

## VENEZUELA

The focus of this chapter is on contemporary bargaining in Venezuela's oil industry, involving President Hugo Chávez, IOCs, the U.S. government, China, and various NOCs as the main actors. The main determinants of the outcome of oil industry bargaining in Venezuela are of political nature, as politics trumps economics when it comes to Venezuela's oil policy. Economics do however play a limited role in determining the outcome of oil industry bargaining in Venezuela, as high oil prices provide Chávez with much needed petro-dollars. Regardless, cheap energy that Chávez provides to much of Latin America defies any economic logic, and so does China's attempt to secure equity deals in Venezuela. Chávez's reform, or re-nationalisation, of the oil industry was carried due to his attempt to secure the regime stability, and in relation, to support his Bolivarian Revolution, success of which is fundamental for regime survival. An increased share of oil income at the expense of IOCs allows Chávez to pay social benefits, reward friends, punish enemies, buy elections and maintain power without seeking the sort of political legitimacy a broad tax base usually demands in a diversified economy.

### Introduction to Venezuela's Oil Industry

Venezuela's oil industry history can be roughly divided into six major periods: the discovery and initial production of oil (1878-1920s); foreign oil companies' domination (1920s-1945); government's assertion of control (1945-1974); the oil boom and nationalisation (1974-1990); loosening of government control over PdVSA in 1990, followed by launch of the policy of *la apertura* (opening) in 1993, which was an open invitation to foreign investment (1990-1999); and finally government's resumed control over an increasingly independent oil industry (1999-present). Although the history of

Venezuela's oil industry is fascinating, much of it is beyond the scope of this study, and below, only recent history is briefly examined.<sup>1</sup>

In 1975, and as a part of the 'La Gran Venezuela' plan, in what President Carlos Andrés Pérez called "an act of faith,"<sup>2</sup> Venezuela nationalised its oil industry creating *Petróleos de Venezuela S.A. (PdVSA)*, the country's state-run oil and natural gas firm and Latin America's largest company.<sup>3</sup> Control over PdVSA has been in dispute ever since, and critics of the nationalisation process, such as Carlos Mendoza, argue that the newly nationalised oil industry was nothing more than a Trojan horse used by western oil companies.<sup>4</sup> This was particularly the case from 1990 when Andre Sosa Pietri was appointed chairman of PDVSA. Sosa Pietri began questioning both the government control of the company and its association with OPEC. He wanted a free hand in running PdVSA, which he hoped to open to various forms of interaction with foreign companies and capital.<sup>5</sup> He did not want to be subjected to OPEC, which he dismissed as "only a myth," a relic of the past that, were it to survive, would be transformed into nothing more than a "research centre."<sup>6</sup> Taking advantage of a corrupt political system paralysed by the impending impeachment proceedings against President Pérez, Sosa Pietri led PdVSA to

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<sup>1</sup> For more on early oil history of Venezuela, see Edwin Lieuwen, *Petroleum in Venezuela: A History* (Berkeley: University of California Press, 1954); Brian S. McBeth, *Juan Vicente Gómez and the Oil Companies in Venezuela, 1908-1935* (New York: Cambridge University Press, 1983); and Jonathon C. Brown, "Why Foreign Oil Companies Shifted Their Production from Mexico to Venezuela during the 1920s," *American Historical Review*, vol. 90, no. 2, 1985, pp. 362-85. For more on the nationalisation and general history of Venezuela's oil industry, see Rómulo Betancourt, *Venezuela: Oil and Politics* (London: George Allen & Unwin, 1978); Lieuwen, "The Politics of Energy in Venezuela," in John D. Wirth (ed.), *Latin American Oil Companies and the Politics of Energy* (Lincoln: University of Nebraska Press, 1985), pp. 189-225; Paul E. Sigmund, *Multinationals in Latin America: The Politics of Nationalization* (Madison, 1980), pp. 226-53; Philip, *Oil and Politics in Latin America*, particularly chapter 15; Gustavo Coronel, *The Nationalization of the Venezuelan Oil Industry: From Technocratic Success to Political Failure* (Lexington, MA: Lexington Books, 1983); Luis Vallenilla, *Oil, the Making of a New Economic Order: Venezuelan Oil and OPEC* (New York: McGraw-Hill, 1975); Anibal R. Martinez, *Chronology of Venezuelan Oil* (London: Allen and Unwin, 1969); Laura Randall, *The Political Economy of Venezuelan Oil* (New York: Praeger, 1987); Tugwell, *The Politics of Oil in Venezuela*; Gregory Wilpert, "The Economics, Culture, and Politics of Oil in Venezuela," *Venezuelanalysis.com*, August 30, 2003, [www.venezuelanalysis.com](http://www.venezuelanalysis.com) [April 24, 2005]; and Bernard Mommer, *The New Governance of Venezuelan Oil* (Oxford: Oxford Institute for Energy Studies, April 1998).

<sup>2</sup> Yergin, *The Prize*, p. 650.

<sup>3</sup> "Chávez's Battle to Keep the Oil Flowing," *The Economist*, August 2, 2003, p. 36.

<sup>4</sup> Mendoza is an oil industry expert, who briefly served on the PdVSA board of directors in the days leading to the April 11, 2002 coup d'état attempt. *Ibid.* Besides, the 1975 Nationalization Law stated that "in special cases and if it convenient for the public interest, the National Executive [or the state-owned enterprises to be founded] may agree in joint ventures with private enterprise for a fixed time, with a participation guaranteeing the control of the state... Both Houses of Congress will have to authorise them beforehand in joint session..." *Nacionalización del Petróleo en Venezuela* (Caracas: Catalá/Centauro/Editores, 1975), pp. 3-4. Bernard Mommer argues that those special cases related mainly to foreign capital. "The Political Role of National Oil Companies in Exporting Countries: The Venezuelan Case," *Oxford Institute for Energy Studies, Working Paper*, no. 18, September 1994, p. 14.

<sup>5</sup> Maugeri, *The Age of Oil*, p. 171.

<sup>6</sup> On Sosa Pietri's policy see Bernard Mommer, *Global Oil and the Nation State* (Oxford: Oxford Institute for Energy Study, 2002), pp. 212-5.

become independent source of power that could bend the will of Congress to its own aims. Thus, it was not a major effort for him to obtain green light for making deals with foreign companies, and he drove the steady growth of Venezuelan oil production irrespective of the country's OPEC quota.<sup>7</sup>

Moreover, between 1993 and 1999, a policy of *la apertura*, under the direction of Luis Giusti, Sosa Pietri's successor as the chairman of PdVSA, set Venezuela on a course which 'incentivised' foreign investment by exempting certain projects from the basic petroleum fiscal regime.<sup>8</sup> In January 1996, PdVSA launched the largest round of international bidding on oil exploration and production rights since nationalisation in 1975, making it possible for IOCs to return to the country.<sup>9</sup> Giusti thus continued his predecessor's policy and pushed it to extremes. Until 1999, Venezuela's oil industry thus maintained an anti-statist and MNC management culture much throughout its existence.<sup>10</sup> Following *la apertura*, Venezuela arguably defected from OPEC into the opposite camp.<sup>11</sup>

In 1998, Bernard Mommer argued that Venezuela "underlines the spread of the new liberal governance structure of international oil elsewhere. Hence, the trend in the governance of international oil at present is in precisely the opposite direction to that in the decades before the 'OPEC revolution'."<sup>12</sup> Mommer also argued that "looking to the future, PDV, the producing company, will be privatised" and "will only survive as far as required in its new role as a licensing agency in a position strong enough to ward off the state and to limit its sovereign rights over the natural resource." Nationalisation, according to Mommer, "has already been defeated, definitively, radically, and irreversibly."<sup>13</sup> His predictions were

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<sup>7</sup> Maugeri, *The Age of Oil*, p. 171.

<sup>8</sup> Rutledge, *Addicted to Oil*, p. 87. "La apertura" meaning "the opening" of Venezuela's oil industry between 1994 and 1999. See Luis E. Giusti, "La Apertura: The Opening of Venezuela's Oil Industry," *Journal of International Affairs*, vol. 53, no. 1 (Fall 1999), pp. 117-28. For more on regulatory framework in Venezuela's oil and gas industry following *la apertura*, see Elisabeth Eljuri, "Corporate Structuring of Oil and Gas Projects in Venezuela: Views from the North and South," *Journal of Energy and Natural Resources Law*, vol. 18, no. 1, 2000, pp. 53-66.

<sup>9</sup> Maugeri, *The Age of Oil*, p. 171.

<sup>10</sup> The ties to the former owners of the nationalised Venezuelan companies were maintained primarily through technical assistance contracts, and through commercialisation contracts, which heavily discounted the price of oil to their former owners. "The Political Role of National Oil Companies in Exporting Countries: The Venezuelan Case." Also, see Rutledge, *Addicted to Oil*, p. 87. For analysis of oil policy before the Chávez government, see Luis E. Lander "La Apertura Petrolera en Venezuela: de la Nacionalización a la Privatización," *Revista Venezolana de Economía y Ciencias Sociales*, vol. 4, no. 1 (January-March 1998), pp. 153-182; and Mommer, *The New Governance of Venezuelan Oil*.

<sup>11</sup> Mommer, *The New Governance of Venezuelan Oil*, p. 76.

<sup>12</sup> *Ibid.*, p. 77.

<sup>13</sup> *Ibid.*, p. 76.

to be proven incorrect by 1999 when Hugo Chávez, explicitly targeting *la apertura*, became Venezuela's president.

A radical nationalist and socialist who had grown up in the military, Chávez had unsuccessfully tried to overthrow the government in 1992 through a military coup. Arrested and released from prison after two years, he had then decided to use political and constitutional means to come to power, setting a program that promised Venezuelans to free the country from poverty and corruption, and to break the traditional concentration of wealth in the hands of small elite. During his first three years in power, Chávez took bold steps to overhaul Venezuela's institutions and attempted to redress the country's social ills, justifying the hopes of many Venezuelans who had supported him. However, his policies also provoked economic problems, and a backlash from those who were losing their power.<sup>14</sup>

Thus, in recent years, under the influence of President Chávez, Venezuela's oil industry has been reformed, PdVSA's autonomy has been reduced and the rules regulating the country's hydrocarbons sector amended. The changes brought up by *la apertura*, were reversed. PdVSA was placed under the jurisdiction of the Ministry of Energy and Petroleum (MEP), in practice controlled by Chávez, and has lost all of its earlier independence. This is not surprising since Chávez was Giusti's long-standing opponent,<sup>15</sup> declaring that PdVSA was "a state within a state,"<sup>16</sup> and blaming its executives for lavish spending.<sup>17</sup> The reform encompassed four main areas: solidification of state ownership of the oil industry, tax reform, subordination of the oil industry to national interests, and the strengthening of OPEC.<sup>18</sup> I will briefly discuss three of them, while the fourth one – tax reform – will be discussed in the next section.

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<sup>14</sup> Maugeri, *The Age of Oil*, pp. 189-90. For more on the rise of Chávez, see Richard Lapper, "Living with Hugo: U.S. Policy Toward Hugo Chávez's Venezuela," Council on Foreign Relations (CFR), CSR no. 20, November 2006, pp. 6-9.

<sup>15</sup> Rutledge, *Addicted to Oil*, p. 91.

<sup>16</sup> *Oil and Gas Journal*, December 21, 1998, p. 33.

<sup>17</sup> *Financial Times*, March 10, 1999.

<sup>18</sup> Ali Rodríguez, the former president of OPEC and current president of PdVSA provides a good summary of the policy in "La Reforma Petrolera Venezolana de 2001," *Revista Venezolana de Economía y Ciencias Sociales*, no. 2, May/August 2002.

The privatisation of PdVSA is banned under Venezuela's 1999 Constitution.<sup>19</sup> The new constitution anchors state ownership of Venezuela's oil industry by stating, "For reasons of economic and political sovereignty and national strategy, the state shall retain all shares of Petroleos de Venezuela, S.A. or the organ created to manage the petroleum industry."<sup>20</sup> This article of the constitution marks a definitive break from neo-liberal policies that PdVSA had been pursuing prior to Chávez's election. In practice, all oil and other hydrocarbon reserves within Venezuela are owned by Venezuela and not by the firms that discovered, or who operate them. The MEP supervises the state of the industry, trade and operations, and designs the governmental energy policy, which is overlooked by Chávez. PdVSA is the operator, as it coordinates, monitors, and controls all hydrocarbon operations.

When Chávez came to power, in February 1999, one of his highest priorities was to strengthen OPEC and raise the market price of oil.<sup>21</sup> Oil had dropped to less than \$10 per barrel, to an extent because Venezuela was ignoring its OPEC production quotas during the previous government(s).<sup>22</sup> Within the new government's first 100 days, Alí Rodríguez, a former president of OPEC and then a new Minister for Energy and Petroleum, visited most OPEC countries and returned with a commitment from most of these countries to reduce production and abide by their OPEC quotas.

Today, Venezuela is important to world oil markets because it holds the sixth largest proven oil reserves in the world, and the largest outside the Middle East, amounting to 79.7 billion barrels in 2005, excluding billions of barrels of extra-heavy oil and bitumen.<sup>23</sup> Further, Venezuela ranks as the world's ninth largest producer and fifth largest exporter of

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<sup>19</sup> "Venezuela Country Analysis Brief," Energy Information Administration, [www.eia.doe.gov](http://www.eia.doe.gov), June 2004 [June 22, 2005].

<sup>20</sup> Constitution of the Bolivarian Republic of Venezuela, Article 303, 1999. A backdoor to privatisation remains open because the constitution also says that the state shall own all shares of PdVSA, "except those of subsidiaries, strategic associations, businesses, and whatever other that has constituted or constitutes PdVSA as a result of the development of its business." In other words, in theory, PdVSA could turn its various activities into subsidiaries and then sell them off, one by one. However, in practice, it will enable PdVSA to sell unprofitable subsidiaries.

<sup>21</sup> Harold A. Trinkunas, "What is Really New about Venezuela's Bolivarian Foreign Policy?" *Strategic Insights*, vol. 5, no. 2, February 2006.

<sup>22</sup> Wilbert, "The Economics, Culture, and Politics of Oil in Venezuela." The last government "came close to abandoning OPEC," and PdVSA's "publicly heralded policy to maximise volumes disregarding OPEC quotas and price objectives was a major cause of the 1998 oil price crisis. President Chávez and his oil minister, Alí Rodríguez Araque, reversed this situation completely." Bernard Mommer, "Venezuelan Oil Politics at the Crossroads," *Oxford Energy Comment*, [www.oxfordenergy.org](http://www.oxfordenergy.org), March 2001 [May 8, 2005].

<sup>23</sup> BP Statistical Review of World Energy 2006. There is as much as 270 billion barrels of extra-heavy oil and tar-like bitumen in the Orinoco Tar Belt.

crude oil. The oil industry is the mainstay for Venezuela's economy, accounting for 85 percent of total export revenues, 52 percent of total government revenues, and about one-third of GDP.<sup>24</sup> Venezuela had a functioning democracy and the highest per-capita income on the South American continent before the oil boom in the 1970s.<sup>25</sup> However, by the early 2000s, the country's per-capita income was lower than in it was in 1960. Hence, Venezuela is usually considered a 'rentier', or petro-state, suffering from the 'resource curse' or the 'Dutch Disease'.<sup>26</sup>

In 2002 and 2003, Venezuela's oil output fell, largely because of difficulties at the state-owned PdVSA. Political conflict and unrest, particularly a nationwide strike beginning in early December 2002,<sup>27</sup> compounded the deteriorating situation of the country's economy, which contracted by 8.9 percent in 2002 and 9.2 percent in 2003. This nationwide strike, organised by opponents of President Chávez, was also joined by the employees from PdVSA, shutting down a large portion of the country's oil industry and drastically reducing the production of Venezuelan oil and its delivery to internal and external markets.<sup>28</sup> President Chávez declared the strikers' demands, which called for an early referendum on the President's rule, unconstitutional and dismissed around half (18,000) of PdVSA's employees (32-40,000).<sup>29</sup> Chávez then took full control of the company, and in December 2004, inaugurated Rafael Ramirez, a political loyalist, in charge of both PdVSA and the MEP.<sup>30</sup> In 2003, Chávez also imposed an ideological set of guiding principles upon PdVSA, the most notable of which were subordination to the state, and high

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<sup>24</sup> See "Hugo Chávez's Venezuela," *The Economist*, May 14, 2005, p. 24; and "Venezuela Country Analysis Brief."

<sup>25</sup> Sonia Shah, *Crude: The Story of Oil* (Sydney: Allen & Unwin, 2005), p. 89.

<sup>26</sup> For supportive evidence and a detailed study of Venezuela as a petro-state see Karl, *The Paradox of Plenty*. For studies of Venezuela's political economy of oil and structure of the oil industry see Randall, *The Political Economy of Venezuelan Oil*; Juan Carlos Boué, *Venezuela: The Political Economy of Oil* (Oxford: Oxford University Press, 1993); Bernard Mommer, "Integrating the Oil: A Structural Analysis of Petroleum in the Venezuelan Economy," *Latin American Perspectives*, vol. 23, no. 3, 1996; and Bernard Mommer, "Subversive Oil," in Steve Ellner and Daniel Hellingers (eds.), *Venezuelan Politics in the Chávez Era* (Boulder, Colorado: Lynne Rienner, 2003).

<sup>27</sup> See Marc Lifsher, "Strike in Venezuela Paralyzes Oil Exports," *Wall Street Journal*, December 6, 2002; and T. Christian Miller, "Venezuela Strike Pushes Nation Toward Crisis," *Los Angeles Times*, December 6, 2002. For more on the strike see Rutledge, *Addicted to Oil*, p. 95-6.

<sup>28</sup> Venezuela's production dropped from 3.3 million bpd in November 2002 to about 700,000 bpd in January 2003. "Venezuela Country Analysis Brief."

<sup>29</sup> *Ibid.*

<sup>30</sup> David R. Mares and Nelson Altamirano, "Venezuela's PDVSA and World Energy Markets: Corporate Strategies and Political Factors Determining its Behavior and Influence," paper prepared in conjunction with an energy study sponsored by Japan Petroleum Energy Center and the James A. Baker III Institute for Public Policy, Rice University, March 2007, pp. 40 and 56.

consciousness of national sovereignty,<sup>31</sup> and the firm's de facto strategy has become to maximise transfers to social programs.<sup>32</sup>

After a strike that resulted in a near complete shutdown of PdVSA's operations in late 2002 and the early months of 2003, and the departure of company's most experienced managers, oil production levels in Venezuela remained lower than before the strike. In 2005, Venezuela's total crude oil production was 3 million bpd, 15.3 percent higher than in 2003, but still more than 4 percent short of pre-strike production (see Table 4.1 and Figure 4.1). At the same time, in recent years Venezuela consumed between 500,000 and 600,000 bpd, allowing between 2.1 and 2.7 million bpd being available for exports. Historically, Venezuela's production and exports peaked in 1970, when they were 25 percent (production) and 44 percent (exports) higher than they were in 2005 (Table 4.1). It is interesting to note that PdVSA is one of the top five integrated oil firms in the world,<sup>33</sup> as besides domestic refining capacity, it also has holding interests in approximately 15 refineries outside Venezuela, mainly in the US, the Caribbean, Germany, Sweden and the UK. PdVSA's total refining capacity of 3.1 million bpd positions it as the fourth largest refining firm in the world.<sup>34</sup> As PdVSA is a state-owned company, between 1996 and 2005, its total payments to the Venezuelan government in dividends and taxes averaged \$10.8 billion per year.<sup>35</sup>

Table 4.1: Venezuela's Crude Oil Production and Consumption (Selected Years and 1998-2005)

| Year | Production (mbpd) | Consumption (mbpd) | Balance (mbpd) |
|------|-------------------|--------------------|----------------|
| 1970 | 3.754             | 0.211              | 3.543          |
| 1985 | 1.744             | 0.370              | 1.374          |
| 1998 | 3.480             | 0.475              | 3.005          |
| 1999 | 3.126             | 0.474              | 2.652          |
| 2000 | 3.239             | 0.496              | 2.743          |
| 2001 | 3.141             | 0.545              | 2.596          |

<sup>31</sup> For more of these guiding principles, see <http://www.pdvsa.com>.

<sup>32</sup> Mares and Altamirano, "Venezuela's PDVSA and World Energy Markets," p. 64.

<sup>33</sup> Petroleum Intelligence Weekly, December 2006.

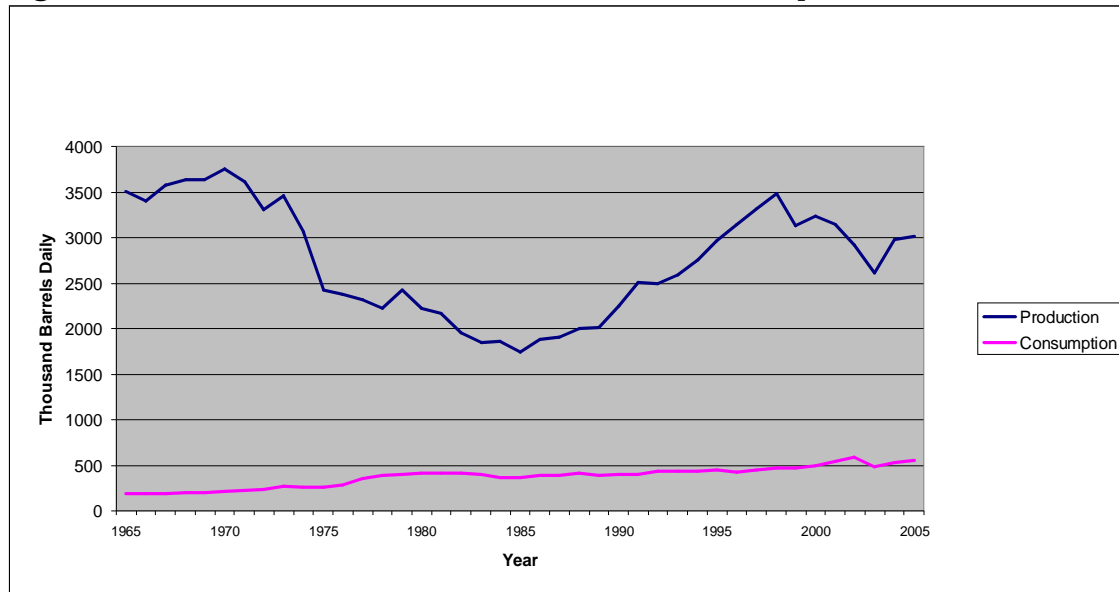
<sup>34</sup> Giacomo Luciani and Mario Salustri, "Vertical Integration as a Strategy for Oil Security," in Paul Stevens (ed.), *Strategic Positioning in the Oil Industry: Trends and Options* (Abu Dhabi: The Emirates Center for Strategic Studies and Research, 1998), p. 32. Of PdVSA's total refining capacity, 1.28 million bpd is domestic. The rest is refined mainly in the U.S. (865,000 bpd through CITGO), in the Caribbean (U.S. Virgin Islands, the Netherlands Antilles) and in Europe (Sweden, Germany, Finland, Belgium, UK). "Venezuela Country Analysis Brief." For more on PdVSA, see Mares and Altamirano, "Venezuela's PDVSA and World Energy Markets".

<sup>35</sup> Mares and Altamirano, "Venezuela's PDVSA and World Energy Markets," p. 12.

|      |       |       |       |
|------|-------|-------|-------|
| 2002 | 2.916 | 0.594 | 2.322 |
| 2003 | 2.607 | 0.479 | 2.128 |
| 2004 | 2.972 | 0.525 | 2.447 |
| 2005 | 3.007 | 0.553 | 2.454 |

Source: BP Statistical Review of World Energy 2006

Figure 4.1: Venezuela's Crude Oil Production and Consumption (1965-2005)



Source: BP Statistical Review of World Energy 2006

### CASE STUDY 3: Oil Industry Bargaining in Venezuela – ‘The End of the Royalty Holiday’

A vast majority of Venezuela's total oil exports go to the United States. The U.S. share of Venezuela's oil exports has been at, or above, 50 percent every year since 1985, with the peak of over 65 percent in 2003. At the same time, Venezuela has been one of the top sources of imported crude for the United States, often having a larger share than Saudi Arabia. Its share in total U.S. crude oil imports has been above 10 percent in every year since 1983, with the peak of 17.7 percent in 1996. In absolute terms, Venezuela's oil exports to the U.S. peaked in 1997, with almost 1.8 million bpd.<sup>36</sup> Thus, the two countries have historically been dependent on each other, and “oil looms large in the realm of U.S.-Venezuelan relations.”<sup>37</sup> Venezuela has been dependent on the United States for petrodollars needed to fill up its budget, and the United States has been dependent on

<sup>36</sup> All data in this paragraph has been derived from EIA and BP websites.

<sup>37</sup> Nikolas Kozloff, Hugo Chávez: Oil, Politics, and the Challenge to the U.S. (New York: Palgrave Macmillan, 2006), p. 7.



Venezuela as a geographically proximate, safe and reliable source of crude oil.<sup>38</sup> After all, until December 2002 strike Venezuela had been a steady supplier of oil for more than seven decades and had never suffered a complete halt in its oil production.<sup>39</sup> Venezuelan strike was the first time that the U.S. oil supply was significantly disrupted by strife in a region other than the Middle East.<sup>40</sup>

In line with the strategy of diversification of sources of imported oil, the U.S. National Energy Policy (NEP) of 2001 recommended pressuring and cajoling leaders of non-Gulf producers to increase their exports to the United States. The report places special emphasis on the producers in Latin America (notably Venezuela, Mexico and Colombia), as they possess large reserves, are geographically close, and fall within the U.S. sphere of influence.<sup>41</sup> In order to meet the growing American need for oil imports, these countries will need substantial investment in new infrastructure to boost production in older, mature fields, which are yielding less, and start the development of the new ones. In order for this to take place, it is argued that the U.S. should intensify its efforts to promote greater 'energy integration' with nations within the western hemisphere.<sup>42</sup> 'Energy integration' means opening up Venezuela and other oil exporters in the western hemisphere to U.S. oil companies.<sup>43</sup>

However, Chávez opposes any deeper American, or other Western involvement in the country's oil industry. Chávez's opposition to their involvement stems from his economic imperialist understanding that the MNCs are intimately linked with their home government, and their policies inextricably related. According to such theories, to which Chávez clearly subscribes, the government needs the economic power of the MNC to help expand its political reach, and the MNC needs the government to protect it from other

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<sup>38</sup> As a non-Arab and non-Middle Eastern member of OPEC, Venezuela had continued exporting oil during the 1973 Arab oil embargo and had provided additional supply during the shortages brought on by the 1991 Gulf War. Additionally, it only takes six days for Venezuelan oil to reach U.S. shores, which reduces costs and allows Venezuela to quickly compensate for supply problems in other regions of the world, from where it often takes at least a month to get oil to the U.S. Michelle Billig, "The Venezuelan Oil Crisis," *Foreign Affairs*, vol. 83, no. 5 (September/October 2004), p. 3.

<sup>39</sup> *Ibid.*, p. 4.

<sup>40</sup> *Ibid.*, p. 2.

<sup>41</sup> National Energy Policy Development Group, *National Energy Policy* (Washington, D.C.: White House, May 17, 2001), chap. 8, pp. 9-10. Also see Arturo Valenzuela, "The United States and Latin America: Security and Energy," paper presented at the Seventh Conference on U.S. Policy in Latin America, The Aspen Institute, Washington, D.C., 2006.

<sup>42</sup> Rutledge, *Addicted to Oil*, p. 67.

<sup>43</sup> *Ibid.*, p. 68.

governments, as well as to help maintain orderly conditions when stability is threatened.<sup>44</sup> The source of Chávez's hostility towards Americans comes from the fact that the Bush administration provided funds to some of the anti-government organisations in Venezuela,<sup>45</sup> and U.S. intelligence agencies provided support to Venezuelan military personnel who had briefly toppled Chávez in April 2002.<sup>46</sup> The United States also rushed to bless the new military regime that had temporarily removed Chávez from power, only to discover that two days later he was freed by military units that had remained loyal to him and returned to power.<sup>47</sup> The Venezuelan president enjoyed far stronger support than expected. In response, Chávez has repeatedly threatened to retaliate by cutting off oil deliveries to the United States.<sup>48</sup>

It becomes certain that the American and other Western IOCs will have significant problems assembling the necessary capital needed to maintain or expand Venezuela's production, and therefore its exports to the United States. In past, private, profit-driven IOCs were not likely to invest vast sums of money unless they could exercise a significant degree of control over local operating conditions and somehow insulate themselves from other problems, and in very few cases, they would receive the required assurances, and therefore pursue their investments.<sup>49</sup> However, as outlined in Chapter 2, and as evident from oil industry bargaining in Russia (Chapter 3), IOCs have extremely limited options for investing their money in order to increase reserve base and production. Their bargaining power vis-à-vis Venezuela is very low, particularly due to the emergence of oil-importing countries' NOCs as competitors. Does Chávez have these NOCs in mind to replace the IOCs present in Venezuela? If so, given the special emphasis placed on Venezuela in the 2001 NEP, will the U.S. easily give up on Venezuela's oil and on American IOCs engaged there?

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<sup>44</sup> For more on theories of economic imperialism see S. J. Rosen and J. R. Kurth (eds.), *Testing Theories of Economic Imperialism* (Lexington, Mass.: D. C. Heath 1974). For a modern version of Leninist theory, see L. G. Countinbo, *The Internationalization of Oligopoly Capital* (Ann Arbor: Xerox University Microfilms, 1975).

<sup>45</sup> Klare, *Blood and Oil*, p. 128.

<sup>46</sup> Washington hoped that by replacing Chávez with someone less anti-American, the United States could better ensure that Venezuelan oil would keep flowing to American refineries. Roberts, *The End of Oil*, p. 255. Also, see Eva Golinger, *The Chávez Code: Cracking US Intervention in Venezuela* (Northampton, MA: Olive Branch Press, 2006); and Engdahl, *A Century of War*, p. 266.

<sup>47</sup> Maugeri, *The Age of Oil*, p. 190.

<sup>48</sup> See Juan Forero, "Venezuelan Leader Denounces U.S. and Mocks Bush," *New York Times*, March 1, 2004; Juan Forero, "Chávez Condemns U.S., Citing Efforts to End His Rule," *New York Times*, March 11, 2004.

<sup>49</sup> Klare, *Blood and Oil*, p. 123.

Table 4.2: Goals of Main Actors in Oil Industry Bargaining in Venezuela

| Actor                                     | Bargaining Goals  |
|---|---|
| Hugo Chávez and the Venezuelan government | Maintaining regime stability; keeping the US at bay by establishing friendly relations with other developing countries; high oil revenues |
| The U.S. government                       | Steady inflow of Venezuelan oil; possibly regime change in Venezuela, which would be friendlier to American IOCs                          |
| The government of the PRC                 | Increasing oil imports from Venezuela   |
| Western IOCs                              | Maintenance of their Venezuelan operations; taxes as low as possible  |

In order to restore its oil sector and increase current levels of production, Venezuela is needy of foreign investment. However, IOCs are discouraged from investment because of Venezuela's 2001 Hydrocarbons Law, which came to effect in January 2002, and to practice in October 2004. This law replaced the Hydrocarbons Law of 1943 and the Nationalization Law of 1975. The new Hydrocarbons Law raised royalties paid by private companies to 20 – 30 percent from the previous 1 – 16.66 percent, and from 1 to 16.66 percent for those producing from the tar sands (for example in Orinoco Belt). At the same time, the government increased a corporate tax rate for oil companies from 'preferential rate' of 34 percent to 50 percent.<sup>50</sup> The tax rate was to be applied retroactively to profits made between 2000 and 2005.<sup>51</sup> All of this implies that Venezuela has been trying to change and re-negotiate contracts with IOCs present in the country. By shifting its emphasis from income taxes to royalties, the government is closing loopholes in the tax collection process.<sup>52</sup> The law also guaranteed PdVSA at least 51 percent stake in any project regarding exploration, production, transportation and initial storage of oil.<sup>53</sup> With new measures, the government has been putting increasing pressure on all foreign companies, including France's Total, Italy's ENI, Spain's Repsol, Statoil, Norway's NOC, the UK's BP and U.S. companies Conoco Phillips, Chevron and Exxon Mobil, with existing operating agreements to change over to the new regime.

<sup>50</sup> De jure, the tax rate for hydrocarbons production was 67.7 percent. However, the oil companies were de facto subjected to the 34 percent rate applicable to the non-oil sector. The de facto increase in corporate tax rate for hydrocarbons, from 34 to 50 percent in 2001 was de jure a drop from 67.7 percent to 50 percent.

<sup>51</sup> "Venezuela: Proposed Measures against Oil and Gas Investors," Freshfields Bruckhaus Deringer Briefing, May 2005, p. 1.

<sup>52</sup> "Venezuela Country Analysis Brief." Taxes based on oil income are difficult to control because PdVSA or other oil companies deduct their expenses from the income on which they have to pay the taxes. Since expenses are not that easily identifiable for an outside auditor, the taxpayer can attempt to inflate expenses, in order to lower their tax payments.

<sup>53</sup> Ibid.

The new law came into practice on 10 October 2004, when Chávez surprised the IOCs by announcing on his weekly radio broadcast that he was increasing royalties paid to the state by companies involved in heavy crude production in the Orinoco Tar Belt.<sup>54</sup> Chávez noted that higher oil prices justified the increase, as oil companies were earning substantially higher profits.<sup>55</sup> In the following week, Stratfor suggested that Chávez's decision revealed that the Venezuelan government was anxious to get its hands on a greater share of oil revenues, despite record high oil prices. It also showed that Chávez recognised that his political control could be undermined if he lost the support of the lower classes, putting pressure on the budget to increase social spending.<sup>56</sup> Besides \$6.9 billion that he channelled through PdVSA to support social expenditures,<sup>57</sup> Chávez clearly needed more money to fund his Bolivarian Revolution, both at home and abroad.

The affected companies signed strategic association agreements in the mid-1990s for the production in the Orinoco Belt.<sup>58</sup> These strategic associations, as well as 32 other operating service agreements with private companies, were signed on very favourable terms for the companies, and they reflected la apertura and the overall cooperative FDI climate of the 1990s, as some have argued that Venezuela went through an informal privatisation in the 1990s.<sup>59</sup> In addition, the low corporate tax rates and royalties associated with the initial contracts were designed to offset the high investment costs needed to set up the upgrading and conversion process for this type of production. Due to new contracts, the IOC share in Venezuela's oil output grew from 300,000 bpd in 1998 to 1.2 million bpd in 2004.<sup>60</sup>

Chávez's decision did not come as a surprise to a follower of events in Venezuela, as he has long railed against what 'sweetheart' deals afforded foreign oil companies in Venezuela,

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<sup>54</sup> "Global Market Brief," Stratfor, October 18, 2004.

<sup>55</sup> Ibid.

<sup>56</sup> Ibid.

<sup>57</sup> The figure is for up to 2005, and includes programs related to education, healthcare, job creation, and subsidised food distribution. For more details, see Mares and Altamirano, "Venezuela's PDVSA and World Energy Markets," pp. 46-7 and 58-63.

<sup>58</sup> "Global Market Brief," Stratfor, October 18, 2004. These are Petrozuata (PdVSA 49.9 %; Conoco Phillips 50.1 %), Cerro Negro (PdVSA 41.67 %; Exxon Mobil 41.67 %, BP 16.66 %), Sincor (PdVSA 38 %, Total 47 %, Statoil 15 %) and Hamaca (PdVSA 30 %, Conoco Phillips 40 %, Chevron 30 %). "Venezuela Country Analysis Brief."

<sup>59</sup> Giusti, "La Apertura," p. 117.

<sup>60</sup> "Hugo Chávez's Venezuela," *The Economist*. Of which, four strategic alliances (or JVs) in the Orinoco Belt account for approximately 622,000 bpd.

and has taken steps for remedy three years prior to his October 2004 decision. Thus, the 2001 Hydrocarbons Law was a legal basis for his action. In announcing the royalty and oil corporate tax increase, Chávez announced that “today, we are starting the second phase of the true nationalisation of PdVSA and of Venezuela’s oil, aiming for full petroleum sovereignty.”<sup>61</sup> Concurrently, Venezuela’s new Energy and Petroleum Minister Rafael Ramirez stated, “We are working on becoming a tool for the state to recover its sovereignty. When the private companies have control over production, it’s impossible to conduct your own national oil policy.”<sup>62</sup>

A telling sign of the emerging adverse political climate in Venezuela came in January 2005 when PdVSA officials ordered the Houston-based firm Harvest Natural Resources to cut production by one third, a step that sent the company’s stock price tumbling.<sup>63</sup> Moreover, on 14 April 2005, Ramirez announced that operating strategic agreements between PdVSA and foreign companies would be terminated from 31 December 2005, with a grace period of six months for companies who are parties to operating contracts.<sup>64</sup> Upon termination, operating strategic agreements would be converted into joint ventures (JVs) in which the government would have a 51-70 percent stake of the equity, and in addition, there was to be an increase in the income tax for the IOCs.<sup>65</sup>

There has been no suggestion that any compensation was to be paid to foreign oil companies for abandoning their rights under current operating agreements.<sup>66</sup> All of the operating agreements currently in force in Venezuela have dispute resolution clauses, which provide for international arbitration. The new Hydrocarbons Law, however, requires all new contracts to contain the following clause:

Any doubts and controversies of any nature that may arise from the agreement and that may not be amicably settled between the parties, including arbitration in cases permitted by the law on the matter, shall be settled by the competent courts of the republic [of Venezuela] pursuant to its laws, and may not give rise to any foreign claims for any reason whatsoever.<sup>67</sup>

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<sup>61</sup> “Global Market Brief,” *Stratfor*, October 18, 2004.

<sup>62</sup> Venezuela’s Energy Minister Rafael Ramirez, quoted in Nelson D. Schwartz, “Oil’s New Mr. Big,” *Fortune*, October 3, 2005, p. 57.

<sup>63</sup> *Ibid.*

<sup>64</sup> “Venezuela: Proposed Measures against Oil and Gas Investors,” p. 2.

<sup>65</sup> “Hugo Chávez’s Venezuela,” *The Economist*.

<sup>66</sup> *Ibid.*

<sup>67</sup> Article 34 b) quoted in *ibid.*

This clause is dangerously ambiguous as it clearly establishes Venezuelan law and jurisdiction as the 'default' clause if no arbitration clause is included in the contract. Thus, it is possible to interpret the clause as an attempt to exclude foreign arbitration clauses altogether, and the result could cause uncertainty for the IOCs.<sup>68</sup>

There was no shortage of disturbing news for the IOCs, as it came out in May 2005 that the IOCs operating in the country have been compared to Yukos and ordered to pay between \$2 and 3 billion in back taxes for the last ten years.<sup>69</sup> For illustration, in early August, 2005, Royal Dutch/Shell's office in Maracaibo, city in western Venezuela, was closed by the Venezuelan tax agency for challenging its \$132 million tax bill, which was given to Shell in July 2005.<sup>70</sup> High oil prices meant that other IOCs had to acquiesce,<sup>71</sup> or face similar problems. Rafael Ramirez said, "Most companies are willing to pay, and they are paying."<sup>72</sup> As of 2006, the government has collected around \$266 million in back taxes from the IOCs for the period between 2001 and 2004.<sup>73</sup>

By October 2005, 22 of the 32 operating agreements signed by foreign oil companies with PdVSA have been migrated to the new regime,<sup>74</sup> and in late 2005, Caracas reaffirmed that future investments in the Orinoco Tar Belt would be subject to higher royalties and that the current terms would be renegotiated at some point.<sup>75</sup> Initially, the affected IOCs have said publicly only that they were studying the matter, and they were very unlikely to pull out of the projects.<sup>76</sup> However, the 2001 Hydrocarbons Law clearly discouraged the IOCs from any new investment in Venezuela, as higher royalties and the limitations placed on JVs made FDI very unattractive. The new tax regime will most likely have a negative effect

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<sup>68</sup> Ibid.

<sup>69</sup> This has no legal foundation, as "the 2001 Hydrocarbon Laws are not retroactive. They only apply to new licenses, concessions or contracts, not to the old ones." Mommer, "Venezuelan Oil Politics at the Crossroads."

<sup>70</sup> "Venezuela Tax Agency Closes Shell Office," *Business Week*, August 11, 2005.

<sup>71</sup> Mommer, "Venezuelan Oil Politics at the Crossroads." Brazil's Petrobras, Royal Dutch/Shell, Spain's Repsol, and Chevron, all have expressed interest in projects despite the shift in taxes. Millard, "Venezuela Assails Past Oil Contracts," p. 1.

<sup>72</sup> Schwartz, "Oil's New Mr. Big," p. 58.

<sup>73</sup> "News in Brief," *Petroleum Economist*, no. 1, 2006, p. 10.

<sup>74</sup> "Venezuela Says All But 10 Companies Have Switched to New Contracts," AFX News Limited, October 25, 2005.

<sup>75</sup> Nelson D. Schwartz, "Oil's New Mr. Big," *Fortune*, October 3, 2005, p. 57.

<sup>76</sup> Ibid.

on balance sheets of foreign oil companies in Venezuela, and in future, PdVSA will be able to use its controlling interest in all JVs to direct the decision-making process.<sup>77</sup>

On 1 April 2006, Venezuela's government took control of two oilfields, one operated by France's Total and the other by ENI of Italy, after the companies refused to sign up to new arrangements converting their operating contracts into JVs in which PdVSA will have a majority stake. Ramirez claimed that Venezuela does not need companies that refuse to adjust to the new terms, and that Total and ENI would not be compensated for the fields they lost.<sup>78</sup> ENI, which has invested some \$1.65 billion in its 60,000 bpd field, lost \$900 million, while Total lost approximately \$320 million.<sup>79</sup> Exxon Mobil earlier sold a minority stake in a small, 15,000 bpd field to Repsol, the field's operator, to avoid the change and confrontation with the government,<sup>80</sup> but it remained active in a bigger, heavy oil project.

In late April 2006, after all 32 oil fields have been shifted to joint ventures, rumours have started that four heavy oil projects in the eastern Orinoco River basin, where Exxon Mobil, Chevron, Total, BP, Conoco Phillips and Statoil convert extra heavy crude into 600,000 bpd of synthetic crude using specialised refineries,<sup>81</sup> could follow suit in near future.<sup>82</sup> This was just "a matter of time" according to Juan Carlos Sosa Azpurua, president of Grupo Petroleo YV, a Caracas-based energy consultancy.<sup>83</sup> It was suggested that the companies involved could see income taxes increased to 50 percent from 34 percent and royalties hiked to 30 percent from 16.66 percent, as according to the new law.<sup>84</sup>

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<sup>77</sup> "Venezuela: Proposed Measures against Oil and Gas Investors," p. 2.

<sup>78</sup> "This country does not allow itself to be blackmailed," said Ramirez. "These two multinational companies resist adjusting to our law. Our sovereignty isn't under negotiation." Quoted in Jens Gould, "Venezuela Tightens Oil Grip," *The Christian Science Monitor*, April 14, 2006. Also see Peter Millard and Angel Gonzalez, "Pressure Rises on Total in Venezuela, Sincor Under Fire," *Dow Jones Energy Service*, May 30, 2006.

<sup>79</sup> Stanley Reed and Stephen Ixer, "You're Working For Chavez Now," *Business Week*, May 15, 2006.

<sup>80</sup> "Leaving the Door Ajar," *The Economist*, April 8, 2006, p. 43.

<sup>81</sup> The companies have invested a combined \$16 billion in developing the technology and infrastructure to extract tar-like bitumen and convert it into lighter, more marketable crude at the giant Jose refinery. The Orinoco projects in eastern Venezuela differ markedly from the 32 oil fields where the state has already taken a majority share, because companies operating in the Orinoco, unlike in the other fields, own the bulk of the infrastructure in the area.

<sup>82</sup> Eulogio Del Pino, a director of PdVSA suggested this cause of action. The government should "do the job completely and the participation of the state should be 51 percent." See "Venezuela to Expand Joint Oil Ventures," *Washington Post*, April 23, 2006.

<sup>83</sup> Quoted in Natalie Obiko Pearson, "Venezuela Seeks Control Over Oil Projects," *Business Week*, April 24, 2006.

<sup>84</sup> *Ibid.*

Indeed, it did not take long for these rumours to materialise. On 8 May 2006, Chávez increased royalties for all companies involved in the country not to 30, but to 33.3 percent.<sup>85</sup> This measure was to affect the abovementioned companies extracting heavy crude in the Orinoco tar belt, as this area had been exempt from higher royalties in past due to higher investment needs. The income tax was also raised, as predicted, to 50 percent from 34 percent. Rafael Ramirez indicated that the new policies were not open for negotiations: “We don’t have anything to discuss with the companies ... The companies have to adjust.”<sup>86</sup> Finally, in late February 2007, Chávez signed a decree for the government to take a majority (60 percent) stake in four heavy crude upgrading projects in the Orinoco River basin by 1 May 2007.<sup>87</sup>

All the measures taken by Venezuela serve as evidence that the 2001 Hydrocarbons Law has been applied in practice, and that Venezuela is in a strong bargaining position vis-à-vis the IOCs. With demand for oil booming and the majority of reserves shut out to foreign investment in the Middle East, oil companies have had no choice but to accept the new terms in Venezuela,<sup>88</sup> and “[t]he negotiating position of countries with reserves has strengthened.”<sup>89</sup> In the Western hemisphere, Canada already has new projects under way, and Mexico’s reserves are in decline, improving Venezuela’s chances for achieving favourable terms on new projects.

Ramirez is not just setting his sights on foreign firms in Venezuela. He wants PdVSA to work with NOCs in countries such as Iran, Saudi Arabia and Algeria so that the NOCs can wrest even more power away from the likes of Exxon Mobil and other IOCs: “This does not mean we will refuse to work with private companies,” says Ramirez. “But when oil companies have the high hand over a country, there is no way for a country to resist the pressure coming from these companies.”<sup>90</sup> Thus, PdVSA found new partners for Orinoco JVs – NOCs from political allies, including Brazil, Iran, Russia, Argentina, Spain, China,

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<sup>85</sup> Natalie Obiko Pearson, “Chavez Tax Targets Foreign Oil Companies,” *Washington Post*, May 8, 2006. For more detail, see “Chavez Triumphant,” *Petroleum Economist*, March 2006.

<sup>86</sup> Quoted in Obiko Pearson, “Chavez Tax Targets Foreign Oil Companies.”

<sup>87</sup> Enrique Andres Pretel, “Exxon to Cede Oil Project Ops to Venezuela by May,” *Washington Post*, March 1, 2007.

<sup>88</sup> Mazhar al Shereidah, a professor of oil economics at the Central University of Venezuela, quoted in Peter Millard, “Venezuela Assails Past Oil Contracts,” *Wall Street Journal*, June 8, 2005.

<sup>89</sup> *Ibid.*

<sup>90</sup> Schwartz, “Oil’s New Mr. Big,” p. 57.



India, Uruguay, Bolivia, Ecuador, Belarus, and Vietnam, operated with technology purchased off the shelf.<sup>91</sup> For example, one of the NOCs involved, China's CNPC, received a best production technology award for its achievements in heavy oil recovery during 2006.<sup>92</sup> While PdVSA is to develop 14 blocks in the Orinoco Belt on its own, the other 13 blocks will be developed through JVs with other NOCs who will have at most 49 percent ownership. This is an obvious sign that Caracas intends to use its billions of barrels of heavy oil as bait to secure pragmatic diplomatic alliances. Venezuela, therefore, has an 'ace up its sleeve' in negotiating with Big Oil – NOCs eager for a foothold. Any Western corporation that exits Venezuela could eventually be replaced by a Chinese, Indian, Russian or some other country's NOC. As Ramirez says, "There is a lot of interest from China and India, that's a brand new condition.... Yes, they have huge, deep pockets."<sup>93</sup>

After being triumphant in his policy, Chávez declared, "We [Venezuela] have buried that perversion that was the oil opening. Anyone who doesn't like that can go elsewhere."<sup>94</sup> However, according to *The Economist* "most of the multinationals are not leaving" and "Venezuela is still worth being in," as "few countries with abundant reserves are open to foreigners."<sup>95</sup> For example, the head of Royal Dutch/Shell's operations in Venezuela, Sean Rooney did not complain after the tax hike was imposed retroactively:

The government of Venezuela is auditing the majority of oil companies' returns. We were lucky enough to be the first. It is hard to turn away from the tremendous opportunities in Venezuela. The Venezuelans can and will be extracting higher rents, and we expect and accept this. We are prepared to pay more when the opportunity merits.<sup>96</sup>

In addition, Chevron, just like Royal Dutch/Shell, has adopted a remarkably accommodating stance towards Venezuela. Although tax auditors raided a Chevron office in Maracaibo in July 2005, the company was not protesting while it awaited a possible back-tax bill. Vice chairman Peter Robertson insisted Chevron had "a good, excellent

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<sup>91</sup> "Chavez Triumphant;" *El Universal*, November 14, 2006; and Mares and Altamirano, "Venezuela's PDVSA and World Energy Markets," p. 67.

<sup>92</sup> Mares and Altamirano, "Venezuela's PDVSA and World Energy Markets," p. 76; and *World Oil Magazine*, October 20, 2006. For more on CNPC's impressive operations in Venezuela, see Xu, "Chinese NOCs' Overseas Strategies," p. 8.

<sup>93</sup> Schwartz, "Oil's New Mr. Big," p. 59.

<sup>94</sup> Quoted in "Leaving the Door Ajar," *The Economist*, April 8, 2006, p. 43.

<sup>95</sup> *Ibid.*

<sup>96</sup> Schwartz, "Oil's New Mr. Big," p. 58.

relationship with Venezuelan government.” His boss, CEO Dave O’Reilly, added, “Venezuela will work its way through this. Ramirez is a very straight shooter.” Indeed, O’Reilly said Chevron would like to invest more in Venezuela.<sup>97</sup> According to Luis Giusti, former president of PDVSA, “the foreign companies will accept [Chávez’s] decisions because they have so much capital sunk there, and they can’t afford a confrontation with the government.”<sup>98</sup>

The only foreign giant initially fighting hard against Venezuela’s moves was Exxon Mobil. It was threatening to sue the Venezuelan government and bring international arbitration proceedings, citing the legal sanctity of the original contracts. However, Ramirez was betting it would not go that far: “I have a hunch that they will finally read the clauses of the contract and realise we are right.” An Exxon Mobil spokesperson said that while arbitration remained an option, the company “wishes to explore an amicable resolution.”<sup>99</sup> Exxon Mobil was at a particular disadvantage in dealing with Venezuela, as it had “developed a reputation for arrogance that has at times rankled host governments” under the lead of Lee Raymond.<sup>100</sup> In Russia, Lee Raymond’s high-handed manner in pursuing Yukos without government blessing offended Vladimir Putin. Raymond’s abrasive style also reportedly annoyed Saudi Arabia’s oil minister so much that it was partly responsible for failing to materialise a big investment deal.<sup>101</sup> Raymond’s retirement in 2006 caused a change in ways Exxon Mobil deals with oil producing governments. Firstly, the company decided not to pursue matters in Venezuela any further, and as shown above, sold its small stake to Spain’s Repsol. Secondly, in late February 2007, after Chávez signed a decree for the government to take a 60 percent stake in four heavy crude upgrading projects in the Orinoco basin by 1 May 2007, Exxon Mobil announced plans to hand its \$30 billion Cerro Negro operations to the Venezuelan state before deadline. Chevron was also expected to accept the new terms.<sup>102</sup> As of early May 2007, all companies, but ConocoPhillips, have

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<sup>97</sup> Ibid.

<sup>98</sup> Quoted in Robert Collier, “Chavez Drives a Hard Bargain, But Big Oil’s Options are Limited,” San Francisco Chronicle, October 19, 2006.

<sup>99</sup> Schwartz, “Oil’s New Mr. Big,” p. 59.

<sup>100</sup> “Life after Lee,” The Economist, December 24, 2005, p. 90.

<sup>101</sup> Ibid.

<sup>102</sup> Pretel, “Exxon to Cede Oil Project Ops;” and Simon Romero and Clifford Krauss, “High Stakes: Chávez Plays the Oil Card,” The New York Times, April 10, 2007.

agreed to state control, and it is likely that ConocoPhillips will follow suit due to Chávez's expropriation threats.<sup>103</sup>

### Chávez vs. the United States

For Chávez, American might is reflected in the continuing operations of major U.S. IOCs like Exxon Mobil and Chevron in Venezuela, and this is something that had to be changed. As discussed above, PdVSA raised the royalties and the corporate tax rates, and reviewed the terms of 32 existing contracts with foreign oil corporations,<sup>104</sup> turning most of them into JVs what gives the state a majority share. Chávez, now fully in control of PdVSA, which has become his foreign policy tool,<sup>105</sup> seems determined to use his country's vast oil reserves as a weapon against the Bush administration.<sup>106</sup> In a statement that affirms this, he stated that "[Venezuela has] a strong oil card to play on the geopolitical board ... against the world's roughest players, the United States."<sup>107</sup> Moreover, Chávez is sending signals that he wants to do less energy business with the United States and more with other countries. In a move that would clearly indicate his ambition to reduce oil exports to the U.S., Chávez appears set on reducing the size of CITGO, a big refiner and marketer of gasoline in the United States and a wholly owned subsidiary of PdVSA, and at reducing Venezuela's oil exports to the United States.<sup>108</sup> Although as of late 2006, Venezuela was still the fourth largest supplier of crude oil and products to the U.S., its exports to the U.S. dropped by 18 percent between January and June 2006. While in the first four months of 2005 Venezuela sent 190.1 million barrels to the U.S, the figure for the same period in 2006 stood at 178.2 million barrels of crude oil and petroleum products.<sup>109</sup> Moreover, in July 2006 CITGO announced plans to reduce its network of U.S. gas stations by 14

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<sup>103</sup> "Venezuela Pulls Control From Big Oil," Reuters, May 1, 2007.

<sup>104</sup> Contreras, "Balance of Power," p. 35.

<sup>105</sup> Personal communication with oil industry expert Ivor Williams, currently situated in Venezuela.

<sup>106</sup> Joseph Contreras and Phil Gunson, "Balance of Power," Newsweek, February 14, 2005, p. 34; and "Venezuela's Chavez Threatens to Halt Oil Exports to U.S., Says Foes Unwelcome in State Firm, Military," International Herald Tribune, November 4, 2006. For more on Chávez's grievances with the U.S., see Kozloff, Hugo Chávez, particularly chapters 1 and 2.

<sup>107</sup> Hugo Chávez quoted in "Chávez Squeezes the Oil Firms," The Economist, November 12, 2005, p. 43.

<sup>108</sup> "Hugo Chávez's Venezuela," The Economist. See also "Petroleos de Venezuela: State Oil Company is in Talks to Sell 2 Refineries of U.S. Unit," Wall Street Journal, April 19, 2005, p. 1; Peter Wilson, "Venezuela's Oil Sales to U.S. Drop as Chavez Sends More to Asia," Bloomberg.com, July 12, 2006.

<sup>109</sup> Peter Wilson, "Citgo to Drop Retail Sales in 10 States, Part of Arkansas," Bloomberg.com, July 13, 2006.

percent, to 11,200,<sup>110</sup> and in August 2006, this was followed by the \$2.3 billion sale of 42.1 percent share in the Lyondell-CITGO refinery.<sup>111</sup> In early April 2007, Rafael Ramírez sent a chilling signal to the U.S., saying Venezuela might sell refineries in Texas and Louisiana that process crude from Exxon's Venezuelan oil fields.<sup>112</sup> To some in the United States, the Venezuelan leader is starting to look like their worst hemispheric nightmare: a second Fidel Castro – but, unlike the Cuban, with lots of oil and therefore money. They accuse him not only of crushing Venezuelan democracy but also of destabilising much of Latin America by helping Colombia's guerrillas and funnelling money to radical movements in Nicaragua, Ecuador and Bolivia.<sup>113</sup>

Besides reducing American and other Western IOC presence in Venezuela, and threatening to reduce oil exports to the U.S., there are signs that Chávez wants to redirect Venezuela's oil from the United States to China. For example, in March 2007 Chávez said that China was set to rival the United States as Venezuela's top oil buyer.<sup>114</sup> A possible impact of a decrease in Venezuelan exports to the U.S. would, at a minimum, increase U.S. reliance on oil from the Middle East, what would work against the U.S. diversification strategy as outlined in the 2001 NEP. In December 2004, President Chávez was reported to have referred to Venezuela's long oil-producing history as "100 years of domination by the United States." He asserted that "Now we are free and place this oil at the disposal of the great Chinese fatherland."<sup>115</sup> In January 2005, upon Chávez's visit to Beijing, Venezuela signed 19 bilateral oil and gas agreements with China in order to increase exports to Beijing in exchange for the promise of future Chinese investment in Venezuelan oilfields.<sup>116</sup> Moreover, in May 2005, the first ever tanker with 1.8 million barrels of crude left Venezuela for China,<sup>117</sup> and in August 2005, Venezuela opened its first oil office in China. After exporting only 12,300 bpd in 2004, in 2005, Venezuela exported 65,500 bpd

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<sup>110</sup> Christopher Palmeri and Geri Smith, "Chavez Starts Punishing America," *Business Week*, September 25, 2006, p. 39.

<sup>111</sup> Mares and Altamirano, "Venezuela's PDVSA and World Energy Markets," p. 52.

<sup>112</sup> Romero and Krauss, "High Stakes".

<sup>113</sup> How Big a Threat is Hugo Chávez?" *The Economist*.

<sup>114</sup> "Chavez: China to Become a Top Client," *Associated Press*, March 23, 2007.

<sup>115</sup> Juan Forero, "China's Oil Diplomacy in Latin America," *New York Times*, March 1, 2005.

<sup>116</sup> Contreras and Gunson, "Balance of Power." The agreements signed in January 2005, commit the CNPC, which was already operating two Venezuelan oilfields, to spend over \$400 million in developing 15 mainly mature oil fields and a gas project. Auerback, "The Militarisation Of Oil;" Kerry Dumbaugh and Mark P. Sullivan, "China's Growing Interest in Latin America," *CRS Report for Congress*, Washington, D.C.: Congressional Research Service, The Library of Congress, April 20, 2005, p. 3; and Chietigi Bajpae, "China's Quest for Energy Security," *Power and Interest News Report*, February 25, 2005, <http://www.pinr.com> (November 20, 2005).

<sup>117</sup> Steven Dudley, "In Ideology, Oil, Two Nations Find Common Ground," *The Miami Herald*, August 14, 2005.

of crude oil and products to China.<sup>118</sup> However, after the signing of two contracts for crude and fuel oil between CNPC and PdVSA in November 2005, Venezuela was to double oil sales to China, to 160,000 bpd average in 2006, with ambitious plans to bring this to 300,000 by the end of 2006, 500,000 bpd by 2010, and 1 million bpd by 2012.<sup>119</sup> In announcing Venezuela's future plans in March 2007, after meeting with CNPC officials, Chávez said, "As a power, the United States is going down, while China is moving up." Thus, "When we [Venezuela and China] begin speaking of 1 million barrels of crude, we're nearing the level of Venezuelan supplies to the United States". Although these ambitious plans did not materialise by January 2007, when China imported around 135,000 bpd from Venezuela,<sup>120</sup> Venezuela's oil exports to China have been on the constant rise.

Beyond oil, Venezuela bought a Chinese communications satellite in 2005, to be named 'Simón Bolívar' and launched in 2008.<sup>121</sup> It has also purchased Chinese radar equipment to monitor its borders, and it is interested in working with the Chinese to upgrade its ageing air force, since the purchase of Spanish military aircraft was blocked by the United States in January 2006 on the grounds of a 1976 act permitting it to prevent the transfer of U.S.-sourced technology.<sup>122</sup> The two countries are even cooperating on the internet. The oil-industry source says members of PdVSA travelled to Beijing to learn techniques for eavesdropping on internet traffic!<sup>123</sup>

However, some have cautioned that both countries will have to overcome major obstacles before China can become a significant alternative to the United States.<sup>124</sup> One problem is geography, as Venezuela has no outlet on the Pacific Ocean. Another is logistical, as PdVSA's shipping fleet consists of relatively small vessels that can reach American shores within a week, much shorter period than to reach China. The company lacks super tankers,

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<sup>118</sup> Mares and Altamirano, "Venezuela's PDVSA and World Energy Markets," p. 19.

<sup>119</sup> Peter Wilson, "Venezuela Sign Pacts to Double Oil Sales to China," Bloomberg.com, November 14, 2005; Michael Locker and Dave Hancock, "Venezuela and China – Towards a Multi-Polar World," Venezuelanalysis.com, October 16, 2006, <http://www.venezuelanalysis.com>, [October 22, 2006]; "Chavez: China to Become a Top Client."

<sup>120</sup> David Harman, "China's Crude Oil Import Rises 3.5% in January," Resource Investor, March 1, 2007.

<sup>121</sup> Cited in "Chavez: China to Become a Top Client."

<sup>122</sup> Ben Schiller, "The Axis of Oil: China and Venezuela," Global Envision, April 2006, <http://www.globalenvision.org/library/3/1020>, [April 24, 2006].

<sup>123</sup> Ibid.

<sup>124</sup> Contreras, "Balance of Power," p. 35.

needed to reach the Far East. A third impediment is China's energy infrastructure, which lacks refineries capable of processing Venezuela's high-sulphur brand of crude.<sup>125</sup>

Since there is a strong interest for cooperation on both sides, steps have been taken to overcome all of these obstacles, and the Chinese have invested in transport networks to help take its purchases home. Firstly, there have been indications that up to a \$4.7 billion pipeline will be constructed from Venezuela, through Colombia and then to the Pacific Coast. This would enable Venezuelan crude to bypass the U.S.-controlled Panama Canal.<sup>126</sup> The two countries have been moving forward on the pipeline plan, and China has been interested in funding this project. This pipeline would reduce the tanker trip to China by ten days. China has also expressed interest in constructing and financing various projects to modernise the Panama Canal. Secondly, China and PdVSA are building a large fleet of their own super tankers which, when built, can be utilised to carry Venezuelan crude.<sup>127</sup> In May 2006, PdVSA announced that it planned to buy 18 oil tankers from Chinese shipyards at a cost of \$1.3 billion to allow for increased shipments to China.<sup>128</sup> Moreover, in March 2007, Chávez said the two countries decided to start a joint oil shipping company with its own tankers to carry crude and other products between Venezuela and China.<sup>129</sup> Thirdly, China is building a number of refineries along its coast in order to be able to process more of Venezuela's high-sulphur crude. For example, in March 2007, Chávez announced plans for Venezuela and China to build three refineries in China that will process a total of 800,000 bpd of heavy Venezuelan crude, which according to Chávez, will be ready "within two or three years."<sup>130</sup> Until then, sales to China do not necessarily have to be direct, as they can be channelled through other major refining centres, such as Singapore, where they are processed, and then shipped to China.<sup>131</sup>

As evident from its interests in Venezuela, China's interest in Latin America is significant and expanding, although China's interest in Latin America is a new phenomenon that has

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<sup>125</sup> *Ibid.*

<sup>126</sup> George Jahn, "China, India Pursue Oil-rich Countries Hostile to U.S.," *The Washington Times*, July 21, 2005.

<sup>127</sup> PDV Marina, an affiliate of PdVSA, plans to invest as much as \$2.2 billion between 2005 and 2012 to build 42 new tankers, so it can ship 45 percent of its crude production by 2012, mainly in order to sell more to Asia. "Venezuela Opens Oil Office in China," *China Daily*, [www.chinadaily.com.cn](http://www.chinadaily.com.cn), August 21, 2005.

<sup>128</sup> Wilson, "Venezuela's Oil Sales to U.S. Drop."

<sup>129</sup> "Chavez: China to Become a Top Client."

<sup>130</sup> Cited in *ibid.*

<sup>131</sup> Ivor Williams confirmed that Venezuelan sales are already channelled through an unidentified agency.

developed since April 2001, when President Jiang Zemin toured Latin America.<sup>132</sup> China's Venezuelan policy is part of what some analysts call its 'south-south' strategy – a plan to build a coalition of cooperating countries across Latin America and Africa.<sup>133</sup> In the past six years, Chinese imports from Latin America have grown six fold, or by nearly 60 percent a year, as the region has become a vital source of raw materials and foodstuffs for China.<sup>134</sup> Many people in Latin America in general and Venezuela in particular look to China as an economic and political alternative to U.S. hegemony and both countries "reject a 'uni-polar' world dominated by Washington."<sup>135</sup> Beijing's interests in the region as a whole and in Venezuela per se, mainly focus on greater access to needed resources, primarily oil.<sup>136</sup> China is a natural new partner for Venezuela. It has capital, technology, managerial skills and markets Venezuela needs to develop old and new oil fields and to sell its crude, since the government has an ambitious plan to expand oil output to 5 million bpd by 2009, mainly by bringing in NOCs.<sup>137</sup> In return, Venezuela will help China diversify the sources of its imported oil. While China is a long way from threatening, or even competing with the overall U.S. influence in Latin America, the former is engaged in a pragmatic and aggressive pursuit of economic and political advantages in the region, as in many other regions of the world.<sup>138</sup>

At the official level, the U.S. reaction to China's Latin American campaign has been muted, and critics of the administration point out that it has taken its 'eye off the ball' while it has been engaged in the Middle East. Washington only recently showed signs of worries about China's growing presence in Latin America in general, and Venezuela in particular, and this concern has been the subject of congressional hearings. In fact, some members of Congress view China as the most serious challenge to U.S. interests in the region since the collapse of the Soviet Union. They cite the huge financial resources China is promising to bring to Latin America, its growing military-to-military relations in the

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<sup>132</sup> Followed most recently with high-profile visits by President Hu Jintao (November 2004) and Vice-President Zeng Qinghong (January 2005).

<sup>133</sup> Schiller, "The Axis of Oil."

<sup>134</sup> China has pledged investing over \$100 billion in Latin America and has invested in Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

<sup>135</sup> William Ratliff, "Pragmatism over Ideology: China's Relations with Venezuela," *China Brief*, vol. 6, no. 6, March 15, 2006.

<sup>136</sup> Dumbaugh and Sullivan, "China's Growing Interest in Latin America," p. 1.

<sup>137</sup> "How Big a Threat is Hugo Chávez?" *The Economist*.

<sup>138</sup> Peter Hakim, "Is Washington Losing Latin America?" *Foreign Affairs*, vol. 85, no. 1, January-February 2006, p. 43.

region, and its clear political ambitions there, all as potential threats to the long-standing pillar of U.S. policy in the hemisphere, the Monroe Doctrine.<sup>139</sup>

In addition to its increasing cooperation with China, Venezuela has been improving relations with other non-Western powers, such as India, Iran, and Russia. In April 2006, Venezuela has begun to ship around 2 million barrels of oil per month to India, making use of India's heavy crude refineries, for which Venezuela's high sulphur oil is not an issue.<sup>140</sup> Venezuela's deal with India is just one part of a nascent multi-tier cooperation between the two nations in which Venezuela is helping India develop its own heavy crude fields, and India is in turn purchasing Venezuelan heavy crude and investing in the facilities necessary to refine heavy crude. While the new deal with India is relatively small, it nevertheless represents a step down a sustainable path towards diversifying Caracas' oil markets away from the United States, and towards Asia. Moreover, in March 2005, a delegation from Tehran visited Caracas, and PDVSA employees are now getting technical training from Iran.<sup>141</sup> In addition, in his July 2006 visit to Tehran, where after pledging that Venezuela would "stand by Iran at any time and under any condition," Chávez invited Iranian investment in Venezuela's oil industry.<sup>142</sup> He received a response in August 2006, when Iran's state-owned Petropars pledged to spend \$4 billion to develop two oilfields in Venezuela.<sup>143</sup>

Finally, the relationship between Russia and Venezuela has also been very close in recent years. While Chávez took the initiative in cultivating ties to Putin in 2001 when he visited Moscow for the first time in May and also in October that year, little of substance occurred in Russian-Venezuelan relations until Chávez's third visit in November 2004, when the two sides concluded an agreement setting the stage for Venezuelan purchases of Russian arms. Agreements on energy and other matters were also signed.<sup>144</sup> In February

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<sup>139</sup> Ibid.

<sup>140</sup> Jon Duarte, "Venezuela: Turning Off the Taps to U.S." Rigzone, April 18, 2006, <http://www.rigzone.com>, [April 24, 2006]; and "India, Venezuela: Caracas Diversifies its Oil Markets," Stratfor Situation Report, April 14, 2006.

<sup>141</sup> Ibid. Also see "Venezuela, Iran Said Discuss Oil Project," Houston Chronicle, May 30, 2006.

<sup>142</sup> "Chávez Invites Iranian Investment," BBC News, July 30, 2006, [http://news.bbc.co.uk/go/pr/ft/-/2/hi/middle\\_east/5226290.stm](http://news.bbc.co.uk/go/pr/ft/-/2/hi/middle_east/5226290.stm), [August 9, 2006].

<sup>143</sup> According to Iran's Oil Minister, Kazem Vaziri Hamaneh, quoted in "News in Brief," Petroleum Economist, no. 2, 2006, p. 15. Also, see Simon Romero, "Venezuela, Tired of U.S. Influence, Strengthens Its Relationship with the Middle East," New York Times, August 21, 2006; and Lapper, "Living with Hugo," pp. 18-9 and 31-2.

<sup>144</sup> Mark N. Katz, "The Putin-Chavez Partnership," Problems of Post-Communism, vol. 53, no. 4, July/August 2006, p. 5.



2005, Rosoboroneksport signed a contract to sell 100,000 Kalashnikov rifles to Venezuela, and in addition to this deal, Moscow has offered Venezuela the opportunity to manufacture Kalashnikovs under license. In March 2005, representatives of the two countries signed a \$120 million agreement for Venezuela to purchase nine attack and one transport helicopter, first three of which were delivered in December 2005. Additionally, there are indications that Caracas may purchase another 34 Russian helicopters and 50 MiG-29 fighter aircraft to replace its fleet of 22 American-made F-16s, which cannot fly because Venezuela cannot purchase replacement parts for them from the United States.<sup>145</sup> Finally, an agreement on cooperation in the energy sphere was signed that envisions Russian firms building petrochemical and power plants in Venezuela as well as participating in oil and gas exploration, extraction, refining, and transport.<sup>146</sup> Russian firms will also engage in modernising the Venezuelan coal industry.<sup>147</sup> Clearly, Putin and Chávez see each other as allies against U.S. unipolarity and hegemony, and their relationship “seems likely to continue and even intensify.”<sup>148</sup>

Besides improving relations with China, India, Iran, and Russia, Chávez’s actions against IOCs contributed to similar developments in Bolivia,<sup>149</sup> as in early May 2006, Bolivia’s President Evo Morales, a close friend of Hugo Chávez, signed a decree placing his country’s energy industry under state control, and claiming, “The pillage of our [Bolivia’s] natural resources by foreign companies is over.” In a May Day speech, he said foreign energy firms must agree to channel all their sales through the Bolivian state-run firm, Yacimientos Petroliferos Fiscales Bolivianos (YPFB), or else leave the country.<sup>150</sup> Although he set the firms a six-month deadline, the military and state energy officials have as of May 2006 started taking control of the oil fields and overall 56 energy installations.<sup>151</sup> Of major IOCs, Exxon Mobil, Total and BP have existing operations in Bolivia. Moreover, there are

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<sup>145</sup> Ibid, p. 6.

<sup>146</sup> Twenty-three Russian companies are to supply Venezuela with exploration and production technology – such as mobile perforation, steam injection, deep-well construction and other techniques – to help extract heavy crude. “News in Brief,” *Petroleum Economist*, no. 4, 2006, p. 15.

<sup>147</sup> Katz, “The Putin-Chavez Partnership,” p. 6.

<sup>148</sup> Ibid, p. 7.

<sup>149</sup> For more on Latin America’s movement to petro-nationalism see a forthcoming book by George Philip, *Oil and Politics in Latin America: Nationalist Movements and State Companies* (Cambridge: Cambridge University Press, 2008).

<sup>150</sup> “Bolivia Gas under State Control,” BBC News, May 2, 2006, <http://news.bbc.co.uk/go/pr/fr/-/2/hi/americas/4963348.stm>, [May 2, 2006].

<sup>151</sup> Ibid. For more on Bolivian energy nationalisation see Dan Glaister, “How Morales Took on the Oil Giants – and Won His People Back,” *Guardian*, May 6, 2006.

strong rumours that Ecuador may follow Venezuela and Bolivia's path by nationalising its oil and gas industry.<sup>152</sup> In May 2006, Ecuador nationalised oil fields operated by Occidental, an American IOC.<sup>153</sup> Evidence therefore suggests that Chávez has so far succeeded in his efforts to spread Bolivarian Revolution to the rest of Central and South America, and to reduce the U.S. influence and control over the region. Besides Morales and Ecuadorian President Rafael Correa, Argentina's President Néstor Kirchner, Brazilian President Luiz Inácio Lula da Silva, and Nicaraguan President Daniel Ortega, all share Chávez's belief that Latin America's social and economic inequalities are rooted in external dependence, and are thus opposed to recent U.S.-led free trade proposals. Peter Hakim, in his early 2006 article in *Foreign Affairs*, suggested that "relations between the United States and Latin America today are at their lowest point since the end of the Cold War."<sup>154</sup> I find Hugo Chávez most responsible for this state of affairs.

### Outcome

Venezuela's President Hugo Chávez increased taxes and royalties for oil companies operating in Venezuela, bringing government's effective take to more than 80 percent.<sup>155</sup> He also changed law so that strategic agreements with foreign companies are now at least 51 percent controlled by the government-owned PdVSA. In the 1990s, Venezuela abandoned its previous policy of restricting oil output to force higher prices, and threw its state-owned oil industry open to investment by IOCs. Under Hugo Chávez, it is moving back, gradually, to re-nationalisation. From now on, IOCs will be minority partners in JVs with PdVSA. Despite this, most IOC executives believe that staying in Venezuela is worthwhile because there are not many other places where they can tap such massive reserves.<sup>156</sup> Clearly, Chávez and China are on the winning side, and the U.S. and the IOCs are on the losing side of the bargain. Moreover, as evident from above, Russia, Iran, and India are also reaping benefits of Venezuela's move away from the U.S.

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<sup>152</sup> Ecuador, for example, wants a larger revenue share from foreign oil companies and recently approved a new hydrocarbon law that amounts to a unilateral breach of production contracts. For more on oil in Ecuador see Suzana Sawyer, *Crude Chronicles: Indigenous Politics, Multinational Oil, and Neoliberalism in Ecuador* (Durham, NC, and London: Duke University Press, 2004).

<sup>153</sup> See "Ecuador Moves Against US Oil Giant," *Herald Sun*, May 17, 2006; "Grabbing Occidental," *The Economist*, May 20, 2006, p. 43; and Geri Smith, "In Ecuador, One Slippery Oil Patch," *Business Week*, October 23, 2006, pp. 50-52.

<sup>154</sup> Hakim, "Is Washington Losing Latin America?" p. 39.

<sup>155</sup> Reed and Ixer, "You're Working For Chavez Now."

<sup>156</sup> *Ibid.*

## Analyses and Conclusions

Issue linkage is important in analysing Chávez's policy in contemporary oil industry bargaining in Venezuela. The outcome of oil industry bargaining in Venezuela is primarily influenced by the country's domestic concerns, but also by Venezuela's strategic security preferences, China's domestic and strategic factors, and high oil prices. Venezuela's international position does not influence the bargaining outcome. While Venezuela lost some credibility in the West, and particularly with the U.S., it gained some with its new partner, China, and other developing states (Brazil, Russia, India, and Iran), and much of the rest of Latin America. These balance each other out. Finally, the United States and the IOCs have practically no influence on the outcome of oil industry bargaining in Venezuela.

Venezuela's strategic security preferences influence its decision to attempt to balance the hegemonic rule of the United States. The main goal of Venezuela's foreign policy is to defend the Bolivarian Revolution in Venezuela by opposing globalisation and neoliberal economic policies,<sup>157</sup> and by "explicitly seeking out allies in a bid to check U.S. power and influence in Latin America."<sup>158</sup> Therefore, its newly established friendship with China could help to serve this purpose. While Chávez is trying to spread the Bolivarian Revolution and thus gain concessions around Latin America by offering cheap energy through initiatives such as Petrocaribe, Petroandina, and Petrosur,<sup>159</sup> the United States fails to support this.

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<sup>157</sup> Elsa Cardozo da Silva and Richard S. Hillman, "Venezuela: Petroleum, Democratization and International Affairs," in Frank O. Mora and Jeanne K. Hey (eds.), *Latin American and Caribbean Foreign Policy* (Lanham, MD: Rowman and Littlefield, 2003), pp. 158-60.

<sup>158</sup> Trinkunas, "What is Really New about Venezuela's Bolivarian Foreign Policy?"

<sup>159</sup> Venezuela is providing up to fifteen Central American and Caribbean nations with crude oil and products under preferential terms in order to buy their political support. The San Jose Accord, originally implemented in 1980 and renewed annually, currently covers the following eleven countries: Barbados, Belize, Costa Rica, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Nicaragua, Panama and the Dominican Republic. Venezuela also supplies Cuba with between 50 and 100,000 bpd on "favorable financing terms," or the services of thousands of Cuban doctors, under an agreement signed between Chávez and Cuban President Fidel Castro in 2000. See also, "How Big a Threat is Hugo Chávez?" *The Economist*, May 14, 2005, p. 11. According to *Business Week*, Chávez's Petrocaribe initiative offers 196,000 bpd to 13 countries; see "Chávez' Oil-Fueled Revolution," *Business Week*, October 10, 2005, p. 31; and "Using Oil to Spread Revolution," *The Economist*, July 30, 2005, pp. 37-8. *The Economist* has suggested that Venezuela offers over 300,000 barrels a day at a discount under a variety of concessionary deals. "The World According to Chávez," *The Economist*, September 30, 2006, p. 49. Petrosur and Petroandina are yet new initiatives to provide cheaper fuel to South America. For more, see Mares and Altamirano, "Venezuela's PDVSA and World Energy Markets," pp. 72-6.

However, this is not Chávez's main goal. His main objective, maintaining his regime stability, comes from the domestic arena. Thus, the main factor influencing the outcome of oil bargaining in the case of Venezuela is Chávez's attempt to maintain regime stability. This is the main driving force of Chávez's policies regarding PdVSA. The re-nationalisation of PdVSA and the new rules of the oil game in Venezuela are all aimed to fill up the government coffers, and strengthen Chávez's regime. Chávez needs piles of petro-dollars to bribe the population and maintain his rule, and given the history of U.S. intervention in Latin America (Chile, Panama, Nicaragua etc.) he wants to protect his regime from destabilising attempts by the U.S. A Chávez-controlled oil industry allows him to spend at will, which is also useful during election season,<sup>160</sup> evident in his overwhelming victory in December 2006 presidential election.

There is no viable option the United States can pursue to influence the outcome of bargaining with Venezuela. The United States cannot impose economic sanctions against Venezuela since the latter did not do anything illegal by international norms and rules.<sup>161</sup> In any case, economic sanctions against Venezuela would be a disastrous policy, especially at the time of high oil prices. Support of Chávez's opponents would backfire, as it already did in 2002. Decision not to import oil from Venezuela would go against the 2001 National Energy Policy and would result in the U.S. becoming overly reliant on a single region – the Middle East – for its oil imports, which would go against its diversification policy. Hence, the American strategic security, which incorporates energy security, dictates the U.S. to keep Venezuela as one of its major oil suppliers. The only way to do this is to support the presence of American IOCs in Venezuela and of CITGO in the U.S., and to limit the Chinese presence in Latin America. Thus far, while the U.S. has been engaged in the Middle East, domestic reaction to China's growing ties with Latin America has been muted.

The overall U.S. bargaining position does not have any influence on the outcome of oil industry bargaining in Venezuela, and thus far, "American policymakers have been unable to influence the Chávez government."<sup>162</sup> The U.S. can decide to pressure Chávez on human rights issues, or on him collaborating with terrorists in Colombia or Bolivia, but

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<sup>160</sup> Javier Corrales, "Hugo Boss," *Foreign Policy*, no. 152, January-February 2006, p. 33.

<sup>161</sup> See Chapter 3, footnote 123.

<sup>162</sup> Lapper, "Living with Hugo," p. 3.

with very little or no effect. Domestic pressure on the official U.S. position also has no effect on oil industry bargaining in Venezuela. Calling Chávez “Venezuela’s Mussolini”, “Castro with oil,” comparing his turn to authoritarianism to that of Hitler, and calling for U.S. special forces to “take out” Chávez, backfires and makes him even more hostile to the U.S. interest,<sup>163</sup> and fuels the spread of Bolivarian Revolution around Latin America. The conservative circles may even suggest military action taken against Venezuela, but this is an extremely unlikely option to be pursued considering the oil prices and potential international condemnation. The bottom line is that Venezuela can easily find other customers and investors, while it may be extremely hard for the U.S. to find new suppliers of crude oil. In June 2006, the U.S. Government Accountability Office (GAO) reported that any move to replace oil from Venezuela with fuel from other suppliers would take several years and would require a significant increase in production capacity elsewhere in the world.<sup>164</sup>

The U.S. and other Western IOCs are in similar situation as the U.S. government. Since very few options exist elsewhere, they have no other option but to stay in Venezuela and adhere to the government’s decisions, due to this bargaining power asymmetry. Those who resist the most will fare the worst. According to Michelle Billig, compared to Russia or Nigeria, “Venezuela may start to look more attractive.”<sup>165</sup> This highlights the lack of options available for the IOCs. The bargaining position of major IOCs is weakened by the rise of resource nationalism in Venezuela. The companies that began 2006 vowing not to give up their contracts have fallen into line with the government, with almost no protest, and this speaks volumes about the balance of power between governments and their NOCs, and international investors.<sup>166</sup> By raising taxes and royalties, and reducing IOC stakes to a minority component, Chávez is strengthening the hand of NOCs around the world.

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<sup>163</sup> U.S. Congress Representatives Connie Mack (R-Florida), Mark Kirk (R-Illinois), and Rev. Pat Robertson quoted in Schwartz, “Oil’s New Mr. Big,” p. 56. U.S. Secretary of Defense Donald H. Rumsfeld provocatively compared Chávez’s election and subsequent turn to authoritarianism in February 2006 to that of Hitler. See “Rumsfeld Likens Venezuela’s Chávez to Hitler: Defense Chief Expresses Concern at ‘Populist Leadership’ in Latin America,” Associated Press, February 3, 2006.

<sup>164</sup> Government Accountability Office (GAO), “Energy Security: Issues Related to Potential Reductions in Venezuelan Oil Production,” Report to the Chairman, Committee on Foreign Relations, U.S. Senate, June 2006.

<sup>165</sup> “Leaving the Door Ajar,” *The Economist*.

<sup>166</sup> “Chavez Triumphant.”

Oil prices play a role in determining the outcome of bargaining in Venezuela's oil industry. Chávez decided to pursue 're-nationalisation', to improve relationship with OPEC, and to establish oil-based friendship with China at the time when oil prices are high. This means that the American, or Western IOC response, or retaliation, can be very limited since it would result in further rise in oil prices. The outcome may have been different had the oil prices been low, as the U.S. and the IOCs would possess more bargaining power. This highlights the importance of bounded rationality – changes in market conditions – on the outcome of bargaining.

In precisely the same way as they are influencing bargaining for pipelines with Russia, China's domestic and strategic concerns influence the outcome of oil industry bargaining in Venezuela. Increased oil imports are deemed necessary to feed the growing Chinese economy, healthy growth of which is crucial to maintain regime stability. Venezuela cannot provide China with as much oil as Russia, but its share may be important in China's attempt to diversify its sources of imported oil as much as possible away from the Middle East, and U.S.-controlled sea-lanes linking the Middle East with East Asia. Unlike the U.S. government, China, together with Russia and many non-Western countries, have nothing against Chávez personally or ideologically, and they support him, albeit tacitly, in his efforts to spread Bolivarian Revolution to the rest of Central and South America.

#### Relationship with Hypotheses

The case study of Venezuela's contemporary oil industry bargaining has direct relevance to all of the hypotheses set in Chapter 2. Evidence presented in this case study is supportive of hypothesis one. Due to their weak bargaining power, the IOCs have been on the losing side of their bargain with Venezuela in the current decade and we are witnessing the return of the obsolescing bargain in Venezuela. The evidence is only partially supportive of hypothesis two, as although the interests of the U.S. governments and its IOCs were aligned, the IOCs were not supported by the U.S. government, and thus they lost bargaining power vis-à-vis Venezuelan government. In addition, evidence presented is also supportive of hypothesis three, since the IOCs are losing their bargaining power in Venezuela due to the rise of and interference from the NOCs from oil importing

countries, such as China. Evidence only partially supports the hypothesis four, as although China and America's oil supply security is perceived as threatened when bargaining in Venezuela, only the U.S. government did not emerge victorious from bargaining. Finally, it is not supportive of hypothesis five, as in bargaining with other actors, Venezuela uses oil, explicitly and/or tacitly, and this allows it to earn concessions from the other actors. These primary conclusions will be elaborated on in more detail in Chapter 7, when I discuss my findings in detail.