Kozmino, Russia has become China’s largest source of imported crude oil. In 2016, Rosneft supplied 550 thousand barrels per day to the China National Petroleum Company under long-term contracts. For years, the two companies talked about implementing a refinery project in Tianjin. Rosneft has also negotiated cooperation in Russia with Chinese companies, with varying degrees of success. It currently has joint ventures with Sinopec, Beijing Gas, and ChemChina.

Most intriguingly, it was announced in September 2017 that a little-known private Chinese energy and financial services company CEFC will buy 14.2 percent stake in Rosneft for $9.1 billion, which would make it the third-largest shareholder after the Russian state and BP. This is supported by a loan of more than $5 billion by the majority state-owned Russian bank VTB. Rosneft will also supply CEFC with around 240 thousand barrels per day of crude oil for the next five years. Whatever is behind this murky deal, it appears certain that the energy relationship between the world’s largest importing and exporting countries will continue to grow, with Rosneft being a prime mover on the oil side.

However, this has not stopped Rosneft from participating in various offshore exploration and pipeline projects in Vietnam, which has an ongoing dispute with China over territorial claims in the South China Sea; nor has it stopped the Russian government from selling arms to both China and Vietnam.

With rapid economic growth, the oil import requirement of India is rising rapidly just as China’s once did. In August 2017, Rosneft and partners finalized a $13 billion takeover of the Indian refiner Essar Oil, which includes the Vadinar refinery, with a capacity of 400 thousand barrels per day, located in Gujarat, Prime Minister Narendra Modi’s home state. Rosneft has indicated that crude oil from its recent ventures in the Middle East as well as export barrels that it controls from Venezuela could be refined in India.

Similarly, in Indonesia, Rosneft is duplicating its approach in India to capture part of its booming oil demand. It signed a joint-venture agreement with Pertamina, the Indonesian state oil company, to build a refining and petrochemical complex, with a capacity of 300 thousand barrels per day, in the eastern part of Java, the most populous island. If the project proceeds, the Tuban refinery would become Indonesia’s first new refinery since 1994 and help fulfill its government’s ambitious target to more than double its refining capacity by 2020.

It is natural for Rosneft, as Russia’s largest oil producer, to be interested in the fastest-growing oil demand growth region in the world. Given Asia’s increasing strategic importance, its activities also help Russia to diversify its political interests beyond its increasingly troublesome relationship with the West.

CONCLUSION
Among experts on Russia, including most importantly those inside the country, there is consensus that the Russian economy, which has been moribund since 2012 (well before the oil price collapse in 2014), cannot grow in a sustained manner without structural reform. Much-needed reforms include establishing the rule of law, protection of private-property rights, reduction of military spending, investment in infrastructure, improvement in public health and education, and others. Oil and gas volume and price increases, which fueled Russia’s previous post-Soviet growth spurt from 2000 to 2008 during Putin’s first two terms as president, can no longer be relied upon to generate sufficient growth to improve living standards for ordinary Russian citizens. At the peak in 2014, oil and gas represented 70 percent of Russian export earnings and half of all government revenue.

Yet countries, like people, often do what they know best, not necessarily what is needed. Russia is not alone in this way and Russia knows how to do oil and gas. It is the world’s leading exporter of the two commodities combined. Furthermore, under Putin’s system of centralized political and economic decisionmaking, oil and gas do better than other sectors that depend on market competition, efficient use of capital, and innovation. The other sector that can thrive in a centralized system is the defense industry, as well as security forces to enforce state control.

A presidential election is scheduled in Russia for March 19 of this year. Putin is expected to win and serve another six-year term as president. If his policies do not change, we should expect oil and gas to play a central role in the economy and in Russia’s projection of power and influence abroad. Past attention focused on majority state-owned Gazprom and its monopoly control over pipeline gas exports, which gives the Kremlin political and economic leverage in central and eastern Europe and influence in western Europe and northeast Asia in the future. However, gas trade is a blunt instrument as it relies on fixed infrastructure, which tends to commit both buyers and sellers to longer-term codependent relationships. Oil trading is a far more nimble affair, and it is more difficult to sanction a national oil company that has widespread international operations than one that does not, for example, NIOC or PdVSA. Oil and gas exports allow Russia to punch above its economic weight internationally.

In the past three years, we have seen Rosneft jump into the top league of international oil companies (in terms of the scale of its overseas activities), notwithstanding its financial challenges, by working in concert with the Russian government and with the support of state banks. America’s inattentive and reactive foreign policy across recent administrations is an open invitation to other countries to spread their interests globally and Russia is not the only country that has taken note.

We did not attempt to catalog every one of Rosneft’s international activities but tried to illustrate the breadth and depth of its growing ambition. Clearly the Kremlin and Rosneft, led by Igor Sechin, see mutual opportunity and benefit in aggressive overseas expansion. It is too early to assess whether they will succeed in achieving their overlapping objectives. However, it is a development worthy of future monitoring and close examination. There are always execution risks and the danger of overextension in the oil industry, as there are in foreign and security policies as America knows all too well.

In the petroleum industry (as in most industries), the United States has no national champion, relying instead on a competitive marketplace composed of a multitude of small, medium-sized, and large companies. If they operate overseas, these companies do so with very limited government support. This makes it hard for the United States to direct its companies to pursue foreign policy objectives. It is generally a comparative advantage for the companies not to be seen as direct instruments of American foreign policy. This is not the Russian model with state-owned and controlled national champions. Czar Alexander III said Russia has only two allies, its army and navy. For Vladimir Putin, they may well be gas and oil—Gazprom and, more recently, Rosneft the new international oil major.

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