Governance, risk and the role of NOCs (Part 1)

By David Casallas - Friday, August 23, 2013

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National oil companies have gained greater protagonism in Latin America and the Caribbean as some countries look to increase state control of natural resources.

To learn about the challenges faced by these state enterprises and the role they play in policymaking, BNamericas spoke to Mark Thurber, associate director of Stanford University’s Program on Energy and Sustainable Development (PESD).

BNamericas: How have NOCs approached risk and what is your outlook?

Thurber: Risk is a very important characteristic of the oil and gas industry because of massive investment and a lot of uncertainty.

When looking at NOCs and private oil companies there are some typical differences in how both approach risk, and that derives from the fact that state companies have some other objectives the government is asking them to pursue in addition to just commercial objectives.

And the other piece of it for the state oil companies is that usually the mechanisms through which their shareholders can control them are different from the case where you have purely private shareholders.

BNamericas: Could you provide some regional examples?

Thurber: A thing that has challenged Pemex, for example, is that it has been unable to approach risk in a way that would be normal for a private oil company.

There are a lot of different players who look to the company and the sector for different things.

You have the finance ministry who looks to it as a way to supply much of the government budget due to the weak tax base; you have unions who look to it for jobs; you have different political parties who look to it as a political axe that can be wielded for their advantage. Issues around the patrimony of oil in Mexico can be very potent politically.

[Brazil's] Petrobras is a case that is interesting in a different way. It is a company which over the years has taken a lot of risk to become an innovator in deepwater technologies. I would argue that its historical monopoly position has freed it up to do so because it is not as exposed to the negative impacts of taking risk as a private company.

BNamericas: On the governance front, public pressure seems to have dictated sector policy in certain countries, in particular in Bolivia, Ecuador and Venezuela.

Thurber: Public pressure is an issue that almost all NOCs face to a greater degree than private oil companies. This pressure can be cultivated by politicians to enhance their political base.
The salient issue is how much this pressure impinges on operational decisions, and in Bolivia, Ecuador and Venezuela it has to a significant degree.

Venezuela is a case where demands to use PDVSA as a financing vehicle for development programs and for various other goals outside of oil and gas certainly make it harder for the company to operate efficiently and effectively.

Often NOCs become administrators of fuel subsidies - Venezuela is a great example of this - which can be really problematic for the companies. These subsidies can starve them of capital they need and distort oil and gas markets domestically, but they are politically popular.

**BNamericas:** Do you see leaders more tempered and moving away from more extremist positions?

**Thurber:** In Venezuela, there has been a backing away from the more extreme positions that have been taken at some points because the government has realized that, although it would like to create a coalition of ideologically aligned NOCs to develop the Orinoco belt, it also needs partners who know heavy oil.

I think a similar struggle is playing out in Mexico. There is a lot of political resonance to the idea of Mexico owning its oil, and that is a hot button kind of issue, but increasingly there seems to be recognition across the political spectrum, or at least across most of it, that we have to do something with Cantarell declining and Pemex losing money.
Governance, risk and the role of NOCs (Part 2)

By David Casallas - Friday, August 30, 2013

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The following is the second of a two-part interview with Mark Thurber, associate director of Stanford University's Program on Energy and Sustainable Development (PESD).

BNamericas: How have government plans of some countries in Latin America to increase government take impacted the attractiveness of the region's hydrocarbons sector?

Thurber: If you think about it from the perspective of a private international oil company, or for that matter even an internationalized NOC that is trying to go abroad and look for resources, there just aren’t that many choices.

Big oil majors are very familiar with these kinds of risks because they're dealing with them all over the place. That is part of why they need a diversified international portfolio.

It's not a black and white issue; countries may find that oil companies are willing to come back despite past contention. If the carrot is bigger, that helps a lot.

BNamericas: Some regional countries - such as Bolivia and Ecuador - have migrated to service from participation contracts. Will this trend continue?

Thurber: The trend is toward a greater diversity of contract arrangements. As an example, Iraq has offered big service contracts that some of the majors are involved in but might not have agreed to in the past.

As an oil producing government, your calculus always has to be: what is the right balance between high government take and keeping the country sufficiently attractive for investment?

One thing Norway did fairly well throughout its oil sector development was to stay attentive to this tradeoff.

In countries where political systems are more chaotic and fragmented, however, the government may make tradeoffs that are not really optimal because some of these decisions are not made with a technocratic calculus of maximizing the country's take but more for political reasons.

BNamericas: On Mexico's energy reform, what's your outlook?

Thurber: When I talk to people from Pemex and the government there certainly seems to be some optimism today that was not there a year or two ago. I'm hopeful the crisis has become obvious to everybody and that different political players will refrain more than they have in the past from trying to score political points by blocking reform.

It's not a done deal. The history is not that encouraging with cycles of trying to implement reforms which start out very ambitious and then get watered down.

BNamericas: What makes an NOC successful?
Thurber: It helps to appoint good, smart people at the top - people who have industry experience and are pragmatic and willing to learn from others. You want to insulate them a bit from politics; let them do their thing, grow and create stability.

However, it's not all about having good managers, because so much of the context in which NOCs operate is conditioned by what the government wants from its NOC. The greater the non-hydrocarbon burdens a government lays on its NOC, the more difficult it usually is for NOC management to run an efficient and effective company.

Another thing governments have to think hard about is whether they need an independent regulator. Some countries have used this approach successfully, like Norway, but others have made progress without an independent regulator. Whether the approach of having an independent regulator works depends a lot on the political and institutional context.