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FEATURED Q&A

Is Venezuela's Entire Oil Sector About to Collapse?

Officials from PDVSA and India's Reliance Industries, a major partner in the massive Jamnagar refining complex, met on Tuesday "to evaluate new business opportunities" and promote technical exchanges on refining processes, PDVSA said in a statement. // Photo: PDVSA.

Q Venezuela's crude production is at its lowest annual average in more than 30 years, as tightened U.S. sanctions continue to squeeze President Nicolás Maduro's budget. State-run oil company PDVSA has reported its oil exports dropped 32 percent in the first half of June, as compared to May, as it struggles to afford equipment, retain employees and contain theft of its infrastructure as the country's hyperinflation continues. Is PDVSA close to collapse? What would its collapse mean for the South American country and foreign oil companies operating there? What will it take to turn the company around, and are the new PDVSA board members and leadership named by Maduro in recent weeks up to the task?

A Francisco J. Monaldi, Baker Institute Fellow in Latin America energy policy at Rice University: "By almost any definition, PDVSA has already collapsed. Production has fallen by 1.2 million barrels per day (b/d) since January 2016 and by 2.1 million b/d from its peak in 1998 (a 62 percent decline). Of the 1.3 million b/d produced, more than 0.8 million b/d do not generate cash-flow: they are committed to repay loans or sold at a massive loss in the domestic market. PDVSA has defaulted on most partners, suppliers and creditors. The recent fall in exports is partly the result of injunctions obtained by Conoco seeking to collect an arbitration award by seizing control of PDVSA's facilities in some Caribbean islands, which are involved in more than 20 percent of its exports. The government has made things worse by giving control over the company to the military and appointing an inexperienced, politically-connected board. Looking forward, the

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Pence, Central American Leaders Meet on Migration

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Argentina to Stay the Course on Economy: Macri

Argentine President Mauricio Macri gathered a small group economic advisors together on Thursday, a day after the Merval stock index in Buenos Aires fell nearly 9 percent.

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Mexicans Head to the Polls Sunday

The head of Mexico's National Electoral Institute, Lorenzo Córdova Vianello, said the July 1 election will be "the most observed in the democratic history of Mexico." Voters are choosing their next president, as well as 500 members of the Chamber of Deputies, 128 members of the Senate and eight governors.

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Córdova // File Photo: @lorenzocordovav via Twitter.

POLITICAL NEWS

Pence Meets With Central American Leaders on Migration

U.S. Vice President Mike Pence on Thursday called on Central American governments to do more to contain illegal immigration because the "need for stronger actions is more urgent than ever," the Associated Press reported. Speaking in Guatemala City to the presidents of Guatemala, Honduras and El Salvador, Pence said that "this exodus has to end ... Just as we respect your borders and your sovereignty, we insist that you respect ours." The comments came as the administration of U.S. President Donald Trump has faced condemnation globally for its now-discontinued "zero tolerance" policy, which resulted in the separation of more than 2,000 children from their families. Pence did not mention the family-separation issue on Thursday. Guatemalan President Jimmy Morales appealed to the United States to consider an immigration reform "in which many of the legal processes and procedures can be done openly," Reuters reported. President Salvador Sánchez Cerén of El Salvador said one of his ministers had confirmed that the minors in the shelters had their basic needs covered, but he emphasized that "it's vital for their psychological health and their emotional health to reunite them immediately with their families." In Ecuador earlier in the day, Pence focused remarks on Venezuela, calling for help to isolate the United States' ideological adversary, socialist President Nicolás Maduro, Reuters reported. "We respectfully urge Ecuador and all of our allies across the region to take steps to further isolate the Maduro regime," Pence said. Maduro replied, saying Pence had "failed on this mini-tour of South America." Ecuadorean President Lenín Moreno said a solution to Venezuela's crisis is ultimately up to its own people, but added that he and Pence agreed to work together in coordination with the Organization of American States to promote citizen rights and fundamental freedoms throughout Latin America, the Associated Press reported.

Mexicans Head to Polls Sunday to Elect a New President

The citizens of Mexico head to the polls Sunday to choose their next president, as well as 500 members of the Chamber of Deputies, 128 members of the Senate and eight governors. The head of Mexico's National Electoral Institute, Lorenzo Córdova Vianello, told reporters Thursday that the July 1 election will be "the most observed in the democratic history of Mexico," El Universal reported. Some 30,000 election observers will be joined by 907 foreign visitors from 60 countries. Nearly half of the volunteers who have agreed to serve as polling station officials belong to the millennial generation, he added. After two failed attempts, Andrés Manuel López Obrador is on the verge of becoming Mexico's next president, according to opinion polls, which show the former Mexico City mayor with a lead of more than 20 percent over his opponents, second-placed Ricardo Anaya of the National Action Party, or PAN, and ruling PRI party candidate José Antonio Meade, running a distant third. Both Meade and Anaya insist the polls are wrong and that each has the party infrastructure needed to win the presidency this year. At his final campaign rally this week, López Obrador promised a "radical" government that would end unearned privilege and stamp out impunity if he wins, CBC reported. "The country will be cleansed," he said on Wednesday to more than 80,000 supporters who turned out at the Azteca Stadium to see him. "It's going to be a peaceful, orderly but deep transformation," he said. Corruption has been among the most prominent issues in the campaign. The country's federal electoral tribunal recently found financial irregularities with at least one candidate, and 14 former and current governors are under investigation for corruption. Violence has also marred the election. Thirty-six candidates have been killed since September, marking the most deadly election season in the country's recent history, The Washington Post reported. [Editor's note: See related **Q&A** in Wednesday's edition of the Advisor.]

NEWS BRIEFS

NII Holdings Looks to Sell Brazil Mobile Phone Assets: Report

Mobile phone service provider NII Holdings has hired Rothschild & Co. to sell control of its Nextel-branded operations in Brazil, Reuters reported Thursday, citing unnamed people with knowledge of the matter. NII holds a 70 percent stake in Nextel Brazil. Potential suitors include Spain's Telefónica and Access Industries, according to the report. Earlier this week, Scandinavian telecoms firm Ice Group sold its 30 percent stake in Nextel to Access Industries for $70 million in cash, TeleGeography reported.

Nike Sales Rise 13 Percent in Latin America, Asia Pacific in Latest Quarter

Oregon-based apparel maker Nike said Thursday that sales in Latin America rose 13 percent in its latest fiscal quarter excluding currency effects, CNBC reported. The company tracks sales in Asia Pacific and Latin America together. The company sold $5.1 billion in footwear, apparel and equipment in the combined regions over the 12 months ending May 31, up 10 percent as compared to the year before, excluding currency effects.

Unemployment in Colombia Ticks Up

Unemployment in Colombia reached 9.7 percent in May, slightly higher than last year's figure of 9.4 percent during the same period, according to a survey released Thursday by the National Administrative Department of Statistics (DANE). However, the survey also registered the highest number of employed people—around 22 million—for the month of May since it implemented the current calculation method in 2001. This hike was driven by the growing employment rate in 13 of Colombia's cities and metropolitan areas, the state-run agency said in a statement.

ECONOMIC NEWS

Argentina to Stay the Course on Economy, Macri Advisors Say

Argentine President Mauricio Macri gathered a small group economic advisors together on Thursday, a day after the Merval stock index in Buenos Aires fell nearly 9 percent, La Nación reported. The group, which included Finance Minister Nicolás Dujovne, Macri's chief of staff, Marcos Peña, and Interior Minister Rogelio Frigerio, among others, discussed potential changes to economic policy but in the end

Macri addressed a group of small business leaders Thursday evening. // Photo: Casa Rosada.

confirmed support for recent steps taken by newly installed central bank chief Luis Caputo, according to the report. "We will avoid reacting every day with measures before each circumstance generated by external factors," a senior official told the newspaper after the meeting. Caputo this week kept the central bank's benchmark interest rate at 40 percent, putting pressure on the government to find new ways to stimulate growth. While the Merval index recovered 3.3 percent in trading Thursday, Argentina's country risk, as measured by JPMorgan, climbed 2.2 percent to 593 points, nearing its highest level since September 2015. Pressure on the peso continued as well, despite a move by the central bank to spend $150 million in reserves to shore up the currency. Administration officials have cited external factors, such as a global emerging market rout in recent months and fallout from the trade dispute between the United States and China, for the falling peso, which has lost a third of its value against the dollar this year, Bloomberg News reported.

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regime and PDVSA face two dramatically divergent paths. The first one requires a macroeconomic adjustment program; debt restructuring; support from the IMF; and massive foreign investment in the oil industry. It would require the cooperation of the U.S. and other Western countries, lifting sanctions in exchange for steps towards re-establishing democracy. The remaining path is one in which oil production continues to collapse; Venezuelan creditors corner the country, trying to seize assets, cargoes and revenue flows; Western companies have a declining role in the oil sector; Russia and China increasingly manage Venezuela's oil exports and reluctantly become the largest operators in the declining oil industry; the country becomes highly politically isolated; and the massive exodus of emigrants to the region continues."

A **David Voght, managing director, and Joel Guedes, corporate finance advisor, both at IPD Latin America:** "IPD's preliminary estimates put Venezuelan crude and condensate production at 1.54 million barrels per day in June 2018, a 30,000 b/d contraction from the previous month. Active rig count has fallen 50 percent since January, to a mere 28. Seven rigs were lost in May alone, foreshadowing further output decline. In just six months, extra heavy oil production has fallen by 130,000 b/d. Lack of diluent for blending and upgrader bottlenecks are to blame. Power outages are commonplace, negatively affecting production nationwide. IPD estimates that more than 30,000 employees have left the oil industry since 2016. Less than 25 percent of PDVSA's current employees hold a university degree, and less than 40 percent have more than 10 years of experience. PDVSA's new board is certainly not qualified to mend the broken industry. But even if it was, the government will not drive structural reforms to the oil sector, much less the overall economy. Barring unmitigated transformation, IPD expects production to fall to 1.2 million b/d by December 2018, a 490,000 b/d decline for the year. A similar 500,000 b/d drop in 2019 would leave the Maduro administration with just 700,000 b/d of production, and scarcely 450,000 b/d available for export. Much of that would go to repay Chinese and Russian loans. One would expect such a scenario to drive change—deep political and economic reform that would allow U.S. sanctions to be lifted, and massive foreign direct investment to flow to the world's largest crude reserves. Otherwise, collapse becomes inevitable, at which point private oil companies may finally have to give up."

A **Asdrúbal Oliveros, director, and Guillermo Arcay, economist, both at Ecoanalítica in Caracas:** "It would be difficult to overstate the consequences of PDVSA's collapse. As of May, PDVSA's average daily oil output has fallen to 1949 levels, and Venezuelan per capita oil output fell to 1927 levels. To contextualize, oil became Venezuela's main export in 1928 when it surpassed coffee and cocoa, two products that now

> **"Although collapse has been substantially gruesome, it is far from over."**
> **— Asdrúbal Oliveros and Guillermo Arcay**

account for less than 1 percent of exports. Additionally, not all oil barrels generate a positive cash flow for the government, because we estimate 338,000 b/d are used for domestic consumption and 395,000 b/d are transferred to China and Russia for debt service, leaving only 659,000 b/d for generating revenue. Although collapse has been substantially gruesome, it is far from over. Since October 2017, the average daily oil output has been shrinking 64,400 barrels

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every month, and 2008's average output of 3.1 million b/d seems like an unrealistic standard to aim for if somehow the industry is properly reformed. If PDVSA wishes to turn around their situation, the company would need to invest in reopening several oil fields, but the corporation's board was reshuffled twice in less than a month, and they have been unable to stop the number of active rigs from falling 44 percent, from 50 to 28 in the first 5 months of 2018. According to our estimates, the number of active rigs that were necessary to maintain May's oil output was approximately 54, and if PDVSA keeps slashing the rig count, their output will follow the trend. If the status quo is maintained, we expect aggregate output to fall below 1 million b/d by the fourth quarter of this year or first quarter of 2019."

A **Antero Alvarado, Venezuela director at Gas Energy Latin America:** "In reference to the industry's collapse, there are some areas more affected than others. There's crisis in some zones; in others, there's chaos. Different problems exist. Undoubtedly, PDVSA's operations alone—that is, without private partners—are the most affected. Fields in the Occidente region and the northern area of Monagas is where production has fallen the most. It is in these areas—where PDVSA operates on its own—that large companies are no longer providing well services. It makes one think that things as simple as a work over are not getting done. No one wants to sell anything to PDVSA, first and foremost because PDVSA makes purchases in local currency and takes several days to actually pay—if it does pay. The company's debt to service businesses surpasses $25 billion. That's why the decrease in production is so dramatic. But production in places where private partners operate has also suffered a lot. Only five of the 40-plus joint ventures have a positive cash flow. It is in these projects that companies like Schlumberger provide their services. The solution will come by paying the pending debt and negotiating PDVSA's majority field operations with its partners. Something like that will come in the short term. Hyperinflation, PDVSA's low wages and sanctions are some of the other difficulties that the energy minister should sort out. In the meantime, investors are waiting for the right moment to enter and buy assets at low prices, betting that this situation will soon end."

A **Gustavo Coronel, a founding board member of PDVSA:** "Although the significant decline of PDVSA's oil production has been accelerated by U.S. sanctions, its primary causes have been corruption and gross managerial incompetence. During the recent OPEC meeting, PDVSA's president, Manuel Quevedo, stated that the company would increase production by 1 million barrels per day during the rest of the year. This is an impossible task to accomplish and illustrates the ignorance and irresponsible behavior of the people running the company. PDVSA has already collapsed, as shown by all of its operational and financial statistics and, in my view, is no longer recoverable. A new legal and operational model will be required to manage what is left of the Venezuelan oil industry, and this will only be possible with a change in government. Such a new model would not need to include a state-owned petroleum company since the nation could obtain optimum benefits by regulating and supervising the development of a Venezuelan oil industry operated by private companies. The PDVSA experience during the last 40 years has shown the progressive loss of efficiency of a state-owned petroleum company due to the fact that politicization is an inevitable process, at least in Venezuela. This has been a tragic lesson for the country and should not be repeated."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

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