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What Does a State-Run Energy Company Need to Succeed?

Inter-American Dialogue's Latin American Energy Advisor

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Q and A: What Does a State-Run Energy Company Need to Succeed?

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Argentina last week announced it would seize the 51 percent of YPF owned by Repsol, arguing that the company had not invested enough in the country's energy sector development. Meanwhile, the top two contenders for the Mexican presidency have suggested that state-run Pemex should be opened up to private investment, following examples in Brazil and Colombia, to improve productivity. What does it take to make a state energy company succeed? What policies should governments seek to emulate and which should they avoid? Does history stand on the Argentine government's side in YPF's nationalization?

A: Francisco Monaldi, director of the Center on Energy at Instituto de Estudios Superiores de Administración, IESA, in Caracas:

"Governments tend to nationalize oil companies (or expropriate their revenues) when the price of oil is high, significant resources have been found or large investments have been sunk. In the case of Argentina, the first two conditions are met, but not the last one. The country needs massive investment to develop its resources. State-owned companies tend to prevail when investment risks are low and oil is easily extractable, as in developed oil basins. However, when risks are significant, in frontier developments (e.g., deep off-shore or unconventional) or in the exploration of new basins, state-owned companies are usually not able, or willing, to assume the high risks involved by themselves. In Mexico, production has been declining and significant investments with high risks are needed, while Pemex has been over-milked for decades. As a result, there is a need to attract private capital to make Pemex financially sound, share the investment risks and obtain know-how. All these objectives would be advanced by having some private investment in Pemex. Likewise, Mexico requires an institutional framework that gives financial autonomy to Pemex, improves accountability and allows it to partner with IOCs. The way nationalization is being implemented in Argentina will not help to generate credibility. However, in the future, having the advantage of high oil prices, a more credible institutional framework, the presence of private shareholders in YPF and new joint-ventures with IOCs could help Argentina develop its significant resources. State-private alliances can be an effective way to develop the energy sector."

A: Jeremy Martin, director of the energy program at the Institute of the Americas:

"Depart our hemisphere and head to the North Sea for a helpful case study: Norway. The 'Norwegian Model,' far from perfect, does offer insights for hydrocarbon policy administration and fiscal management. Most useful are the guideposts established by clear delineations of state control, a well-defined role for the national oil company in economic and natural resource development and the importance of competition and private participation.Norway's ability to separate commercial, regulatory and policy functions across its oil sector—and to tweak those areas when necessary, including the partial privatization of national oil company Statoil in 2001—is highly touted. A framework for fiscal management and control of its natural resource development balanced against government's normal desire to maximize revenue is also quite relevant. In sum, Norway controls its own oil destiny but with a successful state-owned firm open to private investment, partnership and competition. Per a Stanford University analysis: among its state-owned peers, Statoil is perhaps the most similar to an international oil company in governance, business strategy and performance. Turning to Argentina, the energy story is far greater than merely the Repsol gambit. The lack of a national energy strategy and distorted market combined with a confrontational stance toward private firms does not bode well for the nation's energy future. But a unique ingredient and wrinkle for the Argentine energy equation is the nation's apparent unconventional resource bonanza. An Energy Information Administration report placed Argentina first in Latin America in terms of possible unconventional hydrocarbon resources. None other than Repsol underscored the potential with the huge Vaca Muerta discovery. As last seen in Venezuela, vast resources can make for interesting dances on the heads of nationalism pins."

A: Francisco Ebeling Barros, member of the board of Economics and Energy Policy of the Brazilian Institute of Oil, Gas and Biofuels in Rio de Janeiro:

"The discussion about the pertinence of the recently approved nationalization of YPF assumed very ideological tones. In this debate, names as important as the writer Mario Vargas Llosa and Brazilian economist Luiz Carlos Bresser-Pereira delivered their opinions; the latter against and the former supporting Argentina's claim. One party argues that this is an unacceptable return to an archaic statist model; the other one claims that, in the context of a return to state-led development strategies, it is the best answer. In this sense, an important question to be answered is whether the excuse for nationalization—low E&P investments made by Repsol—was the result of a low fuel price policy imposed by the Argentine government or of the excessive profit remittances practiced by the company. Looking beyond those ideological quarrels, two important issues are at stake. On the one hand, the act of nationalizing a company of strategic interest such as YPF is the state's indisputable right. Further, Argentina's claim of expropriation without compensation can be acceptable if Repsol, in the years that it had control of YPF, was able to earn sufficient profits to offset the initial capital invested. The other issue is whether Argentina, after nationalizing the company, has the necessary resources to augment its oil production. Given that the hidden motive for nationalizing the company could have been Repsol's plans of selling YPF to the Chinese, one might consider that there is a new BRICs investments circuit which neoliberal wisdom has not yet grasped."

A: Jed Bailey, managing partner at Energy Narrative:

"In order to succeed, any company—regardless of ownership or industry—must invest its resources to produce goods or services that can be sold for a profit that is greater than the company's cost of capital. Competition, in turn, puts a cap on profitability and forces companies to continually innovate to improve productivity. For oil producers, critical skills include the ability to successfully find oil, manage the cost and logistics of producing it and negotiate the terms of its sale to refiners or the final consumer. There is no inherent reason that a state-owned company would be less able to do these tasks than a privately-held company. In practice, however, state-owned companies tend to face greater pressure to invest or operate in ways that sacrifice profit maximization in favor of other objectives, such as supporting greater employment or providing energy at subsidized rates. State-owned companies also often operate as a monopoly, reducing the external pressure to continually improve or reduce costs. State-owned oil companies that can avoid these traps—that is, those that are insulated from political interference and that operate in a competitive environment—tend to be the most successful."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*