

# Oil Market Report – March 2013

When oil producing countries are discussed, it is usually the likes of Saudi Arabia, Iran, Russia, maybe even Nigeria that are mentioned. Affairs in these countries are constantly scrutinised, in case they have an impact on world oil prices. But events in Venezuela – the country with the largest reserves in the world – rarely elicit a mention. Indeed, the recent death of socialist autocrat, Hugo Chavez, barely caused a ripple on world oil markets. Why so?

Firstly let's look at those reserves; Venezuela has accessible oil in the ground that will take a staggering 387 (!) years to exhaust at current production levels. This can be compared to Saudi Arabia with 81 years of reserves and Russia with a worrying (for them) 21. Venezuela is also the longest established oil producer in the world and a country that until 2000, had equal domination (with Saudi Arabia) of the US import market. But despite this pedigree, production in Venezuela is relatively paltry. The country does not even feature in the world's top 10 oil producers and even within the OPEC production league, it is only 6th. Some might say that there is nothing wrong in minimising oil production, whilst maintaining reserves – just look at Norway, who have curbed production for the benefit of future generations. But Venezuela is not Norway and there are 2 main reasons why production in the South American country is so low: geology and politics.

Venezuelan crude – largely found in the Lake Maracaibo basin – is a highly naphthenic and bitumastic type of crude. In layman's terms, this means it naturally produces very little of the commonly consumed grades (diesel, petrol etc) and instead, is best suited to heavy industrial use (petro-chemical, bitumen). In itself this is not a bad thing, as such products often carry a premium above normal crudes. However, uses for this type of crude are limited and so therefore is demand. This problem has historically been solved by sending the bulk of Venezuelan production to the USA, where the refineries have the required sophistication to break down the heavily viscous crude into usable, light-end transport fuel.

So the decision in 2000 by Hugo Chavez to unilaterally cut exports to the USA was a disastrous one and one routed firmly in the political arena. At about the same time, Chavez also decided that the state would not only nationalise privately held assets (mostly belonging to Exxon and Conoco) but furthermore, that he would replace existing staff in PDVSA (the state oil company) with his mates from school, university and the military.

“Bravo” said the domestic and international acolytes. About time someone stood up to the American bully and besides, most of the Executives in PDVSA were corrupt anyway. Maybe true...but only ideologues tend to throw the baby out with the bathwater. By killing foreign investment and axing most of the technical expertise within PDVSA, production plummeted and the company became a byword for inefficiency and cronyism. The Chavez government was unrepentant and PDVSA workers were given a stark choice – either support the President, or lose their jobs. Indeed in 2006, Energy Minister Rafael Ramírez publicly went on record and said “PDVSA is red from top to bottom. PDVSA's workers are with this revolution, and those who aren't should go somewhere else. Go to Miami.” Many did and a great many more simply stayed away and went to work in Brazil or West Africa instead...

Getting hold of accurate figures to demonstrate PDVSA's decline is predictably difficult, but the fact that in the 1970's, Venezuela was producing 3.7m barrels per day (3.7mbpd) and yet by 2010, the country was producing 2.3mbpd tells its own story. This in a period of soaring world oil demand and a profound improvement in production techniques everywhere else in the world. But low production didn't matter when oil prices kept rising and the resultant increased revenues were used as proof of Chavez' successful Bolivarian Revolution! Even more perversely, they were also used as evidence that PDVSA was a world beater.

The conclusion must be that any comparison with Norway is flawed, in more ways than one. Firstly, Venezuela is holding nothing back on the production front – they simply do not have the ability to produce any more. Secondly, unlike Norway which sells its oil at market rates for the

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benefit of their Sovereign Fund, Venezuela subsidises fuel so heavily, that a litre of petrol in Caracas retails at circa 10 pence per litre (Caracas or Crackers?). And the hard truth for those who still shout “Viva la Revolución”, is that the revenue generated by oil has been used on short-term, vote-winning handouts, whilst at the same time, crime has soared (Venezuela’s murder rate is the highest in South America and 4 times that of “notorious” Mexico), infrastructure has crumbled, power cuts blight the cities and shops often do not have the most basic of staple products. Even at the final reckoning, Chavez chose not to seek hospital treatment in his beloved Venezuela, but instead flew to Cuba where “the doctors are better”. Like many zealous socialists before him, perhaps Chavez finally realised the Orwellian truth that “all are equal, but some are more equal than others”....

The death of Ahmadinejad, the Saudi King or even Vladimir Putin, would have the oil markets buzzing one way or another, but Chavez’ end had no such effect. Instead, the man who changed Venezuelan law so that he could interrupt any television programme at any time and who also hosted a live weekly programme (“Alo Presidente”) that sometimes lasted 12 hours, will simply go down as another South American leader who squandered his country’s riches, for his own ends.

