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China, Russia, India, and the Venezuelan Petroleum Industry

PDVSA is increasingly beholden to foreign oil companies to keep up production. Is it sustainable?

Venezuela is in economic crisis: inflation exceeds50 percent, basic goods run short, reserves are dwindling, and the bolívar trades on the black market at almost 11 times the official rate. In this context, the oil sector -which generates over 96 percent of the country's revenues – finds itself stuck between investors cutting their losses, and a group of Chinese, Indian, Russian, and Western firms who are expanding their presence and commitment to the country.

PDVSA headquarters in Maracaibo.

While the decision to stay may reflect a lack of better alternatives, it also implies a hope or faith that PDVSA will grant them greater autonomy, due to its need for continued investment.This autonomy could include allowing them to rationally manage the operations that are, in name, controlled by PDVSA, as well asensuring that they can take delivery on additional oil, as promised, to repay themselves. In the process, those staying hope to emerge with a strategic position in the Venezuelan oil and gas sector, whose 300-500 billion barrels of oil (depending on assumptions about recovery rates) make its reservesthe largest in the world.

China

The role of China in Venezuela includes:(1) loans to the Venezuelan government (a part of whichis for goods and services that support the petroleum sector), (2) direct investments to quantify, develop and exploit oil blocks, (3) loans to PDVSA to cover its share of petroleum joint ventures, (4) augmentation of Venezuelan refinery capacity, and (5) the sale of major assets for future petroleum deliveries, including oil tankers and drilling rigs.

As of December 2013, loans actually disbursed by China Development Bank (CDB) to the Venezuelan government through its development bank Bandes total $36 billion, with $15.4 billion still outstanding.The vehicle, referred to as the "China Fund" includes three separate instruments: the Heavy Investment Fund (HIF) Phase 1, into which CDB has made two injections of $4 billion each, HIF Phase 2, which has similarly received two injections of $4 billion, and the Large Volume fund, disbursed in two "tranches" totaling $20 billion.

Some confusion exists over the price Venezuela received for its oil to repay these loans.The documents establishing the instruments mention a "Reference Price" used to calculate the volume of oil deliveries to repay the loan, based on the low market price for Venezuelan heavy crude when the deals were signed ($50 for HIF Phase 1 and $40 for HIF Phase 2). The actual credit received by Bandes for each barrel of oil delivered against its outstanding loan balance was based on the market price (plus markup) at the time of delivery.

Outside the “China Fund,”CDB has loaned $4 billion to PDVSA to support the joint venture Sinovensa.International Commerce Bank of China (ICBC) has also explored loaning as much as $4 billion in support of projects being worked in Venezuela by the Chinese company CITIC,although no ICBC funds appear to have been disbursed.

The presence of Chinese companies in Venezuela’s oil industry predates the current “Bolivarian Socialist” regime.In 1997, CNPC was awarded rights to exploit the mature Intercampo and Caracoles oilfields.The project was the largest Chinese investment in the Americas at that time. In 2001 CNPC established a joint venture with PDVSA, Sinovensa, to produce a special boiler fuel, Orimulsion, from heavy petroleum extracted from the MPE-3 oilfield in the Orinoco belt region.In 2006, Sinovensa switched to upgrading the extracted product to sell it as oil instead.In 2004, CNPC was awarded another mature field, Zumano, converted to a joint company in 2007 as part of the nationalization of the Venezuelan oil sector.

Production from these mature fields supported the ramp-up in petroleum exports to China, starting in 2005, although the 2008agreement with CNPC to develop Junin-4 (formalized in 2010) grabbed more attention.PDVSA received $900 million from CNPC for the rights to Junin-4, plus the company’s commitment to contribute its 40 percent share of the $16.4 billion estimated to be required to develop the block.

Despite the initial promise, progress on Junin-4 was very slow, with PDVSA lacking the funds to pay for its 60 percent of the infrastructure required to develop the field.Chinese commitments to other joint ventures were also slow to emerge.In 2010, Sinopec was contractedto quantify reserves in Junin 8, yet there was no award for follow-on development, nor progress on the Junin-1 and Boyacá 4 blockswhich PDVSA head Rafael Ramirez announced in 2011 might be awarded to Sinopec.Similarly, in non-associated gas production, although China National Offshore Oil Company (CNOOC) signed a MOU in 2011 to participate in the Mariscal Sucre field, no commitment emerged.

In February 2013, amidst questions about leadership succession in Venezuela, China’s growing reservations led it to defer a request for a new $4 billion loan.By the summer, however, with Xi Jinpeng officially installed as China’s president, and with serious challenges to Nicholas Maduro’s claim to power in Venezuela in the past, China appears to have decided to proceed with new loans to and projects with the regime.In June 2013, CDB agreed to loan $4 billion, outside the China fund, to help the PDVSA-CNPC joint venture Sinovensamore than double production at MPE-3 in a bid to generate more revenue.In September, trips to the PRC, first by Ramirez and subsequently Maduro, led to agreements with Sinopec to develop Junin 1, and to CNPC for Junin 10, giving PDVSA much needed, albeit small, royalty payments.The meetings also produced a commitment by CDB to inject an additional $5 billion to the China fund, although the latter was reportedly a disappointment for Maduro, who was hoping for an even bigger loan with cash not tied to specific projects.

Beyond loans and joint ventures, Chinese support to Venezuela’s petroleum sector includes a $843 million Wilson Energy Services contract to supportthe Puerto la Cruz refinery in eastern Venezuela and CNPC’s construction of a 400,000 barrel per day refinery in Guangdong to process heavy Venezuelan crude.While CNPC is formally partnered with PDVSA on the refinery, it has had to fund the venture on its own, with PDVSA committing to pay its share through future petroleum deliveries.

Finally, Petrochina'sis supplying eight new oil tankers to PDV Marine through the joint company CV Shipping, also paid for through the China fund by Venezuelan oil deliveries. The tankers are important to control PDVSA's freight costs as itships increasing volumes of petroleum across the Pacific to China and India.While the first of such tankers, the Carabobo, never left China following its September 2012 christening in (now scheduled for delivery in May 2014), the second, the 2 million barrel Ayacucho arrived in Anzoátegui in October 2013, andthe third, the Boyacá,overdue as this article went to press.

Russia

As with China, Russia is also making a long-term play for a stake in Venezuela's petroleum sector, although its presence is more modest.Russia's participation was initially spearheaded by a 5-company consortium, comprised of Rosneft, Gasprom, Lukoil, Surgutneftegaz and TNK-BP, which was awarded rights in 2010 to develop the Junin 6block in partnership with PDVSA(forming the joint company Petromiranda).In 2011, the consortium was named to develop the Mariscal Sucre offshore gasfields, while Gazpromwas separately given a contract for the Bachaquero Tierra and Lagunilla Tierra oil fields in the state of Zulia.The driving force behind the Russian initiatives was arguably Igor Sechin, Deputy Prime Minister until 2012, and current Executive Chairman of Rosneft.

Sechin, with close ties to the leftist regimes in both Cuba and Venezuela, assembled the consortium of Russian companies to present a unified front while negotiating with Venezuela on a state-to-state basis, rather than engagingPDVSA as individual companies. The consortium quickly ran into problems.In 2012, Rosneft began the purchase of TNK-BP, while Surgutneftegazpulled out of Venezuela, with Rosneftpicking up stake.More damaging, however, was Lukoil's 2013 decision to withdraw. Within the consortium, Lukoil arguably had the greatest technical knowledge and capability for operating in Venezuela, and its pullout leftRosneft with a difficult challenge to absorb Lukoil's stake and execute the concession.

Despite such problems, Russian companies remaining in Venezuela have decided to continue with PDVSA and "ride out the storm." In November 2013 Gazprom agreed to loan PDVSA $1 billion to help it to bring production on line.At an industry conference the same month, Rosneft committed to invest $65 billion in Venezuela through 2022, although industry experts are doubtful of the credibility of such commitments.

India

The third significant extra-regional actorin Venezuela is India.Its potential participation expanded significantly at the end of 2013, yet its companies have actually committed very little real money.

Indian companies have been participants in the Venezuelan petroleum sector since the 2008 formation of Petroindovenezolana (which included ONGC Videsh) to develop the San Cristobal project in Junin,followed in 2010 by the formation of Petrocarabobo (including ONGC-Videsh and India Oil) to develop Carabobo-1.Indian engagement with PDVSA has also included contracts to purchase oil through Venezuela forReliance and other Indian refineries.

A September 2013 summit in India between PDVSA head Rafael Ramirez and Indian

Energy and Mines Minister VeerappaMoily, followed by the visit of an Indian delegation to Caracas in October, produced multiple new agreementsincluding with Reliance to evaluate theAyacucho-8 block and with ONGC Videsh to evaluate Ayacucho-3.The agreements also included potential work for Essar and Oil Indiaon transportation infrastructure.Also mentioned was the possible expansion of the ONGC Videshinvestmentin Carabobo-1, to pick up the share being abandoned by the Malaysian company Petronas.The Carabobo-1 investment would also potentially include a multi-billion dollar investment in an upgrading facility so that the product extracted from the blockcould be transported to and processed in conventional refineries.Reportedly, Indian companies also continued to be interested in Ayacucho 3 and Boyaca-4 (previously earmarked by PDVSA forthe Chinese company CNPC).

For PDVSA, the pursuitof new concessions with India were arguably motivated byhoped-for royalty paymentsfrom a potential future agreement.For India, possible motivations included controlling more of the oil used to feed its refineries and decreasing direct oil purchases from Iran, although the imperative for the later diminished as Tehran and Washington moved closer to a nuclear deal that could re-legitimize the latter as an international oil producer.India’s initiatives also reportedly were facilitated by itsAmbassador in Caracas,SmitaPurushottam, who had written a graduate thesis while at Harvard on using China as a model for India’s engagement in countries such as Venezuela.

Other Actors

As noted previously, Chinese, Russian and Indian companies are not the only ones who have made the calculation that the best of bad options is to remain in Venezuela and help PDVSAto bring online the oil production that will repay their extra-contractual collaboration.Although Exxon Mobil and Conoco Phillips pulled out years ago, western companies electing to stay for the moment include Chevron, Spain’s Repsol, and Italy’s Eni.Indeed, the estimated $10 billion in loans provided to PDVSA by its partners this year (although some are simply conversion of accounts receivable with PDVSA to debt) includes an announced $2 billion from Chevron, $1.2 billion from Repsol, and $1.5B from Schlumberger.

Conclusions

Looking toward the future, Venezuela experts consulted for this article generally agreethat the country’s present trajectory is unsustainable.Perhaps the greatest cause for hope is suggestions by persons close to PDVSA that the current crisis is forcing a greater role of foreign firms in the operational, financial, and strategic management of joint ventures.

The complex truth is that PDVSA will be able to bring up production in some areas, and address some problems in refining, transportation and other areas.It will not, however, be able to meet all of its increasingly desperate future commitments to its partners, while simultaneously passing enough money to the government and society to stave off public disorder.The calculus of government and industry actors is thus arguably evolving from desperate attempts to save the ship of state to an ugly struggle over “who gets the last lifeboat.” In this game, the only rule is ruthlessness, and competitors and partners alike are the enemy.Someone will eventually end up in control of 300 billion barrels of recoverable oil, even if market developments in other areas like shale gas diminishes their value, and even if, in the process, Venezuela descends into chaos and bloodshed.

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