Oil and Gas Production in Argentina’s Vaca Muerta Awaits Direction from New President

*Foreign Investors Push Pause Button, Concerned Over Political Uncertainty*

Efforts by the oil and gas industry to develop Vaca Muerta, Argentina’s vast shale reserves in northern Patagonia, have hit pause as the industry awaits direction from the country’s new president, who will take office on December 10. Alberto Fernandez, the incoming president, has not yet announced a new energy secretary, nor named a new president for the state-controlled oil company, YPF, nor outlined a new energy policy. While the country’s leadership change has slowed development of Vaca Muerta, it also offers Argentina an opportunity to chart a new path for its currently failing energy policy.

Rather than relying on unreasonable and costly investments designed to provide oil and gas for export into an oversupplied global market, the new administration could chart a stronger course by lowering production goals and focusing on developing low-cost energy for domestic markets. The new administration would be well-served to learn from the decade-long financial failure of unconventional production (horizontal drilling and hydraulic fracturing, or fracking) in the U.S., despite impressive production gains.¹ The financial difficulties facing the U.S. shale industry, now regularly acknowledged in the Argentine press,² should be top-of-mind for the new administration as it considers its future energy policies.

Rather than aiming for exports, Argentina should provide low-cost energy for domestic markets.

*Foreign Partners Remain Skittish on Development in Vaca Muerta*

While companies await direction from Fernandez, only state-controlled YPF has continued to ramp up its oil and gas production in Vaca Muerta.³ Foreign investors, by contrast, have been spooked by economic and political events throughout the

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year. These foreign partners are crucial to Vaca Muerta’s unconventional production, which relies on horizontal drilling and hydraulic fracturing, or fracking. They are likely to remain on the sidelines until the incoming president articulates a new energy policy.

Fernandez’ new energy policy should learn from his predecessor’s failure. Outgoing President Mauricio Macri’s 2018 Energy Plan had sought to double production of oil and gas within five years, with a goal of creating an export market beyond Argentina’s regional partners. But the Macri plan was overly optimistic that the export market would drive more investment in Argentina. The policy relied on subsidies and other incentives for rapid expansion of production of oil and gas from Vaca Muerta. The subsidies were short-lived because of Argentina’s fiscal distress. The export plans were dead on arrival due to a tight market. The net result? Argentinians faced rising energy prices even as their country had abundant oil and gas reserves.

Macri Administration’s Changing Gas Subsidies, Oil Price Freeze Blamed for Dwindling Development Efforts in Vaca Muerta

Since its inception, the Macri plan faced headwinds that have accelerated throughout 2019. Faced with an oversupply of gas and budget constraints, the government in January 2019 retroactively changed its 2018 subsidies for gas production. Moody’s called the subsidy change “credit negative” for many companies operating in Argentina. Tecpetrol, Vaca Muerta’s largest producer of gas, responded to the shifting subsidy policy by suing the government.

The subsidy changes, pipeline bottlenecks and a general oversupply of gas led many producers, such as Wintershall, Tecpetrol, and Shell, to focus on oil production. But when Macri lost a primary election in August, this strategy also proved fraught. The market responded to Macri’s loss with a rapid devaluation of the peso and a financial crisis.

Companies reacted by reducing unconventional production in Vaca Muerta. Well development plummeted in September and October. When the oil price freeze was announced, Shell, ExxonMobil, Wintershall, Vista and Tecpetrol immediately

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stopped investing in existing wells. And Total and Pan American Energy (PAE), a BP subsidiary, drastically reduced new drilling activity in Vaca Muerta.\(^7\) By October, advanced development in existing wells \(^8\) in Vaca Muerta were only half the August levels, with YPF accounting for almost all new development.\(^9\)

Some companies are divesting from Argentina altogether. For example, Schlumberger, the world’s largest oil services and equipment manufacturer, is trying to sell its investments in Argentina,\(^10\) and claims it has offers.\(^11\) Schlumberger, itself suffering significant financial distress due to an oversupplied global market, must reduce its worldwide activities to concentrate on core investments.

**Foreign Companies Speak Publicly About Need for Stability**

Foreign companies are increasingly speaking out publicly about their skittishness in Vaca Muerta.\(^12\) During a conference in November organized by newspaper *El Cronista* in Buenos Aires, Shell and ExxonMobil executives spoke of the need for stable government policies, greater government spending on infrastructure, and government financing.

"The [Vaca Muerta] resource has great quality... the same or better quality than wells in the U.S.,” said Daniel De Nigris, head of ExxonMobil’s operations in Argentina. But the country’s financial crisis combined with regulatory uncertainty, capital controls, high taxes and price caps have made it harder to plan business and make a profit, he noted.\(^13\)

And Shell’s head of operations in Argentina, Sean Rooney, said, "It is harder to invest in a country with challenging economic and financial conditions."\(^14\)

Wintershall Dea’s Managing Director for Argentina, Manfred Boeckmann, gave a clear message to the current national government and to the incoming government after the October elections: "A more competitive regulatory framework, infrastructure improvements, access to new markets, a cost structure and a more

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\(^7\) Ibid.
\(^8\) Hydraulic fracturing, or fracking, is also called unconventional production is described here. Schlumberger. *Oilfield Glossary.*
\(^10\) Houston Chronicle. *Schlumberger’s $11.4 billion loss blamed on two past acquisitions, weakening shale market.* October 20, 2019.
\(^12\) S&P Global Platts. *Producers delay boosting Vaca Muerta output until political outlook becomes more clear.* November 20, 2019.
\(^13\) Ibid.
\(^14\) Ibid.
competitive tax regime are necessary to ensure sustainable development at scale in Vaca Muerta.\(^{15}\)

**More Government-Financed Infrastructure Needed**

Foreign partners also blame inadequate infrastructure for the slow pace of development in Vaca Muerta. Limited pipelines, railroads and roads have constrained development, as producers struggle with an oversupply of natural gas.

Bids for a long-promised US$2 billion pipeline to connect Vaca Muerta to ports near Buenos Aires have been delayed three times over the past two years. The most recent delay will push the deadline for bids until March 2020.\(^{16}\)

This failure to draw foreign capital into the infrastructure plans further demonstrates the nature of the dilemma. Existing pipeline capacity appears cramped for new gas production, for which demand is highly seasonal. During the summer months, consumption is low and the markets oversupplied. During winter and peak demand, the pipeline capacity is constrained. The popular view is "Until the pipeline is built, it won't be necessary to drill more gas wells," said Rooney.\(^{17}\) The problem is a failure to focus on stability in the domestic market as a top priority.

**Layoffs Are Underway in Vaca Muerta**

As development in Vaca Muerta slows down, layoffs are mounting. Union oil workers said 1,000 workers had been suspended in September following the oil price freeze,\(^{18}\) bringing the total number to 2,000 workers suspended.\(^{19}\) Another round of layoffs are expected this month, which union members are promising to oppose vigorously.\(^{20}\)

Guillermo Pereyra, leader of the Petroleum and Gas Union of Rio Negro, Neuquén and La Pampa, has repeatedly called for clear rules.\(^{21}\) He has pushed for specific legislation that would assure stability in Vaca Muerta, regardless of who is in power at the national level.

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\(^{20}\) Ibid.

Conclusion

As Argentines wait for clear direction on energy policy from their incoming president, foreign oil and gas companies are taking a wait-and-see approach to further development of the country's vast oil and gas reserves in Vaca Muerta. Given that global oil companies are also in a state of financial distress, driven in large part by a low-price environment, the new President faces an uphill battle to use Vaca Muerta as a source of new revenues. A Macri-like approach to foreign companies is certain death. Any policy emphasizing exports is likely to fail. The new President's energy policy will be on a more solid course using Vaca Muerta to stabilize domestic markets first.
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