



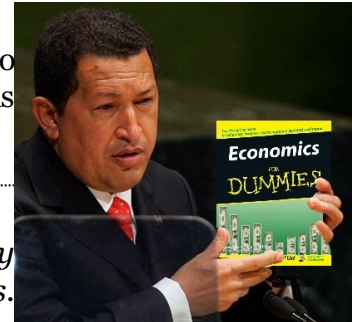
## How to Run an Oil Industry into the Ground

Posted by [Robert Rapier](#) on September 27, 2010 - 9:28am

Topic: [Economics/Finance](#)

Tags: [hugo chavez](#), [venezuela](#) [[list all tags](#)]

Hugo Chavez is putting on a clinic in Venezuela. The theme is “How to Destroy a Domestic Oil Industry.” I have warned for years that this would be the end result of Chavez’s actions. [As I wrote in 2007](#):



*So, can Chavez under-invest in the industry while diverting money to his pet causes? He can for a while, but you can see the results. Despite having enormous oil reserves, he and his cronies are running Venezuela’s oil industry right into the ground. His generosity to the poor has only been possible because he had a goose that laid golden eggs because they constantly reinvested money back into the business. Once he kills the goose, where is he going to get the money to continue his programs?*

Venezuela is in the Top 10 globally in oil reserves, but their national oil company is reaping what Chavez has sown:

### [Declining production will continue to hit Pdvs](#)

*The report, which was prepared by the Ministry of Planning and Finance, includes Pdvs’s consolidated results, characterized by **falling revenues, lower earnings, and a growing debt**. The report conceded that the oil industry was hit by lower production and a decline in oil prices.*

*Financial authorities acknowledged that **production and expenditures have been key factors in the financial situation of the oil industry**. They added that **these factors will continue to hit the industry in the future**.*

*The annual reports highlights that Pdvs’s oil contractors have filed complaints against the state-run oil company over late payments.*

It was pretty obvious that this would happen, but those who were praising Chavez would not listen. I got a lot of knee-jerk reactions about Chavez standing up for the people and sticking it to those greedy oil companies. Actually, I think it is great to use oil revenues to benefit the public. We do that in the U.S. by taxing the industry in various ways — and along with windfall profits for

the oil companies came windfall taxes for the government. Chavez did it by raiding the industry and expropriating property of many private companies. I stress to my kids that actions have consequences, and the wrong actions will have undesirable consequences that one has to face. Chavez's actions are an example of this, and his prediction of rising oil production in the face of siphoning revenues was just wishful thinking.

As I have said many times, the oil industry is very capital intensive. Those big revenues don't come without some very big bills that have to be paid. You can't raid gross revenues for very long without suffering serious production difficulties. But as oil revenues exploded on the back of higher oil prices, they became a very attractive target for governments seeking to pay for expensive social programs. What many didn't understand is that as oil revenues exploded, inflation hit the entire oil sector and everything became much more expensive. I was in the North Sea as oil prices crossed \$100/bbl, and the cost of doing projects escalated along with oil prices.

Chavez can only hope for much higher oil prices, or that he can convince foreign firms to come back and set up shop after [previously stealing their assets](#). More likely he will continue to seize assets and dig himself into an even deeper hole. He has started a downward spiral that can only be corrected by a massive infusion of cash back into the industry; cash that he no longer has. It is a classic case of the [Goose and the Golden Egg](#). Chavez reaped short term "profits" for the government, but in the long run he will have much less money with which to finance his social programs.



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