The decline of the Venezuelan oil industry

Venezuelan President Hugo Chávez. Photo: Carlos Cazalis/Corbis

President Hugo Chávez's oil nationalism is wreaking havoc on Venezuela's oil industry. Oil production has stagnated and threatens to decline even further. But Chávez has one last ace up his sleeve: the oil sands in Orinoco, that harbour more oil than Saudi Arabia.

by Rudolf ten Hoedt

PDVSA, Venezuela's national oil company, is in a sorry state. This state enterprise, that controls virtually all oil and gas production in Venezuela, is facing major problems. In Lake Maracaibo, traditionally the centre of oil exploitation in the north-west of the country, there is more oil spillage than ever before due to deferred maintenance of oil and gas pipelines. Drilling installations regularly catch fire. The management is incompetent and also exposed to severe political pressure. PDVSA is a political instrument of president Hugo Chávez's socialist revolution. With disastrous results.

'PDVSA is in the middle of a deep crisis', says Gustavo Coronel, a former director of the concern. 'On a financial, executive and technical level. The company could collapse at any moment. The number of active drilling installations currently numbers between 60 and 65 and continues to dwindle, while 120 are needed to keep production up to par. PDVSA is caught in a downward spiral from which there is no easy escape. It could ultimately threaten Venezuela's position as a major oil supplier to the North American market. When Chávez came to power in 1999, Venezuela was America's second largest oil supplier. Now the country is ranked fifth.'

In Latin America a split is emerging in the way national oil companies are run. On the one hand there are partly privatized companies over which the state exercises remote authority. In Brazil this has resulted in an efficient oil company and a booming oil industry. On the other hand there are national oil companies that are completely controlled by the state. Petroleos de Venezuela SA, in short PDVSA, is a prime example. For some time now, the company has no longer concentrated solely on oil production, but also distributes food, builds houses and organizes education and healthcare for the poor. PDVSA has become utterly politicized. The company has become involved in shady international scandals linked to the Chávez regime and its aspirations for regional power. Billions of dollars of company assets are siphoned off and sluiced to a fund over which the president has sole jurisdiction. As a result corporate finances are under mounting pressure. Suppliers are no longer being paid. At the end of 2008, PDVSA's debts had increased to $7.56 billion, twice as much as in 2007.

On May 7 this year, to "solve" the problem, the government nationalized 64 specialized oil service companies that were owed money by PDVSA. In keeping with his populist leadership style, president Chávez put in a surprise appearance at Lake Maracaibo to claim a gas compression complex for the Venezuelan people. This was followed a month later by the annexation by the state of 14 other gas compression companies. Some analysts see proof of acute financial problems in this new wave of nationalizations. Others are convinced it forms part of a pre-determined plan. 'Starting August 2008, the second month after the oil price started to fall from its high of $147 in June, PDVSA stopped paying a lot of contractors', says Fulbright scholar Thomas O'Donnell, affiliated to the Centro de Estudios del Desarrollo at the Universidad Central de Venezuela in Caracas, where he studies the "political economy of oil". 'My suspicion is that there were smart people like the minister of finance [Chávez's trusted aide and ex-OPEC president Ali Rodriguez] who ordered PDVSA to stop paying in order to maximize pressure on these companies and renegotiate contracts. Multinationals also renegotiated contracts. But PDVSA's take on it is much more radical. The more they can control, the better, is how they see it.'

Many doubt if PDVSA has the proper management and the strategic capacity to take over the effective operational management of these nationalized companies. A further decrease in Venezuelan oil production cannot be ruled out. That's bad news for the national production figures that have already suffered severely under PDVSA's decline. When Chávez became president in 1999, Venezuela was producing 3.1 million barrels of oil per day (bpd) compared to an approximate yield of 1.2 million by Brazil. The Venezuelan minister of Energy, Rafael Ramirez has said his country's

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production is still at the 3.1 million mark. But estimates within the industry put it at 2.4 to 2.1 million bpd or even lower. The expanding Brazilian economy has now drawn level and will soon outstrip its neighbour.

RoseAnne Franco, lead analyst for Latin America with the American consultancy PFC Energy, does not foresee a sudden collapse of PDVSA but doubts whether the company can continue to operate much longer in the way it does now. 'It has a full plate, much more than it can chew. As a result there are a lot of shortcomings in the industry right now. There are concerns about whether they are able to maintain production. The path they are on right now, is clearly not sustainable. When prices go up again and the company will manage to work with partners, then PDVSA may be able to muddle through. When prices do not return to $70, PDVSA may get into serious trouble next year.'

Subversive Oil

Humberto Calderón Berti is a well known personality among the old Venezuelan oil elite. The ex-minister for energy and former OPEC president joined the ranks of the opposition in 2000 and is highly critical of Chávez's Bolivarian Revolution. He has become an entrepreneurial outcast in his own country. His oil company Vetra Group is no longer welcome in Venezuela. 'If you don't go along with this government, well, there's no possibility to be in the energy business at all.'

Like many of his professional and social peers, Calderón views the decline of the Venezuelan oil industry with helpless rage. The industry was once 'one of the most important in the world with a high quality workforce', he recalls. Under Calderón's administration the old PDVSA embarked on a strategy of international expansion in the late 1980s. 'We wanted to get direct access to consumers. We bought in the US what later became Citgo and we made a lot of money. The problem with Citgo is that Chávez wants to divest in the US because he is afraid that sooner or later there will be action from the companies that have been expropriated in Venezuela.'

Much to Calderón's annoyance and that of others, Chávez has abandoned the policy of international expansion. The change of direction forms part of PDVSA's radical metamorphosis after Chávez came to power in 1999. The company was founded in 1976 after the nationalization of the oil industry. PDVSA continued the activities of international oil companies (IOCs) like Shell, Chevron, Gulf and Texaco.

The estuary of the Orinoco River, Venezuela. Photo: Yann Arthus-Bertrand/Corbis

During the 1990's a number of these IOCs returned when the oil sector again opened up to private players. That was welcomed by the PDVSA management.

But it was precisely this commercial inclination of the PDVSA management that was seen as a threat by the left-wing team deployed by Chávez in 1999 to assume control of the oil sector. A serious clash was inevitable. When he became president, Chávez had no specific agenda for the oil sector. At least that's the opinion of Bernard Mommer, son of a former German SPD politician, who is often viewed as one of the most important architects of the Venezuelan oil nationalization. In his 2002 essay "Subversive Oil" he writes: 'Chávez (...) had no specific agenda for oil beyond a more or less vaguely formulated commitment to follow a nationalistic approach.'

In his capacity as top energy advisor and later as vice-minister, Mommer, a former researcher at the Oxford Institute for Energy Studies, accused PDVSA of treachery to the national cause and of selling off oil resources to international oil companies. As early as the 1980s, according to Mommer, the management of PDVSA had started 'to develop its own "hidden agenda" to break away from state control'. In December 2002. PDVSA revolted against a series of political appointments and a widespread strike broke out supported by the management. 'It was a reaction against government intervention', says ex-minister Humberto Calderón. 'Chávez appointed as members of the board total enemies of the industry.' But the strike failed. Chávez dismissed half of the 40,000-strong workforce including many executives, managers, technicians and specialized workers. The doors of the beleaguered PDVSA were thrown wide open for followers of the Bolivarian Revolution. 'In PDVSA there is only room for people who are pro-Chávez', said Rafael Ramirez, the new president of the company and also minister of Energy, during a notorious speech before an audience of managers. (Available on YouTube).

Orinoco

Mommer is now governor of the Venezuelan representative body at OPEC and heads a somewhat dubious energy consultancy in Vienna. Ten years of oil nationalism has transformed PDVSA into an unreliable oil company that is used as political instrument. But the Venezuelan government still has a trump card: the delta of the Orinoco river in the east of the country. In an area of 50,000 square kilometres, Miocene sandstone deposits contain enormous amounts of "heavy oil". Government estimates put recoverable reserves at 314 billion barrels. If this is true, Venezuela would surpass Saudi Arabia's reserves of 264 billion barrels. According to Venezuelan authorities, development of these reserves must make it possible to double national oil production to 5.8 million barrels per day.

Taking into account the current state of PDVSA, this ambition amounts to a formidable challenge. In the Orinoco Heavy Oil Belt (Faja del Orinoco) current production totals approximately 850,000 barrels per day at five different sites. Four upgraders are operating to convert the heavy, tar-like oil into lighter synthetic oil. For a year now the Ministry of Energy has been wrestling with the problem of a tender designed to secure new partners for the development of seven new oil fields in the delta and three extra upgraders. This represents an investment of $18 billion. Nearly twenty oil companies have paid $2 million each for the data package giving information about this so-called Carabobo tender. However, no bid has yet been made. After the last postponement at the end of April, a new date has been set for 28 July. But it is uncertain if the tender will go through. 'There is likelihood of another delay', says PFC's Franco.

Up till now foreign concerns have been unresponsive. They are apprehensive about the uncertainty surrounding PDVSA and the role of the state. Under current conditions joint ventures in the Orinoco will be formed with a majority stake of 60% for PDVSA. However, the industry harbours serious doubts about PDVSA's technical and executive ability to manage these joint ventures. Moreover, those involved anticipate that IOCs will be required to put up at least half of PDVSA's share of investments. There are also misgivings regarding fair market competition. 'If the refineries built are owned by PDVSA, these IOCs are worried that they will not be paid a correct price for the oil they deliver', explains researcher Thomas O'Donnell in Caracas. 'Especially given that Venezuela is insisting on bilateral arrangements away from the open markets.' To ease that uncertainty to some degree, Western oil majors insist on international arbitration in the event of conflicts. To date, the Chávez camp refuses to consider this.

Chávez regards the Orinoco as "the last coke in the desert"

Venezuela may well stick to its guns. With the peak oil theory in mind, Chávez regards the Orinoco as "the last coke in the desert". For Western IOCs it's a question of take it or leave it. Minister Ramirez underlined this when he surprised the industry at the beginning of June with the premature allocation of two oil fields included in the Carabobo tender to a Russian consortium of among others Gazprom, Rosneft and Lukoil. That fits in perfectly with president Chávez's aim to become less dependent on the free market, especially the United States, and strike deals with friendly states and NOCs. The deal with the Russians is an enormous boost for Venezuela's self-confidence. Venezuelan oil nationalists are still convinced that, despite the downturn, the Orinoco can help Chávez to drip-feed and revitalize the dehydrated PDVSA. ■