

States of disarray

## Latin America's state-run oil giants are struggling

*The companies are unprepared for the looming energy transition*



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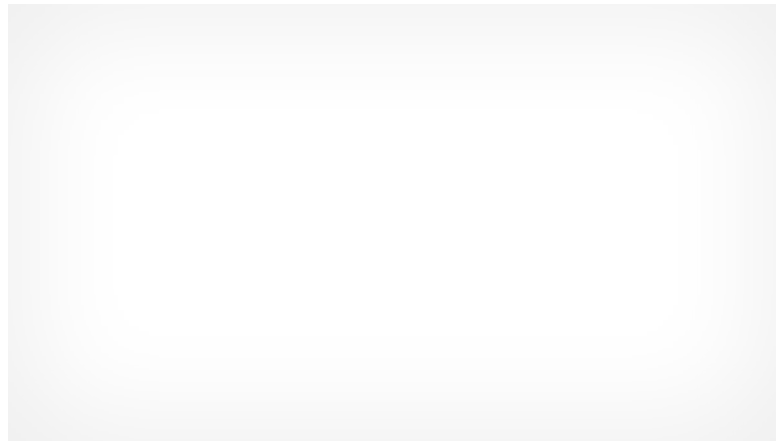
Jul 13th 2019 | BOGOTÁ, CARACAS, MEXICO CITY, QUITO AND SÃO PAULO

**O**IL, IT IS often noted, can bring a country both wealth and woe. In Venezuela, by some measures home to the world's largest proven oil reserves, it has mostly been the latter of late. Petróleos de Venezuela (PDVSA) saw production peak in 1998, when Hugo Chávez was elected president. In the years that followed the left-wing tribune and his authoritarian successor, Nicolás Maduro, purged PDVSA's professional staff, strong-armed its international partners and raided its coffers.

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This uncertainty has added new urgency to the old question of how to maximise the value of crude reserves. Instead of tackling this head on, Latin America's national energy champions—or rather, their political taskmasters—are relitigating debates of yore. Subject firms to political pressures or keep them independent? Invite foreign investment or shun it? Maximise efficiency or create jobs? Subsidise petrol or let prices move with the market? Their responses have, for the most part, been discouraging.

States control about 90% of the world's oil and gas reserves. They do so in different ways, as Latin America illustrates. In Guyana, the region's youngest petrostate, production is about to boom following a discovery in 2015 by ExxonMobil, but the country has yet to create its own oil company. Pemex, by contrast, was founded as a state-owned monopoly in Mexico in 1938. Other countries have both state companies and foreign ones, often in an uneasy partnership. Brazil's state-run giant, Petrobras, listed shares in America in 2000. Its Argentine and Colombian counterparts also have private minority shareholders. In Ecuador the state controls more than 80% of oil output. Perupetro, Peru's firm-cum-regulator, oversees private companies' exploration and production. Venezuela, having opened up its oil sector in the 1990s, in 2006 declared that PDVSA would take majority control of oilfields managed by foreign firms. BP and Chevron were among those that agreed; ExxonMobil and ConocoPhillips packed their bags.

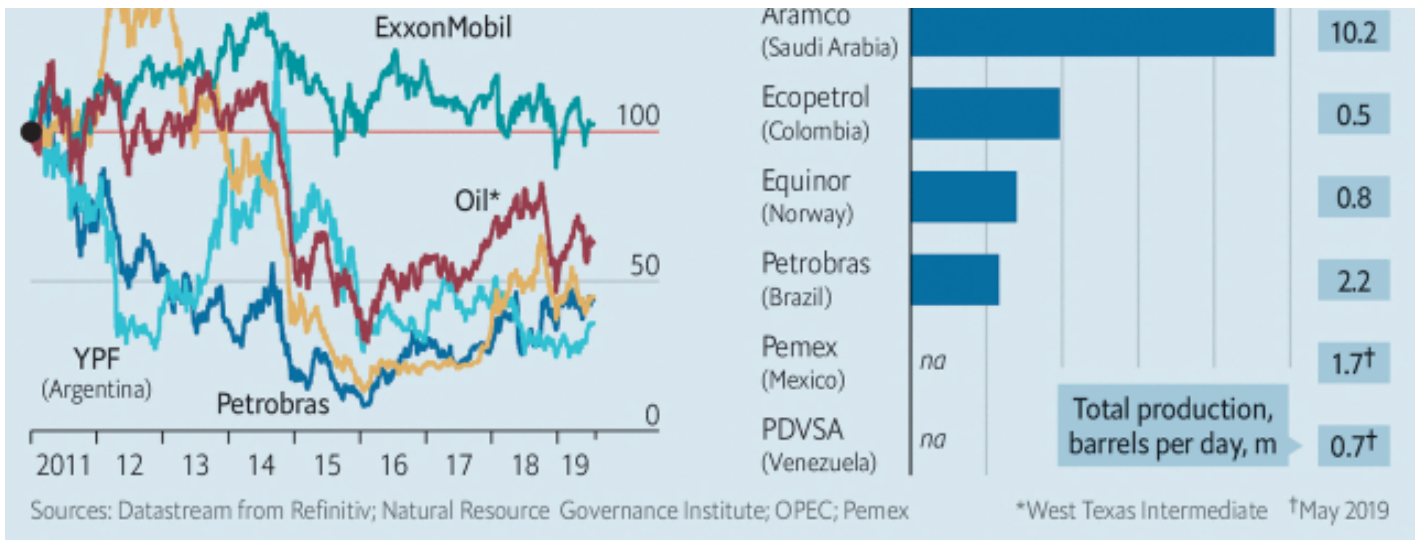
Despite their different corporate forms, most of Latin America's oil giants share three problems in common. The first is mismanagement of cash in good times. That included pouring too much money into government coffers and too little into investment for future growth. In 2013, when the oil price topped \$100 a barrel, Pemex transferred about half of its revenue to Mexico's government. Despite rising crude prices, Petrobras saw its share price decline, as it loaded up on debt and invested in too many marginal projects. As oil prices plummeted, Latin America's oil companies racked up long-term liabilities of more than \$400bn, or 8.5% of their countries' combined GDP, according to data from the Natural Resource Governance Institute, a think-tank. Petrobras accounted for nearly half the total.

Some politicians and executives also used the companies as personal piggy banks—the second common problem. Corruption scandals rocked Petrobras, Petroecuador and Pemex, as well as PDVSA. Petrobras took a particular nosedive when it emerged that construction firms paid Brazilian politicians' millions of dollars in bribes in exchange for padded contracts to

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There are signs the sleaze is being cleaned up in Brazil and elsewhere. Several senior Petrobras executives, and scores of Brazilian politicians, have been prosecuted over the *Petrolão* (“Big Oily”) affair. On July 5th Mexican authorities said they had issued an arrest warrant for Emilio Lozoya, who led Pemex from 2012 to 2016 (and has fled the country). As Lenín Moreno, Ecuador’s president, mops up the mess at Petroecuador, American prosecutors continue to file charges alleging bribery at the company during the tenure of his predecessor, Rafael Correa.

However, companies remain susceptible to political whims—the third and most vexing shared challenge. Start with

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government interference, says one local oil veteran.

### Crisis of abundance

The situation in Mexico, second to Brazil in regional oil production, looks worse. Pemex has been a symbol of sovereignty

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of gas. It had sought foreign partners to jump-start production, but Mr López Obrador has frozen future auctions of exploration sites. Keen to reduce dependence on American fuel imports, he plans to build a refinery in his home state of Tabasco for \$8bn (or more), which may aggravate Pemex's woes, not alleviate them. Mr López Obrador's finance minister has just resigned, apparently in part because he objected to the president's strategy for Pemex (see [article](#)). Further plans for the company are expected this month. JPMorgan Chase, a bank, described an earlier rescue package as worse than underwhelming. Fitch thinks taxes would need to be halved for the company to retain enough cash either to invest in its business or pay down debt. The president's goal of raising crude production by around 50% by 2024, from 1.7m today, looks fanciful.

Latin America's other state oil champions are minnows next to Petrobras and Pemex. But their experiences are nevertheless instructive. In Argentina, the oil industry has been scarred by the decision in 2012 by the then president, Cristina Fernández de Kirchner, to renationalise 51% of YPF, privatised 19 years earlier. Ms Fernández's market-friendly successor, Mauricio Macri, has made it easier for foreign firms to invest in the country.

As it competes with overseas rivals, and forms occasional partnerships with them, YPF is at last beginning to tap Argentina's rich shale deposits in the Vaca Muerta formation in northern Patagonia. But in dollar terms, the company's share price languishes 80% below its peak in 2005. Progress could be undone if Ms Fernández's Peronist ally wins the presidency (the former president herself is currently campaigning as his running mate).

In some ways the region's brightest spot has been Colombia. Álvaro Uribe, president from 2002 to 2010, set about restructuring Ecopetrol. His changes included the creation of an independent regulator and the listing of 11% of Ecopetrol shares, which provided an infusion of capital that helped the company enlist better managers. In 2015 it recruited Felipe Bayón Pardo, a former senior executive at BP, a British oil giant, who became boss in 2017. After the downturn in oil prices at the end of 2014, Ecopetrol slashed spending. When prices ticked up, spending rose, though more slowly than in Mexico. But Ecopetrol's reserves are dwindling. To boost them, it is teaming up with international oil majors and investing \$500m in fracking.

Success is not assured, in Colombia or elsewhere. The International Energy Agency, an intergovernmental forecaster, predicted that Brazilian output would boom last year—yet output dipped as new oilfields were slow to begin production and mature ones fell.

Those concerned about climate change might argue that the region's inefficient state-run firms would do well to return more money to shareholders and invest the rest in cleaner energy. Rivals in other parts of the world are taking tentative steps in that direction. Statoil, Norway's titan, has reinvented itself as Equinor; its portfolio comprises both oil projects and wind farms. Even the world's oil colossus, Saudi Aramco, is making a bet on petrochemicals and refining, demand for which should remain robust even if a global carbon price one day depressed that for crude. Latin American oilmen are too consumed by old challenges to deal with these new ones.

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