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Price Slide Spells Difficult Days for South American Oil Producers

by Benjamin Witte-Lebhar

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Plummeting oil prices are causing no shortage of problems for South America's top petroleum producing countries, a list that is headed by Venezuela, home to the world's largest proven crude reserves, but also includes Colombia, Ecuador, and Brazil.

In the past nine months, the price of crude oil has fallen approximately 56%, from nearly US\$115 per barrel in June 2014 to less than US\$50 per barrel as of mid-March. The drop-off is all the more noteworthy given that it follows a relatively stable four-year run when prices hovered around the US \$100 per barrel mark. Prices were higher still in 2008, peaking at a record US\$145 per barrel before temporarily bottoming out as a result of the 2008-2009 global financial crisis.

Steep oil prices may have been a burden for consumers, but they were a boon for countries like Colombia, which took advantage of a concurrent production increase to rake in billions of dollars. Colombian oil output nearly doubled between 2007-2014, from 550,000 barrels per day to 1 million bpd, according to the US Energy Information Administration (EIA).

Communities like Puerto Gaitán, in the central department of Meta, prospered. The town's population tripled, reaching approximately 45,000. The local government, flush with royalty money from the nearby Rubiales oil field, Colombia's largest, built schools, a large library, and a gaudy four-story arch—erected in 2008 at a cost of approximately US\$1 million—called the Puerta al Paraiso (door to paradise). Puerto Gaitán even hosted performances by pop music idols Marc Anthony, a world famous salsa singer, and Daddy Yankee, a Puerto Rican reggaeton star.

Now, though, the boomtown looks to be going bust. "The economy is devastated and everyone is depressed and looking to leave," Lady Rubio, a local bar owner who claims she's gone from selling 300 beers a day to 60, told the Associated Press (AP) in late February. Local union officials told the news agency that 7,000 Rubiales oil-field workers were laid off in just the past few weeks. Nationwide, some 25,000 oil workers—one-quarter of the industry's work force—risk losing their jobs, according to the Ministerio de Trabajo.

Layoffs are only part of the problem. The sudden price plunge also creates a spending conundrum for the government, which receives approximately 15% of its fiscal revenue from the oil industry; has contributed to a currency devaluation (so far this year the Colombian peso has lost 8.5% of its value against the US dollar); and caused stock prices in Ecopetrol, Colombia's publicly traded national oil company, to tank. Given that oil represents half of all export earnings, the low prices are also likely to eat away at the country's overall economic growth rate, which stood at 4.8% last year, according to the UN Economic Commission for Latin America and the Caribbean (ECLAC).

"Colombia is already running a current account deficit," David Rees, an emerging markets analyst, told the British financial magazine Money Week last October. "The loss of export revenues means that imports may need to contract in order to prevent the deficit from widening further. This, in turn, points to a period of weaker economic growth."

Whirlwind of difficulties

The price collapse has been even more damaging for neighboring Venezuela, South America's largest oil producer (approximately 2.5 million bpd) as well as its most-petroleum-dependent country. More than 90% of Venezuela's export earnings come from oil, which also provides half the country's fiscal revenue. Analysts are now wondering if the country is heading toward a default on its growing debts, which are harder to service now that its only real commodity has lost more than half its value.

President Nicolás Maduro tried unsuccessfully in late November to petition his partners in the Organization of the Petroleum Exporting Countries (OPEC) to cut oil supplies as a way to push prices back up. Saudi Arabia, the cartel's leading member, rejected the plea, presumably because, by keeping prices low, it hopes to squeeze US producers of shale oil, a nonconventional petroleum source. The US shale industry has made tremendous gains in recent years, trimming the country's dependence on foreign petroleum and boosting the global oil supply. The technique, however, involves high overhead costs compared to the kind of standard onshore drilling prevalent in Saudi Arabia and elsewhere in the Middle East.

The current situation has compounded problems, both economic and political, that had been hounding the government of President Maduro even before the price slide. Soaring inflation (above 60% last year), high crimes rates, a perplexing three-tiered currency-exchange system, and supply shortages of basic foodstuffs are fueling growing frustration with the country's leadership ([NotiSur, Feb. 21, 2014](#)), which is also under increasing international pressure because of its decision to jail prominent opposition figures.

On March 9, the US government took the dramatic step of freezing the assets of seven Venezuelan officials it accuses of human rights abuses. US President Barack Obama justified the decision by saying the situation in Venezuela poses an "unusual and extraordinary threat" to US national security and foreign policy. A number of Latin American leaders were quick to challenge Obama's claim. Ecuadoran President Rafael Correa called it a "joke in bad taste," while Uruguay's former President José Mujica, who left office March 1, dismissed the US president's comments as "madness."

Rolling with the punches

South America's other OPEC member, Ecuador, is struggling with the low oil prices as well but appears to be in a far better position than Venezuela to weather the storm. Ecuador produces only about half as much oil as Colombia. Like its northern neighbor, however, it posted solid growth numbers last year (4%) and thus enjoys something of an economic cushion. Venezuela's economy, in contrast, contracted in 2014 by 3%, ECLAC reported.

President Correa is also on far more solid political ground compared with his Venezuelan counterpart. Correa, a trained economist, has an approval rating of more than 70% despite being in office for eight years already, an impressive tenure considering that the country's four previous presidents served just over eight years among them. Support for Maduro currently stands at approximately 22%, according to a survey by the polling firm Datanálisis.

Correa has also earned positive reviews from some economic analysts, who praise his government's "pragmatic" efforts to anticipate the effects of the petroleum price slump. A recent report by LatAm

Confidential, a Financial Times research service, noted that, in January, Ecuador trimmed its oil-dependent budget (approximately one-quarter of the country's fiscal revenue comes from the oil industry) by 4%. The Correa administration also secured a US\$7.5 billion loan from China to help offset its spending deficit and proposed a tax reform that could boost the country's coffers by some US\$200 million annually. The government even made a pitch for more tourism dollars by running a pricey television spot during last month's Super Bowl. The ad reportedly cost the government US \$3.8 million.

"The fund managers we spoke to raised the progress made by Ecuador, contrasting the government's pragmatic and timely actions with the relative inertia in Venezuela," LatAm Confidential reported. "The government has other levers on which it may pull. It could make use of funds held by the social security while further sovereign issuance is also possible."

"Things that could have been"

The deep oil slump is also complicating matters for Brazil, particularly since it coincides with an unfolding scandal involving the partially state-owned oil giant Petrobras, which has lost approximately US\$50 billion of its value because of falling stock prices.

Brazil is South America's largest economy and second-leading oil producer with daily output of approximately 2 million bpd (plus another 500,000 bpd of biofuel). But it also has an economy that is relatively diverse compared with Venezuela, Colombia, and Ecuador. The lion's share of Brazilian oil, furthermore, is sold domestically—at subsidized prices. In that sense the price drop is less troublesome than it is elsewhere in South America because the state can actually save revenue by scaling back its oil subsidies.

Still, the situation is hardly good news for a country that had been setting its sights on being one of the world's top-five oil producers by 2020 but is now sliding toward recession ([NotiSur, Feb. 20, 2015](#)). Brazil had been pinning its hopes on oil reserves discovered in 2007 off the coast of Rio de Janeiro ([NotiSur, Nov. 30, 2007](#)). The "pré-sal" (below the salt) reserves, so named because they lie under several thousand meters of encrusted salt, are enormous. But they're also difficult to access and, given the huge overhead costs involved, make far less economic sense when oil is at US\$50 per barrel versus US\$100 per barrel.

Even if pré-sal exploration and operation were more cost effective, it is not clear right now how much success scandal-plagued Petrobras, which has a virtual monopoly on all things oil-related, would have attracting the capital it needs to really develop the offshore reserves.

In a recent analysis published in Foreign Policy magazine, Christopher Sabatini, the senior policy director with the Americas Society and Council of the Americas (AS/COA), says the Petrobras scandal uncovered "an unholy knot of corruption kickbacks" that is scaring off investors. "Brazil's economy is expected to contract by 0.1% this year, and broiling political turmoil has tainted the governing party, plunging President Dilma Rousseff's popularity to less than 20%," he adds. "The once-promising oil industry increasingly appears to be a symbol of Brazil's endemic corruption and a reminder of things that could have been."

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