Maduro Wrecked Venezuela's Oil Industry; The dictator destroyed a world energy powerhouse. U.S. sanctions will squeeze production even further.

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FULL TEXT

Nicolás Maduro's regime in Venezuela has been waging economic warfare against the country it rules. The result has been an almost unfathomable million-percent inflation rate coupled with near-total social collapse—food shortages, people searching through garbage pails for something to eat, violent crime, lack of medicine, and the breakdown of the health-care system. Three million refugees have fled to neighboring countries.

There are now two competing governments in Caracas. Mr. Maduro's legitimate term ended Jan. 10; Juan Guaidó, president of the National Assembly, is Venezuela's interim president according to the constitution. How the standoff ends will reverberate both for the hemisphere and for the world oil market.

Venezuela has the largest proven oil reserves in the world—larger than Saudi Arabia's—and was for decades one of the powerhouses of world oil production. But Mr. Maduro's policies are making it an increasingly minor producer. Today Venezuela produces only a 10th of what Saudi Arabia does. Last year the U.S. added more new oil production than Venezuela's total output. North Dakota now produces more oil than Venezuela.

The industry has been deteriorating since President Hugo Chávez launched a political takeover of the state oil company, PdVSA, in 2002-03. This led to a drastic fall in investment, a huge exodus of industry professionals, decay in wells and infrastructure, and theft of equipment and materials. Under Mr. Maduro, who took over after Chavez's death in 2013, the decline has accelerated. In 2015, he began to hand control of PdVSA to the military, and in 2017 appointed a general to be both company president and energy minister.

Though the Maduro government is virulently anti-American, the U.S. is the largest potential market for Venezuela's heavy oil. American Gulf Coast refineries are geared with the specialized equipment to process Venezuela's complex quality of crude into gasoline, jet fuel and the other products consumers need.

The sanctions imposed by Washington last week are already severing the main revenue flow to the Maduro regime. U.S. refiners can continue to buy Venezuelan "heavy" until the end of April, with the payments going not to Caracas but into a blocked escrow account. After April the import of Venezuelan oil is prohibited. Given the nonpayment, the Maduro government has stopped exports to the U.S.

Venezuela will try to sell its heavy crude formerly destined for the U.S. to buyers elsewhere in the world, but the regime will find it hard to make up the lost revenue. The U.S. takes about half of Venezuela's total crude. The other main customers are India and China. While China will happily take more Venezuelan oil, it is unlikely to pay cash. Rather, it will use the oil, as it does already, to pay down Venezuela's multibillion-dollar debt to China from its oil-for-loans deals. Meanwhile China is quietly hedging its position by opening channels of communication with the Guaidó government.

Nonetheless, the sanctions on Venezuela may create challenges for U.S. refiners. The bulk of Venezuela's exports are part a global heavy oil market of nine million barrels a day. That market has already tightened because of constraints in Mexico as well as Canada, where the Alberta provincial government curtailed production in December to try to redress a local surplus. The cessation of Venezuelan crude will tighten the market further.

Yet the situation is likely to be manageable. Last week the Alberta government allowed a modest increase in output. Overall, world oil prices—and thus U.S. gasoline prices—will be affected more by such factors as the U.S.-China trade conflict, global economic growth and Mideast geopolitics than by the sanctions on Venezuela. If there is any shortfall in the heavy-oil supply, it can be made up from oil stored in the U.S. government's strategic petroleum reserve.

No one knows how the standoff in Caracas will end. One key factor will be whether the army maintains absolute loyalty to Mr. Maduro's regime or if the rank and file—which endures the same hardships as the rest of the population—wavers if ordered to fire on demonstrators. Mr. Maduro knows his fate lies with the army. He is ostentatiously trying to show that the military is with him—and he with it—by ordering military exercises, showing off its new weaponry, and jogging with troops for the benefit of national television.

If Mr. Maduro prevails, the Venezuelan petroleum industry will continue to decay. By this time next year its production could fall another 30% to 40%. If the National Assembly prevails, then the recovery of the oil industry will be central to restoring the country's economic health. But a recovery wouldn't be guaranteed. It will require investment, technology and the return of talent that has left the country. It will also require another kind of recovery—the restoration of accountability in the Venezuelan government and security for the people of Venezuela.

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Credit: By Daniel Yergin

DETAILS

Subject:	Presidents; Gasoline prices; Petroleum industry; Strategic petroleum reserve; Sanctions; Petroleum production
Business indexing term:	Subject: Gasoline prices Petroleum industry Strategic petroleum reserve Sanctions Petroleum production; Industry: 92111 : Executive Offices
Location:	Mexico; North Dakota; United States--US; Canada; Venezuela; India; Saudi Arabia; China
Company / organization:	Name: IHS Markit; NAICS: 513210, 541512, 541715, 541910
Classification:	92111: Executive Offices
Publication title:	Wall Street Journal (Online); New York, N.Y.
Publication year:	2019
Publication date:	Feb 5, 2019
column:	Commentary (U.S.)
Section:	Opinion
Publisher:	Dow Jones &Company Inc.
Place of publication:	New York, N.Y.

Country of publication:	United States
Publication subject:	Business And Economics
e-ISSN:	25749579
Source type:	Blog, Podcast, or Website
Language of publication:	English
Document type:	News
ProQuest document ID:	2175681495
Document URL:	http://trexler.idm.oclc.org/login?url=https://www.proquest.com/wallstreetjournal/blogs-podcasts-websites/maduro-wrecked-venezuelas-oil-industry-dictator/docview/2175681495/sem-2?accountid=37784
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Last updated:	2025-01-30
Database:	The Wall Street Journal

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