



# Venezuela

**Philipp Müller**

Philipp Müller is Assistant Director of the Global Warming Policy Foundation and a founding member of elephant Minds. He holds an MA in Global Affairs from the University of Buckingham.

Note: This article was originally published on the website of the Global Warming Policy Foundation (<http://www.thegwpcf.org/fossil-fuel-production-higher-venezuela/>) on 2 July 2013.

---

## **Venezuela mismanaged its vast oil resources long before Hugo Chavez but he proved to be particularly good at it.**

*By Philipp Müller*

Venezuela is a country rich in oil in which resource nationalism played a fundamental role in energy policy-making long before Chavez came to power in 1999. The core idea behind resource nationalism is that the natural resources in the ground or under the sea are a 'national patrimony' and, consequently, should be used for the benefit of the nation and its people, rather than for private gain. The goal of resource nationalism is to maximise rent appropriation for the benefit of national development. This is supposedly accomplished by the central government setting the terms for the exploration, production, transportation and distribution of energy.<sup>1</sup>

Venezuela's government nationalised the energy sector in 1975 and created a holding company, Petroleos de Venezuela, S.A. (PdVSA). In the 1980s, when the oil price was low, the government got into severe financial problems. Luis Herrera Campins' administration (1979-84) forced PdVSA to convert US\$ 5 billion in overseas accounts into Bolivars at the Central Bank. PdVSA was later forced to pay taxes in advance and purchase government bonds. Multiple exchange rates permitted the government to manipulate PdVSA's balance sheets and maximise transfers to the treasury. These various mechanisms eliminated PdVSA's ability to finance new oil projects. Shrinking OPEC quotas were limiting PdVSA's ability to offset declining prices by pumping more oil.<sup>2</sup>

Venezuela has the world's largest proven oil reserves. The South American country's deposits were at 296.5 billion barrels at the end of 2011, according to BP. Venezuela holds 18% of the world's proven oil reserves.<sup>3</sup> Venezuela had 195 trillion cubic feet (tcf) of proven natural gas reserves in 2012, the second largest in the Western Hemisphere behind the United States. It contains billions of barrels in extra-heavy crude oil and bitumen deposits, most of which are situated in the Orinoco Belt in central Venezuela. According to a study by the U.S. Geological Survey, the mean estimate of recoverable oil resources from the Orinoco Belt is 513 billion barrels of crude oil.<sup>4</sup> The U.S. Geological Survey concluded that the Orinoco Belt holds the largest accumulation of oil it had ever assessed. Technological progress has made it possible to extract heavy oil mixed in sandstone but it requires specialised production and refining processes. Canada has massive oil sands resources in the state of Alberta, which are similar in consistency to Venezuela's heavy oil. Canada's oil sands production has doubled over the past decade thanks to the application of these new technologies and private investment (see graph on next page). Venezuela's heavy oil development on the other hand has stagnated because it lacks private investment and access to the latest technology.

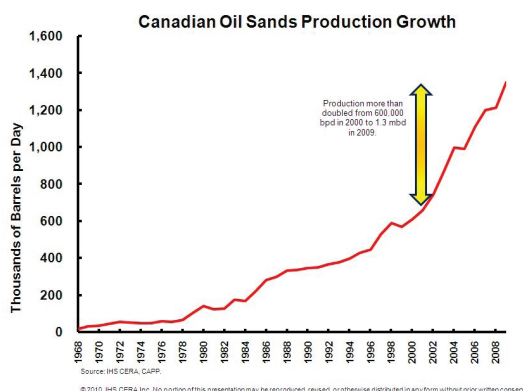
---

1 Mares, David R., 'Oil Policy Reform in Resource Nationalist States: Lessons for Mexico', James A. Baker III Institute for Public Policy, Rice University, 29 April 2011, <http://www.bakerinstitute.org/publications/EF-pub-MaresLessons-04292011.pdf>, pp. 10-11

2 Mares, David R., 'Oil Policy Reform in Resource Nationalist States: Lessons for Mexico', James A. Baker III Institute for Public Policy, Rice University, 29 April 2011, <http://www.bakerinstitute.org/publications/EF-pub-MaresLessons-04292011.pdf>, p. 38

3 Rowling, Rupert, 'Venezuela Passes Saudis to Hold World's Biggest Oil Reserves', *Bloomberg*, 14 June 2012, <http://www.bloomberg.com/news/2012-06-13/venezuela-overtakes-saudis-for-largest-oil-reserves-bp-says-1-.html>

4 U.S. Energy Information Administration, 'Venezuela', 3 October 2012, <http://www.eia.gov/countries/cab.cfm?fips=VE>



Despite the fact that Venezuela's constitution prohibits foreign participation in exploration or production of oil, PdVSA made an effort to attract foreign investment and the technical expertise of the large multi-national oil companies in the 1990s. However, these efforts were halted when Chavez became president in 1999. The new government raised tax and royalty rates on new and existing oil projects and required majority PdVSA ownership of all projects. In 2006 and 2007, the government fully nationalised oil exploration and produc-

tion and implemented a 60% minimum PdVSA share in all projects. Sixteen foreign energy firms, including Chevron and Shell, complied with the new rules while the assets of Exxon Mobil, Total and Eni were forcibly seized. Expelling these foreign oil companies deprived Venezuela of the expertise and capital to tap its heavy oil deposits and the ability to get far more oil revenue from taxes and royalties.<sup>5</sup>

For Venezuela's offshore gas production to expand in a meaningful way, international energy companies will need to play a central role. PdVSA does not have experience in producing non-associated gas – in the company's most recent attempt at operating an offshore natural gas project resulted in the sinking of the drilling rig in May 2010.<sup>6</sup>

Chavez's plans to transform the political, economic and social life of Venezuelans with his 'Bolivarian Revolution' required that PdVSA was run as a rent-generating tool rather than a profit-maximising company. In December 2002, the opposition to Chavez began a 69-day strike that PdVSA's management and many of its workers joined. National oil production dropped from 3.3 million barrels per day (b/d) in November 2002 to 700,000 b/d in January 2003 and produced losses to the economy up to US\$7.5 billion. After the strike, the government made increasing use of his authority under the petroleum legislation. The 1971 Reversion Law gave the government the authority to immediately revise contracts with foreign oil companies if it determined that they were not being exploited 'efficiently'. A newly adopted constitution gave it the right to alter the terms with foreign investors in all sectors of the economy. The government began forcing contract renegotiation under the threat of termination.<sup>7</sup> The government:

PdVSA did not fare well under Chavez's 14-year presidency. Even official government figures show oil production flat for the past five years, and the U.S. Energy Information Administration sees it declining for all but one year of Chavez's presidency. The Venezuelan government forced the NOC to fund its costly social programmes. PdVSA's social plan includes education, agriculture, infrastructure, supermarkets and local developments projects. The target is to create 1.7 million jobs and to benefit 8.4 million people. PdVSA's new role requires expenditure commitments that conflict with the financial needs of its oil operations. Some industry experts claim that the natural field decline rate in PdVSA's oil

<sup>5</sup> Lavell, Marianne, 'Hugo Chavez Leaves Venezuela Rich in Oil, But Ailing', *National Geographic*, 6 March 2013, <http://news.nationalgeographic.com/news/energy/2013/03/130306-hugo-chavez-venezuela-oil/>

<sup>6</sup> U.S. Energy Information Administration, 'Venezuela', 3 October 2012, <http://www.eia.gov/countries/cab.cfm?fips=VE>

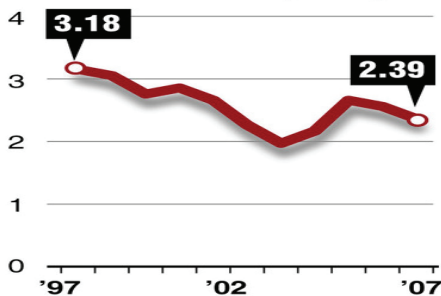
<sup>7</sup> Mares, David R., 'Oil Policy Reform in Resource Nationalist States: Lessons for Mexico', *James A. Baker III Institute for Public Policy, Rice University*, 29 April 2011, <http://www.bakerinstitute.org/publications/EF-pub-MaresLessons-04292011.pdf>, pp. 41-42

fields is as high as 25%, compared with 2-8% in Saudi Arabia's Aramco.<sup>8</sup> The reasons for that are natural decline at older oil fields, maintenance issues and the need for more foreign investment. Many of Venezuela's oil fields are very mature, requiring heavy investment just to maintain current production capacity. PdVSA must spend some \$3 billion each year just to maintain production levels at existing fields given the decline rates.<sup>9</sup> In 2004, PdVSA spent US\$4.3 billion on social programmes and only US\$2.9 billion on oil-related investments. In the first half of 2010, the NOC's contribution to social programmes and transfers to the National Development Fund equalled US\$5.1 billion, contributing to a 14% fall in profits.<sup>10</sup>

In 2002, PdVSA workers went on strike to try to force Chavez from office. In response, Chavez fired 18,000 PdVSA employees, including senior managers. He then stuffed the company with tens of thousands of loyalists from what would later become his United

## Venezuela oil production

In millions of barrels per day



© 2008 MCT  
Source: International Energy Agency  
Graphic: Judy Treible

Socialist Party (PSUV).<sup>11</sup> PdVSA's chairman, Rafael Ramirez, made it an explicit company policy to employ only supporters of the ruling party.<sup>12</sup> Since then, PdVSA's payroll has more than doubled to some 110,000 employees.<sup>13</sup> This policy has hurt the company's productivity. PdVSA's output has declined from 3.3 million b/d in 1998 to around 2.25 million b/d in 2011. Of that some 1 million b/d is sold at subsidised prices domestically or to regional allies like Cuba, leaving just 1.25 million b/d for full price exports.<sup>14</sup> In 2011, PdVSA spent twice as much on government programmes as it did on taxes, royalties and dividends. From 1999 to 2012, its foreign debt has risen fivefold. Moreover, oil union leaders say PdVSA's in-

dustrial safety procedures have deteriorated sharply. The petroleum and mining ministry's annual report shows that maintenance work is frequently postponed for lack of money.<sup>15</sup> Accidents have been increasing. According to Eddie Ramirez, one of the sacked managers, the 'old' PdVSA averaged less than two accidents per million man-hours. In 2010, there were 9.4 accidents and almost six deaths per million man-hours. Jose Bodas, the head of the oil workers union, said: 'PdVSA is falling to pieces. As long as you are a member of the PSUV, they do not care if you are incompetent.'<sup>16</sup>

Will Venezuela's management of its natural resources improve after Chavez's recent death? The statements of the new president Nicolas Maduro give little reason to be optimistic. Maduro announced that PdVSA would 'annex' the share of oil fields owned by the privately held energy company Suelopetrol.<sup>17</sup>

8 Mares, David R., 'Oil Policy Reform in Resource Nationalist States: Lessons for Mexico', *James A. Baker III Institute for Public Policy, Rice University*, 29 April 2011, <http://www.bakerinstitute.org/publications/EF-pub-MaresLessons-04292011.pdf>, pp. 44-45

9 U.S. Energy Information Administration, 'Venezuela', 3 October 2012, <http://www.eia.gov/countries/cab.cfm?fips=VE>

10 Mares, David R., 'Oil Policy Reform in Resource Nationalist States: Lessons for Mexico', *James A. Baker III Institute for Public Policy, Rice University*, 29 April 2011, <http://www.bakerinstitute.org/publications/EF-pub-MaresLessons-04292011.pdf>, pp. 44-45

11 *The Economist*, 'Spilling over', 18 February 2012, <http://www.economist.com/node/21547829>

12 *The Economist*, 'Up in smoke', 27 August 2012, <http://www.economist.com/blogs/americasview/2012/08/venezuelas-oil-industry>

13 Helman, Christopher, 'What Does Chavez's Death Mean For Venezuelan Oil Giant PdVSA?' *Forbes*, 5 March 2013, <http://www.forbes.com/sites/christopherhelman/2013/03/05/what-does-chavez-death-mean-for-venezuelan-oil-giant-PdVSA/>

14 *The Economist*, 'Oil leak', 24 February 2011, <http://www.economist.com/node/18233412>

15 *The Economist*, 'Up in smoke', 27 August 2012, <http://www.economist.com/blogs/americasview/2012/08/venezuelas-oil-industry>

16 *The Economist*, 'Spilling over', 18 February 2012, <http://www.economist.com/node/21547829>

17 Helman, Christopher, 'What Does Chavez's Death Mean For Venezuelan Oil Giant PdVSA?' *Forbes*, 5 March 2013,

