Energy + Power RISK MANAGEMENT

VENEZUELA

By Caitlin Randall

As an Opec member, Venezuela has agreed to this year's oil production cuts. But not everyone in the country is convinced this is a good thing

Damned if they do, damned if they don't

Some high-placed Venezuelans are eager to persuade the government to renege on its commitments to the Organisation of the Petroleum Exporting Countries (Opec). Luis Giusti, president of Venezuela's state oil company Petroleós de Venezuela (PDVSA) says planned cuts will wreck the 1999 budget and derail PDVSA's expansion plans.

At a June Opec meeting, Venezuela agreed, along with other Opec members, to reduce crude oil production for a third time this year. A further 200,000 barrels a day (b/d) off production added to previous cuts of 325,000 b/d earlier in the year. The Opec cuts would bring Venezuela's crude output to 2.84 million b/d.

"I would say Venezuela has no reason to be withdrawing large volumes from the market," Giusti told reporters in Caracas in September. "High prices have done us a lot of harm," he said, referring to Opec's strategy of pushing prices higher by turning down the flow.

Opec compliance, so far, is fairly solid, with the Paris-based International Energy Agency estimating that around 83% of agreed Opec production cuts had been implemented by late September. But, for Venezuela, there has hardly been a more tempting time to ignore the cartel, analysts say. By mid-September, Venezuela said it had reduced production to around 2.9 million b/d and was within reach of its target output levels.

A presidential election is looming in December with oil policy at the centre of the debate. And the linchpin of the country's oil strategy since 1990 – a development plan that would double output by 2006 – looks under threat. Furthermore, a $6 billion drop in oil revenues year-on-year has stirred grumblings from ordinary citizens who fear cutbacks in social spending.

But analysts argue that if Venezuela retreats from oil production cuts or rejects further reductions, it risks forcing a dangerous producer price war and seriously undermining Opec.

"The psychological impact would be very negative. But this is not a decision they are about to make or can afford to make, even if that is PDVSA's brief," says Robert Mabro, head of the UK's Oxford Institute for Energy Studies.

For Ken Miller, a senior principal at Houston-based energy consultants Purvin & Gertz: "Venezuela will continue to cooperate with Opec...If, however, you were to envision a scenario where they abandoned Opec policy, you would initially see a price war and a debilitated Opec...even then there would be an effort made [by remaining members] to balance the market."

Popperfoto/Reuters

Venezuela presidential candidate Hugo Chavez threatens to take the money out of state-owned oil company PDVSA's expansion plan

Miller estimates that Opec needs to cut an additional 500,000 b/d over the next year to rebalance the market so that global supply no longer exceeds demand.

"That works out to 50,000 b/d for Venezuela, which isn't a great deal [given the country's overall crude output]. The market doesn't want the barrels anyway so all talk of ignoring the cuts is really no more than rhetoric," he adds.

For years, Venezuela cut output in pursuit of higher prices. But in 1990, that changed and increasing production capacity became the key. By 1997, Venezuela was producing 3.3 million b/d as it aggressively began grabbing market share, particularly in the US. PDVSA thumbed its nose at the Opec quota system and vowed to hike production to 6 million b/d by 2006.

"Venezuela really is of two minds when it comes to Opec. The government sees itself as a founding member and believes in the cartel. But PDVSA believes it needs to be an aggressive competitor to thrive and production quotas and cuts run counter to that strategy," says Rafael Quijano, managing director of the Washington, DC-based energy consultancy Latin American Petroleum Intelligence Service.

It is, however, PDVSA's market-share approach to oil policy that has come under fire in the run-up to the election. In the early 1990s, PDVSA was able to convince the government and the public that higher production offered more jobs, greater foreign investment and protection against oil price fluctuations.

But with oil prices collapsing, few Venezuelans can muster enthusiasm for a plan aimed at securing more market share. In fact, they blame the programme for much of the country's economic ills and argue that Venezuela's quota-busting over the past few years has helped cause today's glut in worldwide crude supplies. Hugo Chavez, the current presidential front-runner, is eager to play on that sentiment.

He says that while he would respect existing contracts with various oil companies if he won the election, a number violate the constitution and would have to be revised. Exactly what kind of revisions remains unclear.

Chavez also says he will sack the current management at PDVSA and its board of directors and give the government a more direct role in running the company. He threatens to sell off PDVSA's overseas downstream assets and analysts say there is little doubt he would channel money out of PDVSA's $60 billion expansion plan to his own pet social projects. ■