OIL'S NOT WELL

{ *Kamilia Lahrichi* }

Along with dip in prices, Venezuela is battling the world's fastest growing inflation

As global oil prices have more than halved since 2014 to less than $50/bbl, Venezuela – which has the planet's largest crude reserves with about 300 billion barrels – is trying to halt the financial hemorrhaging.

Crude dropped to a six-year low in August 2015 and the cash-strapped Latin American nation is highly vulnerable to tumbling energy prices.

In the streets of Caracas and other cities, anti-government protests are multiplying, as people lack basic goods, such as medicine, milk, flour, coffee and soap. The economy is mired in a severe recession and suffers from the world's fastest growing inflation. Prices increased by 108% from May 2014 to May 2015, according to Reuters' estimates.

To prevent further deterioration of its economy, President Nicolas Maduro and his Russian counterpart Vladimir Putin "have agreed on some initiatives that will be known when put in place, to achieve stability of the oil market" during a meeting in China on September 3, 2015, the state-owned news agency AVN reported.

In an effort to find a consensus, members of the Organization of Petroleum Exporting Countries, including Caracas and Moscow, indicated that they were keen to discuss "fair and reasonable prices" with other oil-exporting nations. OPEC's 12 members produce 40% of the planet's oil.

Heavy dependence on oil

Just like Russia – one of the world's largest oil producers – the Bolivarian Republic is feeling the pain of over-relying on energy income. According to OPEC figures, the income constitutes 95% of the country's revenue and about 25% of its GDP.

The fall in oil prices and subsequent depletion of foreign reserves are having a severe impact on a country that imports three-quarters of the goods it consumes, from diapers to cars. The foreign reserves of Latin America's largest oil producer hit 12-year lows in June 2015.

Ecoanalitica, a Caracas-based consultancy, found that for every $1 decrease of the average price of oil per barrel a year, Venezuela loses around $700 million in oil revenue annually.

"The drop in oil prices has significantly reduced the Venezuelan state's income in foreign exchange. Based on these scenarios, we should expect a change in monetary policy, namely a devaluation of the national currency against the US dollar," says Carlos Miguel, senior economist at Ecoanalitica in Caracas.

In February 2015, Venezuela launched a new foreign exchange platform – Marginal Currency System or Simadi – to devalue the bolivar (VEF) and bolster the nation's coffers.

The country seems to be teetering on the brink of default. Credit Suisse analysts set out in November 2014 that Venezuela needs to sell its riche at $96.9 per barrel – instead of the current $50 per barrel – to keep paying its debts.

This path would alienate the Bolivarian Republic from the international credit markets it needs to develop its energy deposits.

As a sign of economic distress, Venezuela's Central Bank has not issued official figures on balance of payments since December 2014. Besides, Venezuela cut its subsidised oil program to its Caribbean neighbours in March 2015.

Decrease in petroleum production

Aside from the effect of the oil price slump, crude production has significantly

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decreased – compared to the production peaks of the late 1990s and early 2000s.

Although the country has some of the largest oil reserves on the planet, its production does not reach 3 million barrels per day (mbpd) due to a dearth of investment and human capacity.

Rather than re-investing oil revenues to boost production, the government has diverted the income to social programs.

In 2013, the Latin American state produced 2.49 million barrels per day (bbl/d) of oil. Ecoanalitica found that the 2015 oil production is so far similar to that recorded in 2003 – 2.8 mbpd.

However, fluctuating oil prices have not impacted demand for crude in Venezuela as the government sets the price of gasoline for consumers. It costs 6 cents per gallon at the official exchange rate and about 1/700th of that figure at the black market rate. These are some of the cheapest prices in the world.

In fact, the Latin American nation has the highest oil consumption per capita in the region, according to a March 2015 report titled "How the US Energy Boom is Shaping Latin American Refining Markets" by the Inter-American Dialogue, a policy analysis centre based in Washington DC.

Despite the need to cut spending, President Maduro has ruled out cutting oil subsidies.

The Chinese factor

Venezuela's foreign reserves have slightly recovered thanks to China's loans. Beijing is one of the top crude oil importers. It also has the largest foreign exchange reserves.

In the past 10 years, major Chinese banks, namely CDB, China Eximbank and ICBC, lent over $46 billion to Venezuela in exchange for oil. In June 2015, the Bolivarian Republic secured $5 billion from China to develop crude oil projects.

"There is a high risk of relying completely on the Chinese economy's ability to grow because if there are signs of weakening, the price of a barrel of oil will decrease and so will Venezuela's income," explains Miguel.

In other words, if crude prices drop, the Latin American country will have to export more oil barrels to China – as part of its debt payment. Hence, it will have less oil barrels to sell in the international market.

For instance, Venezuela sent to China only 0.8% of its total oil production per day in 2007 while the figure went up to

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13% to 14% in 2015. "This is a significant increase that has led to a drop in oil available for sale," says Miguel.

Alternative solutions?

The fall in oil prices might impact Venezuela's incentive to look for alternative sources of energy.

The country is one of the largest producers of CO_2 per capita in Latin America, according to WWF International data. It produces about 5.95 tons of CO_2 per capita, which is more than how much Latin American giants Brazil and Argentina pollute – 2.22 tons of CO_2 per capita and 4.59 tons of CO_2 per capita, respectively.

The environmental group indicated that 30% of Venezuela's total CO_2 emissions come from transportation while about 19% is derived from electricity and heat generation.

"The cost of fossil fuels in Venezuela has been maintained at extremely low levels in the last decade. This has generated high subsidies to such fossil fuels, which has made the cost of handling vehicles very small," explains Igor Hernández, Deputy Director at IESA's International Center for Energy and Environment in Caracas. He says that Venezuela's total consumption of gasoline per capita is more than twice that of OPEC countries.

In the end, there are few incentives for private investment in renewable energy because of the high macroeconomic risk and political instability in the Bolivarian Republic.

Also, "the decline in oil prices will not have a significant impact on alternative energy sources, such as wind and solar, because renewable energy sources are used for power generation while oil is used for transportation," says Lisa Viscidi, Director of the Energy, Climate Change and Extractive Industries Program at the Inter-American Dialogue.

She explains that Venezuela has great potential to boost the use of clean energy. It seeks to increase electricity generation from natural gas and renewable energies to meet growing electricity demand and cope with droughts that deplete hydropower reservoirs.

"One impact of lower oil prices is that it will be more difficult for the government to invest in new renewable energy generation infrastructure as lower oil prices mean less revenue for the government," adds Ms. Viscidi.

Yet, the reality is that Venezuela's economic and environmental path is unsustainable, which is why investing in clean energies could prompt the government to usher pricing reforms and phase out subsidies.

"Current slump in oil prices can be a motivation for Venezuela to put its money into alternatives that secure more steady long-term returns and that are more resilient to global energy dynamics," says Tabare Arroyo Curra, Advisor on Energy Economics at the environmental advocacy WWF International Global Climate and Energy Initiative in Mexico. He adds that such investment could boost the Venezuelan economy by generating sources of quality employment.

Clean energies create between 1.5 and 7.9 times more jobs per year per unit of electricity generated (GWh) than fossil fuels, and 1.9 to 3.2 times more jobs per million of US dollars invested, according to WWF International figures.

Curra says that renewable energies could also reduce the Latin American country's budgetary burden, which is due to subsidies.

Fossil fuel subsidies "inflate energy demand at the expense of state revenues; they discourage investments, diminish competitiveness of the private sector over the longer term and create incentives for smuggling," he explains. IFM

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