The Political Role of National Oil Companies in Exporting Countries: The Venezuelan Case

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ABSTRACT

The philosophy of modern, capitalist economies favours the pursuit or maximization of profit and frowns upon rent and rent seekers. The international oil companies investing in oil-exporting countries of the Third World naturally shared this philosophy. They were faced, however, with landlord states most concerned with the maximization of ground-rent. Ultimately, nationalization was used by most of these states to achieve this goal.

The national oil company came thus into existence as a rent collector for the landlord states. Yet its own interest, as in the case of international petroleum corporations, lies in the maximization of profit which calls for the minimization of the share of income taken in rent. There are tensions, therefore, between the demands of their owner - that is the landlord state - and their corporate motivations and goals. The central question raised by this paper is whether the national oil companies are able to develop new types of landlord tenant relationships that can cope with these tensions.

To investigate this issue the author studies the national oil company of an important oil-exporting country - Venezuela. He assesses the difficulties encountered by Petróleos de Venezuela (PDV) in creating the necessary legal and institutional framework for operating as a truly commercial enterprise. One of the difficulties is the absence of a clear criterion for distinguishing the company profits from the rent element of its total revenues, and therefore for establishing the correct fiscal base.

The study also refers to PDV's position and role in the three joint ventures with foreign companies, already approved by the Venezuelan Congress. The assessment is that PDV did not succeed in establishing a clear definition of its position in these relationships with foreign investors.

The author's main thesis is that the central role of national oil companies is to create a viable *modus vivendi* between the state, acting as a rent maximising landlord, and the company itself, operating as a new commercial enterprise. He believes that this may be facilitated by an alliance with an actor which has been so far excluded from the scene, namely *national* private capital.

CONTENTS

1 INTRODUCTION

This paper starts by defining the political role of mining companies in terms of the landlord-tenant relationship in a modern economy. We shall then examine the role played by international oil companies in the oil exporting countries of the Third World, thus addressing the question of why they were nationalized. This will be followed by an analysis of the role of national oil companies along the same lines; the issue to be examined is their contribution to the emergence of new types of landlord-tenant relationships, nationally and internationally. Finally we shall conclude with an assessment of the future of National Oil Companies in exporting countries. To illustrate the argument we shall refer to Venezuela and its National Oil Company, Petróleos de Venezuela S.A. (PDV) throughout this paper.

2 MINING COMPANIES AND THE OWNERSHIP OF MINERAL RESOURCES

The fundamental, legitimate category of surplus value in capitalism is profit, and not ground-rent. The modern hero is the entrepreneur, not the landlord. The dynamics of capitalism rests on profit maximization, on the one hand, and ground-rent minimization on the other: the less powerful the landlord, the better. The capitalist ideal for minerals was first formulated by revolutionary France as involving a peculiar concept of public ownership:

> the French idea admitted from the beginning that minerals, insofar as they are a natural resource, could only belong to the community as a whole and not to a particular individual, the argument being that from the outset -- ie, because of the natural origin of these resources -- there was no reason to give any particular group or individual the advantages to be drawn from them.[1]

'Public ownership', however, does not mean here 'state ownership' but is the simple negation of private property because minerals are considered to be free goods:

> Those who drafted the Act of 1791, which is to this day the basis of the French law of mineral property, were careful that the actual ownership of minerals should not be given to the State. They are at the disposal of the nation in this sense only: that such substance cannot be exploited without its consent and except under its surveillance; but no royalties are in fact taken by the government.[2]

Public ownership of mineral resources is the rule in developed countries,[3] but there are important exceptions, the most notable being the USA. In these cases, however, there always exists a legal structure which ensures that mining property owners play a subordinate role to tenants. As a last resort, there is nationalization. The most important example is British coal. Privately owned for ages, a *Conservative* government nationalized this natural resource in 1938.[4]

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[1] Jean Montel: "Concession versus Contract" in Zuhayr Mikdashi (ed.): *Continuity and Change in the World Oil Industry*, Beirut, 1970; p. 104. The same argument applies obviously to all natural resources and, thus, to the surface. For the political problems involved, however, see Bernard Mommer: *Die Ölfrage*, Institut für Internationale Angelegenheiten der Universität Hamburg, Nomos Verlagsgesellschaft, Baden-Baden, 1983; Introduction.

[2] J.U. Nef: *The Rise of the British Coal Industry*, Vol.I, London, Routledge, 1932; p. 272.

[3] Indeed, the public ownership of minerals is the rule all over the world.

[4] Ben Fine: *The Coal Question*, Routledge, London, 1990.

Mining companies have two specific tasks: to exploit the mines or reservoirs with maximum efficiency, and to minimize ground-rent. The first requires a legislation that provides the concession of extensive areas to enable the grantees to exploit the mineral deposits as a unit; long-term contracts that make the necessary long-term investments economically feasible; and renewal terms that still encourage long-term investments as the end of the initial concession period approaches. The second requires efficient legislation that guarantees, for example, that mining taxes are zero at the margin. Subject to these conditions the public ownership of mineral resources results in the lowest prices to consumers.

To promote such legislation, to convince non-mineral enterprise and consumers generally of its necessity, is, of course, the political role of mining companies. In the case of private ownership, this may prove to be difficult. In this case only some kind of second best solution may be feasible. The most important example in this context is that of American oil.[5]

[5] Mommer, op.cit., Chapter I.

3 INTERNATIONAL TENANTS AND THIRD WORLD OIL EXPORTING COUNTRIES

Third World oil exporters became involved in world petroleum markets when foreign companies found oil within their territories. As national enterprise, at the beginning of the oil era, was generally non-existent and domestic petroleum consumption insignificant, the governments concentrated on their role as national property owners. They asked for ground-rent. Thus public ownership developed in a different direction from that defined in Chapter 2, the state acting as a national landlord engaged in a process of maximizing an international ground-rent.

Not surprisingly, the international tenants opposed the state in this respect. A French participant to an international seminar on oil in Beirut, in 1969, once stated explicitly their theoretical viewpoint which denies the legitimacy of ground-rent. Beginning as quoted on p.3, he continued with the following illuminating comment:

> It should also be noted that, from the philosophical point of view at least, the non-allocation of natural resources could also be extended to the states themselves by substituting the general interest of humanity for the interests of individuals comprising these states.[6]

Opposing the landlord states for decades, the international tenants, organized in the International Petroleum Cartel, were supported by foreign consumer countries, international law, and international courts. Indeed, with the exception of Venezuela, Third World oil exporting countries were stripped of their sovereignty and forced to submit concession contracts to international law and international arbitration. Hence, the attempt to maximize ground-rent was inseparably linked to the struggle for national independence and sovereignty, and therefore ended in nationalization.

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[6] Montel, loc.cit.

4 THREE STAGES IN THE PROCESS OF NATIONALIZATION

In retrospect, three stages in the process of nationalization can be distinguished. During the first stage, generally associated with colonialism, international tenants imposed conditions coming very close to their ideal of "non-allocation of natural resources". Rent levels were very low; the concessions covered major parts, if not all, of the national territories; and the contracts were to extend for sixty years at least. As already mentioned, these contracts were subject to international law and arbitration.[7]

However, the bargaining power of the oil exporting countries increased over time, and eventually the landlord-tenant relationship reached a second stage. The tenants had to accept a revision of the contracts, and agreed to pay to the state, as the natural resource owner, the same ground-rent they were paying as a minimum to the private resource owners in the USA, ie, a royalty of one eighth,[8] plus an income tax to be levied at rates similar to those imposed in the USA. The transnational tenants held the most prolific oilfields in the world but were paying the same rent and taxes as on marginal oilfields in the USA. Furthermore, these high cost fields were determining oil prices world wide. Incidentally, these payments to governments added up quite nicely to a fifty-fifty split and this being so neat was hailed by the international tenants as an intrinsically just profit split that should last forever.

Nevertheless, this split was politically unacceptable to the oil exporting countries. The fifty-fifty principle did not change in any way the colonial character of contracts. For example, all taxes, including the newly introduced income tax, were contractually fixed. Yet the oil exporting countries considered that fiscal matters were matters of sovereignty which was of a superior order than landlord-tenant relationships. The right of the owner state to ground-rent was a sovereign one, not to be governed by binding contracts with non-sovereign entities.

Economically, the fifty-fifty split had no theoretical foundation whatsoever. The international tenants reaped huge excess profits. Some oil exporting countries managed to obtain much higher rents in new leases which fostered competition between tenants. Finally, sovereign Venezuela ended the fifty-fifty split in December 1958 when it increased its income tax rate by 19 percentage points. The overall profit split in this country by then became close

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[7] The description of this section does not apply to sovereign Venezuela.

[8] In Venezuela it was one sixth.

to 65:35.

This was the beginning of the third stage that coincided roughly with the foundation of OPEC. The internationally coordinated action of the tenants was now confronted internationally and in a coordinated manner by OPEC. The oil countries developed their own criteria and patterns of landlord-tenant relationships, subordinated to the sovereign state. They were summarized in OPEC's Policy Declaration of 1968. There the oil exporting countries affirmed their sovereign right to a maximum rent, ie, to all excess profits. The Preamble of this Declaration stated:

> the inalienable right of all countries to exercise permanent sovereignty over their natural resources, in the interest of national development, is a universally recognized principle of public law and has been repeatedly reaffirmed by the General Assembly of the United Nations...
> in order to ensure the exercise of permanent sovereignty over hydrocarbon resources, it is essential that their exploitation should be aimed at securing the greatest possible benefit for Member Countries...[9]

Consequently, nationalization was declared to be the ultimate objective:

> this aim can better be achieved if Member Countries are in a position to undertake themselves directly the exploitation of their hydrocarbon resources, so that they may exercise their freedom of choice in the utilization of hydrocarbon resources under the most favourable conditions...[10]

Nevertheless, the participation of foreign private or public capital was not excluded, though it would be only on the basis of something like a working contract:

> foreign capital, whether public or private, ... can play an important role... provided that there is government supervision of the activities of foreign capital to ensure... that returns earned by it do not exceed reasonable levels...[11]

Then followed a set of principles to be applied in new contracts. However, this resolution

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[9] Resolution XVI.90.
[10] Ibid.
[11] Ibid.

in many aspects referred to all OPEC member countries but one: Venezuela. As a former Secretary General of OPEC, Lutfi, pointed out:

> In my references to OPEC's problems about the need for financial adjustments and revision of the abnormal legal provision in oil agreements, I should, of course, have made exception for Venezuela on many grounds. Many of the problems discussed are the exclusive concern of the Middle East countries since they have been to a large extent solved in Venezuela. There it is the government that to some degree plays the paternal role vis-à-vis the oil companies, and on the whole, oil operations in that country are not favoured with special privileges unavailable to other commercial and industrial sectors. The oil operations, foreign and local alike, are subject to the law of the land and pay whatever taxes the government sees fit to impose generally on all sectors without discrimination. If disputes arise between oil operators and governmental agencies, such disputes are taken to the local courts as a matter of course... its government is able to recommend any level of income taxation without having to obtain the prior approval of the foreign operators, as is the case in the Middle East. In general therefore, the Venezuelan Government is free from any fetters on its authority to formulate the oil policy of the nation regarding existing oil exploitation arrangements.[12]

OPEC Resolution XVI.90 marked a turning point. A few years later the concessions of the international tenants in many OPEC countries were nationalized.

[12] Ashraf Lutfi: *OPEC Oil*, Middle East Research and Publishing Center, Beirut, 1968; p. 72.

5 THE LANDLORD STATE, INTERNATIONAL TENANTS, AND PRIVATE NATIONAL CAPITAL

The nationalization of transnational tenants was the most important attack against private enterprise outside the communist countries, launched not by a revolutionary proletariat or communist parties, but by a handful of Third World landlord states. This would not have been possible without the isolation of these *foreign* companies. On the one hand, national interests were clearly identified with ground-rent; on the other hand, the tenant interests were unequivocally perceived as foreign interests. National entrepreneurs, and more generally citizens, firms, and households, were linked to the oil sector, almost exclusively, through the public spending of rent and thus resolutely supported a rent-maximizing policy, and finally nationalization.

It is important to note that private national capital was never involved in a significant manner in oil. This almost absolute exclusion was not only due to historical accidents, but also to a deliberate policy of the landlord states. An examination of the Venezuelan experience will illustrate the point.

5.1 Private National Capital and Venezuelan Oil

Rómulo Betancourt, the founder of Venezuelan democracy, as a young political activist promoted the idea of private national capital participating in oil production,[13] but he soon dropped the issue altogether. In 1960, during his second government, when the state-owned *Corporación Venezolana de Petróleo* was founded, Venezuelan private enterprise asked in vain for participation. Indeed, it was argued that private national capital would turn out to be a front for the participation of foreign capital.[14]

The opportunity for a broad national debate on this question came in the 1970s when the forty-year concessions signed in the 1940s were coming close to their end. Important personalities proposed that by then the oil industry should be operated by joint ventures, with a significant participation of private national capital. For example, Manuel R. Egaña, a former Minister of Development, favoured joint ventures with a share of 50 per cent or more to be

[13] Rómulo Betancourt: *Problemas Venezolanos*, Editorial Futuro, Santiago de Chile, 1940; passim.
[14] Manuel R. Egaña et al.: *Nacionalización petrolera en Venezuela*, Caracas, 1975; p. 30.

held by the state, and the rest to be owned by private national capital.[15] Hugo Pérez La Salvia, then Minister of Mines and Hydrocarbons, favoured tripartite joint ventures: the state, private national, and international capital.[16] President Rafael Caldera supported his position.[17] Carlos Guillermo Rangel, then President of *Fedecámaras*, the national employers' association, confirmed officially the entrepreneurs' interest in the oil business.[18]

The Caldera administration was the first Christian-Democrat government in Venezuelan history. In Congress the Christian-Democrat party was a minority. Moreover, Venezuelan oil policy, since 1945, had been the domain of the majority party, Betancourt's populist Acción Democrática. Arturo Hernández Grisanti, the Acción Democrática spokesman on oil in Congress, made clear the position of his party:

> Some sectors are proposing to found national oil enterprises. It is necessary to be on the alert with this proposition... as oil is a common property... it is ours, all Venezuelans...
> The manoeuvre of founding some supposedly national oil companies... to exploit, after 1983, the major part of the remaining oil... instead of the state owned Corporación Venezolana de Petróleo, will not succeed...
> Acción Democrática, and I think many other, if not all, political forces of the country, will resolutely oppose this proposition... of this supposed Venezolanization of the Venezuelan petroleum industry.[19]

This statement was made in 1971 during the debate on the *Reversion Law*. As reversion approached, not surprisingly, the tenants had stopped investing. At the end of the concessions they would hand over to the state completely worn out production facilities. But given its dependence on oil revenues, this would have put the state in a very difficult and disadvantageous position for negotiating new agreements. For this reason, Congress approved a Reversion Law that obliged the leaseholders to make the necessary investment to keep their production facilities in perfect condition. Not surprisingly, all the tenants opposed the Law.

The attitude of one particular Venezuelan oil company illustrates this point. *Mito Juan*, founded in 1965, operated a few marginal wells, producing on average 1.5 thousand barrels

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[15] Egaña, op.cit., p. 19. - Egaña was Minister of Economic Development in the 1930s and 1940s, before the creation of the Ministry of Mines and Hydrocarbons (today Ministry of Energy and Mines).

[16] *El Nacional*, 9/7/71.

[17] *El Nacional*, 29/7 and 30/7/71.

[18] *El Nacional*, 10/10/71.

[19] Francisco J. Faraco (ed.), *La reversión petrolera en Venezuela*, Caracas, 1975, p. 132-3.

daily in 1965-70. Owned by several thousand stockholders -- almost exclusively employees and workers of the oil industry -- the company considered itself as "pioneering the Venezolanization of the petroleum industry".[20] It was hardly possible to consider Mito Juan as a company of fronts, yet it opposed the Reversion Law with the same arguments that foreign companies had. After all, tenants will always be tenants, and to minimize ground-rent is one of the most important parts of their business.

The Reversion Law passed Congress with only five opposing votes. One of the opposition was Luis Vallenilla Meneses,[21] then the most outstanding leader of the group of entrepreneurs interested in the oil business.[22]

By the end of the sixties Venezuelan enterprise felt strong enough to claim a direct participation in oil production. But, as this was being discussed, and Congress was passing the Reversion Law, the world petroleum market was undergoing radical changes that led to an explosive increase in ground-rents and to a wave of nationalizations. Ground-rents reached their then historical peak. Venezuelan private enterprise, for the time being, had to withdraw. The discussion of the participation of private national capital was cut short.

5.2 Nationalization and Private National Capital

In the debate already referred to, Hernández Grisanti in opposing private national capital in oil argued:

> We associated with foreign capital [by means of concessions] because it contributes with technology, risk capital, and markets. But what could private national capital contribute that CVP could not? Does it have petroleum technology, petroleum markets, and the required amount of capital...? It has none of these.[23]

The Preamble of the Nationalization Law expressly stated that not only foreign capital, but private national capital too, would be excluded from the activities referred to.[24] However, the Law recognized that there might be exceptional circumstances justifying the participation

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[20] Faraco, op.cit., p. 299.
[21] *El Nacional*, 1/7/71.
[22] Luis Vallenilla Meneses: *Auge, declinación y porvenir del petróleo venezolano*, Caracas, 1973.
[23] Faraco, loc.cit.
[24] *Nacionalización del petróleo en Venezuela*, Catalá/Centauro/Editores, Caracas, 1975; p. 3-4.

of private capital. After a hefty debate, it established that:

> In special cases and if it is 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 authorize them beforehand in a joint session...[25]

The debate made absolutely clear that those special cases related to *foreign* capital. The examples mentioned referred to the control of foreign markets, and new technologies relevant to the refining of heavy oil so abundant in Venezuela. Thus, the Venezuelan Nationalization Law intended to exclude private national capital more radically than foreign capital.

5.3 Conclusions

A fundamental weakness of the powerful international tenants was their isolation from national enterprises and businesses in Venezuela. Outstanding politicians like Betancourt and his famous oil minister, Juan Pablo Pérez Alfonzo, knew this from experience. They had studied exhaustively the part played, during the first decades of the century, by Venezuelan landowners and concession dealers. They had proved to be potentially threatening to the rent-maximizing state and, for this reason, were excluded by the petroleum reform of 1943.[26] Mito Juan, on the other hand, was nationalized together with all other foreign companies. -- These conclusions seem to apply to all OPEC countries. Thus, for example, OPEC Resolution XVI.90 explicitly considered only the participation of either *foreign* private or public capital.

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[25] Ibid.

[26] Mommer, op.cit., Chapter III.

6 THE POLITICAL ROLE OF NATIONAL OIL COMPANIES: THE FIRST EXPERIENCE

The First Arab Petroleum Congress took place in Cairo, in 1959, with Iran and Venezuela invited as observers. Indeed, the most important result of the Congress was a "gentlemen's agreement" between all participating oil exporting countries that turned out to be the most immediate precursor of OPEC founded in the following year.[27] Among other things, they then agreed on "the establishment of national oil companies to function beside existing companies".[28] Such a company already existed, for example, in Iran. Venezuela followed suit in 1960 founding, as mentioned earlier, the *Corporación Venezolana de Petróleo.*

6.1 Corporación Venezolana de Petróleo (CVP)

The founding decree of CVP modestly specified two objectives. Firstly, the development of areas neighbouring existing concessions where this was necessary to prevent drainage and, secondly, the promotion of a new type of lease, the so-called *service contract.*[29] According to this provision, an article was introduced into the Law of Hydrocarbons carefully specifying that:

> The terms and conditions established in every contract must be more favourable to the nation than those foreseen by the present Law in the case of concessions.[30]

Five such new contracts were signed in 1971.[31]

CVP was established as an instrument to be used by the landlord state as a window to gain a deeper insight into all aspects of the oil business, as a means to squeeze some additional ground-rent out of existing concessions, and to strengthen the position of the landlord state in new contracts on lands previously evaluated by the national company. As an instrument, it was not meant to gain much autonomous importance. Indeed, twelve years after its establishment CVP produced scarcely 61,000 b/d, or 1.6 per cent of the national crude oil

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[27] Mommer, Chapter V.
[28] Eduardo H. Acosta Hermoso: *Análisis histórico de la OPEP*, Vol.I, Mérida 1969; p. 18.
[29] Juan Pablo Pérez Alfonzo: *El pentágono petrolero*, Caracas, 1967; p. 185-6.
[30] *Extraordinary Official Gazette* No. 1149, September 15, 1967. Article 3.
[31] Luis González-Berti: *Contratos de Servicios y nuevos aspectos impositivos*, Mérida, 1972.

output.

However, the management of CVP conceived itself differently. It wanted to compete with the transnational oil companies, and asked for more oil-bearing lands. Its desire was not to promote *service contracts*, but to develop oilfields itself. It was convinced that, as *the* national oil company, its destiny was to take over the oil concessions of foreign companies upon reversion. It was deceived by the Ministry of Energy and Mines (MEM) that blocked any attempt by the company to become important. The ensuing clashes of its President, Rubén Sader Pérez, with the MEM, are well documented.[32] The Ministry systematically subordinated the development of the *national oil company* to its major goal, the maximization of ground-rent, the reward to be obtained from the *national natural resource*. In the end, PDV absorbed CVP together with all private oil companies.

[32] Ruben Sader Pérez: *Cartas petroleras*, Caracas, 1969. *Problemas de crecimiento de una empresa petrolera del Estado*, Caracas, 1969. *Hacia la nacionalización petrolera*, Caracas, 1972; and *Petróleo polémico y otros temas*, Caracas, 1974.

7 THE POLITICAL ROLE OF NATIONAL OIL COMPANIES: THE SECOND EXPERIENCE

National, state-owned oil companies replaced the international tenants. Now governments could manipulate, at their sovereign will, export volumes and ground-rent per barrel, the two decisive variables determining total rent. National oil companies, initially were nothing but tax-collecting operators.

However, these national oil companies are in all Third World oil exporting countries their most modern, sophisticated, and efficient enterprises. Their human capital is without parallel, with a significant percentage of high-level professionals, including graduates from the best universities all around the world, and those who have been trained for decades by big, transnational companies. Eager for business, enthusiastic about production, these people are proudly fond of *their* companies -- but not necessarily of being state-owned. They would never accept being just tax-collecting operators. They would bring pressure to bear on the governments to create an appropriate institutional environment for commercial enterprise. In a modern economy, landlords may be able to impose high rents, and tenants may be obliged to accept them, but tenants will always claim basic entrepreneurial freedoms. -- Let us now turn to our example, *Petróleos de Venezuela.*

7.1 Petróleos de Venezuela, S.A. (PDV)

The state is the sole stockholder of the company. The President of the country appoints the eleven members of the directorate. The Minister of Energy and Mines presides at the stockholder meeting, which comprises of himself alone, representing the 100 per cent of stocks. The law requires the company "to maximize the economic yield of exports, according to the requirements for national development..."[33]

Regarding the domestic market, however, the Law considers hydrocarbons as "basic commodities" and authorizes the Ministry of Energy and Mines to "fix the wholesale and retail prices... and the freight rates for its transportation".[34] As the natural resource is a common property, there is no ground-rent in the domestic market. Thus, domestic prices are lower than export prices.

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[33] *Extraordinary Official Gazette* No. 1770, August 29, 1975.
[34] *Extraordinary Official Gazette* No. 1591, June 22, 1973.

PDV is a holding company. Its subsidiaries are subject to the same fiscal arrangement as were the concessionaires, but there is one important difference: the subsidiaries transfer monthly to PDV, 10 per cent of their net income from exports free of income tax. This provision is intended to guarantee the financial independence of PDV as a commercial enterprise.

(a) Reasonable Participation

Nevertheless, when the years of superabundance ended in 1982, the Government ordered PDV to deposit its 5.5 thousand million dollar savings, held until then in foreign banks, into the Central Bank of Venezuela. This implied converting them into national currency, the Bolivar. The measure was taken in defence of the Bolivar, then under strain. A few months later the exchange value of the Bolivar collapsed. Subsequent and frequent devaluations reduced those savings to a trifling amount. Later, as the fiscal deficit worsened, the government ordered PDV to buy public debt certificates and to pay taxes in advance. Moreover, differential exchange rates were used to maximize fiscal revenue. After 1985, the government maintained high tax and rent levels against falling prices, and this caused PDV in 1991 and subsequent years to incur foreign debt to obtain resources needed to sustain production levels. The company's investment plans have been revised repeatedly, and made to dance to the tune of the ups and downs of the public budget.

There was, however, a machinery that stripped the company of its profits and that was naturally strongly resented: the system of fiscal reference prices. The system originated in the Middle East, where the fifty-fifty profit sharing was based on posted prices. When market prices began to fall by the end of the fifties and, consequently, posted prices were lowered by the companies, the Middle East exporting countries reacted strongly and eventually succeeded in forcing the oil companies to freeze them at a fixed level. They were transformed into fiscal reference prices. Thus, the landlord states during the sixties protected their ground-rent against the fall in market prices which the tenants absorbed completely. In Venezuela things were a little bit different, because the income tax was based -- as should normally be the case -- on market prices. However, the country incorporated the system of fiscal prices in its income tax law of 1966. In 1970, moreover, Congress empowered the Executive to fix these prices by decree. Thus Venezuela could react immediately to any increase in Middle-East posted prices by increasing in turn its own fiscal reference prices -- generally widening

simultaneously the gap between them and market prices. This was a powerful fiscal mechanism which finally forced the transnational tenants to accept nationalization. -- Indeed, the mechanism was strong enough to squeeze out all profits even after nationalisation.[35] PDV never paid dividends.

PDV always insisted that the system of fiscal reference prices should be abolished, and finally succeeded. Congress approved in 1993 its phasing out over the next three years. However, this may be a temporary solution, given the present circumstances, but the fundamental problem of profit sharing between landlord states and tenant companies has not been addressed at all, although the issue has been discussed for decades. Thus, in 1943 Pérez Alfonzo stated the principle that everything above an "adequate and just" profit should fall to the state.[36] In 1948, when the 50 per cent "additional tax" was introduced in the Venezuelan income tax law -- the famous fifty-fifty split -- this special tax only applied to after-tax profits in excess of 15 per cent return to net fixed assets.[37] In other words, if the after-tax profit was lower, the state was willing to accept less than a 50 per cent share of profits. Later, Pérez Alfonzo used the expression "reasonable participation",[38] and explained that:

> The characteristic of the mining sector is *to be not simply tax-payers*. Above all, they are *concessionaires*, ie, special contractors to whom exhaustible mineral resources of national property have been handed over... Thus a business relationship exists between the conceding state and the concessionaire, both interested in maximizing benefits to be shared reasonably... This situation is very different from that of ordinary tax payers, who are simply obliged to pay taxes...
> Taxes are justified by public spending. Payments made by concessionaires are integral parts of the reasonable participation due to the State...
> There is no relationship with the needs of public spending... It is his part in the business, and the other part has no right to question this participation because of the destiny the state will give to those incomes. Likewise, the state should not pretend to increase its participation arguing fiscal needs. This reality distinguishes the situation of the concessionaires from ordinary tax payers...[39]

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[35] For the evolution of fiscal reference prices see Juan Carlos Boué, *Venezuela - The Political Economy of Oil*, Published by the Oxford University Press for the Oxford Institute for Energy Studies, 1993; p. 190.

[36] *Acción Democrática ante la Ley de Hidrocarburos*, Caracas, 1943.

[37] If after-tax profits were lower than 15 per cent, but higher than 10 per cent, an additional tax of 25 per cent applied.

[38] Juan Pablo Pérez Alfonzo: *El pentágono petrolero*, Caracas, 1967.

[39] Pérez Alfonzo, op.cit., p. 131-2.

Consistent with this position, the Venezuelan government in 1966 proposed to reform the Income Tax Law introducing a new excess profit tax for hydrocarbons. The same concept of excess profit was maintained as in 1948: after-tax profits in excess of 15 per cent return to net fixed assets.[40] However, the biggest oil companies opposed this motion fiercely and successfully. The new Income Tax Law, instead of the excess profit tax, introduced the system of fiscal reference prices.

It is worth while pointing out the difference: the excess profit tax would have discriminated against low cost producers -- ie, Creole (Exxon) and Shell -- in a way consistent with Ricardian rent theory; the system of fiscal reference prices, however, discriminated against high cost producers, and thus tended to create a higher floor to market prices. (That is, of course, why OPEC adopted the system in the sixties.)

Twenty-seven years later PDV successfully opposed this system too, and it did so without ever addressing the basic issue involved: the need to design practical fiscal machinery for *reasonable participation.*

(b) Domestic Market

The domestic oil market in Venezuela absorbs about one third of all productive activities realized by PDV measured in real terms of labour and capital inputs. Hence, in its importance it ranks second after the USA.[41] However, there is a fundamental difference between export and domestic market prices. In the latter case they have to reflect real costs, including capital costs, and taxes, but no ground-rent, as the natural resource is a common property. Hence they can be, and often are, set below export prices. This is in line, too, with the comparative advantage the country enjoys in its energy sector generally.

As the difference between domestic and world market prices should consist of ground-rent, there should be no reason for PDV to prefer one market to the other. Of course, this supposes that the fiscal regime in place differentiates properly between the two markets. What happens in practice is that production for national consumption is subject to the same fiscal regime as exports. Thus, even though the MEM by decree fixes lower product prices for the

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[40] Ibid., p. 134-5.

[41] Bernard Mommer, "A Structural Analysis of an Oil Economy Using Input-Output and Social Accounting Matrixes", *Latin American Perspectives*, forthcoming.

domestic market, royalty payments are based on export prices. To make things worse, since the collapse of the Bolivar in 1983 inflation has been high, yet the MEM has been reluctant to fully adjust prices. Thus, in the final analysis the monopoly of PDV in the domestic market turns out to be a liability rather than an asset although, of course, its losses in the domestic market are compensated by its export profits.

From the viewpoint of the company the relevant variables are the refinery gate prices of its products (the city gate prices in the case of natural gas) and the fiscal regime. The importance of the domestic market notwithstanding, PDV has never formulated any proposition to reform the fiscal regime that applies to this sector or the Domestic Market Law which introduced rules for the determination of prices by the Ministry.

(c) Foreign Public Debt and the Come-Back of Private Capital

Though PDV was founded as a commercial enterprise and supposed to be financially independent, when Sosa Pietri was appointed President in 1990 reality had already become completely different. He wrote:

> I found that the administrative and financial autonomies... had been fundamentally hampered. Investment and operational budgets were no longer within PDVSA's competence, but belonged... to the Minister of Energy and Mines...
> I found in 1982 that PDVSA's foreign currency deposits in the Central Bank followed a particular concept of public finance... In according with this theory, PDVSA's operational budget... were part of public expenditures, as were the corporation's investments... A fiscal deficit, consequently, could be reduced by lowering PDVSA's costs and expenses, or its investment budget.[42]

Thus, when Venezuela had to submit to an IMF structural adjustment program in 1989, PDV was considered as part of the public sector. Hence, when the company started in 1991 to finance its growth by borrowing, this was accounted for by the IMF as part of the public sector deficit Venezuela was committed to reduce. Sosa Pietri tried to convince the President of the IMF, Michael Camdessus, to exclude PDV from these accounts because of the commercial character of the company and its investment projects. His efforts were to no

[42] Andrés Sosa Pietri: *Oil and Power*, Barrows, New York, 1993; p. 74-5.

avail.[43]

One of the consequences was that the government obliged PDV to allow private -- foreign -- capital into production, for the first time since nationalization, by means of so-called "production contracts".[44] These were working contracts to recover idle oilfields, the contractors being paid a fee on a per barrel basis. A number of these agreements were finally signed in 1992 and 1993. Sosa Pietri opposed them, questioning their legality and arguing:

> Leaving to third parties the portion of oil production that PDVSA could undertake with its own human and technical resources was to condemn PDVSA to a secondary role... In lieu of a strong... PDVSA, we would have a small, weak corporation, a government agency that really carried out the responsibilities of the Ministry of Energy and Mines.[45]

On the other hand, the PDV program of internationalization got into trouble. It had been successfully launched at the beginning of the 1980s, when PDV first entered into a joint venture with German VEBA Oel, followed by other joint ventures in refining and distribution mainly in Europe and the United States. Part of this was the acquisition of a 50 per cent interest in Citgo Petroleum Corporation in the USA by the end of 1986.[46] In 1989, the foreign partner wanted to sell its remaining 50 per cent, and PDV was interested in buying it at a price of US$ 500 million. PDV was only allowed to proceed after arguing special circumstances and promising that it would resell in the near future. It did not honour commitment, even though President Perez himself repeatedly and publicly urged the company to do so.

But this incident had another consequence. PDV was then promoting several integrated projects in orimulsion™, extra-heavy crude oil and off-shore free gas.[47] The company asked for a reduction of the usual 67.7 per cent income tax for hydrocarbon enterprises, to 30 per cent, the usual income tax for non-hydrocarbon enterprises. The argument, of course, was the low profitability of these projects. The government and Congress finally agreed in 1991, but the new law explicitly stated that the reduction would only apply to associations with private

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[43] Op.cit., p. 76.
[44] Op.cit., p. 149.
[45] Op.cit., p. 149.
[46] Boué, Chapter VIII.
[47] Op.cit., Chapters IV and V.

capital. In other words, the same project will have to pay an income tax of 67.7 per cent if carried out by PDV alone, but only 30 per cent if there is a foreign partner!

(d) Joint Ventures

PDV promoted for several years some joint ventures, called "strategic alliances"[48] to underline their importance. The Congress authorized three of them in August 1993.

The first one is a joint venture between Shell, Exxon, Mitsubishi, and Lagoven (subsidiary of PDV) to produce LNG for exports, exploiting offshore natural gas fields. This is a pioneering project, as Venezuela has never exported gas before, and thus it was named, somewhat pompously, Cristóbal Colón (CC). The other two joint ventures are in extra-heavy crude oil, one to produce about 114 thousand barrels daily, and the other about 120 thousand, and they include the construction of refineries for upgrading. The Venezuelan partner in both cases is Maraven, a subsidiary of PDV, and the foreign partners are Conoco, in one case, and Total, Itochu, and Marubeni in the other. We shall concentrate on CC, as this venture was the model for the other two, and we will refer to the other two projects only if differences are substantial.

(i) Distribution of Shares - Duration of Associations - Reversion. There will be two types of shares: 33 per cent of privileged and 67 per cent of ordinary shares. Lagoven will be the owner of the privileged shares "to comply with the legal mandate of a controlling interest for the state"[49], the rest being distributed initially as follows: Shell 30 per cent, Exxon 29 per cent, and Mitsubishi 8 per cent. The privilege consists of three parts: firstly, nobody is allowed to retain a higher percentage of shares than Lagoven; secondly, Lagoven will appoint the President of the company and its General Manager and, thirdly, the 67 per cent of ordinary shares cannot vote down Lagoven's 33 per cent privileged shares. This is in no way equivalent to a controlling 51 per cent participation and, what is more, it is explicitly stated that "the participation of Lagoven... will never exceed... 49 per cent".[50]

The association will last for 30 years from the date of the first commercial shipment, or for 35 years from the date of the definitive decision to execute the project, whichever comes first. Indeed, for the time being, the association is still evaluating the economic

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[48] Op.cit., p. 125.
[49] *Extraordinary Official Gazette* No. 35.293, September 9, 1993.
[50] Ibid.

feasibility of the project. The deadline is December 31, 1996, though Lagoven, at its sole judgement, may concede an extension. On the other hand, the association may be prolonged by a maximum of five additional years if production is interrupted at any moment by *force majeure*. Thus, this association will definitely extend beyond thirty years, and maybe even beyond forty years, and therefore beyond the limits determined by the Law of Hydrocarbons for *service contracts* and concessions.

At the end of the Association Agreement, Lagoven will become the sole owner of the company as "all shares of the Enterprise will be fully transferred to Lagoven... without any cost".[51] The wording of this reversion provision complies with the minimum conditions established for concessions by the Law of Hydrocarbons of 1943, but not with the obligation to maintain the equipment in good order at the time of the handover, once established for *service contracts* and then applied to concessions by the Reversion Law of 1971. In other words, there are no provisions guaranteeing the continuity of operations at the end of the agreements, or for covering the abandonment costs -- environmental or otherwise -- following shut down.

(ii) Rent Payments: Law of Hydrocarbons. Regarding specifically ground-rent, the agreement only states that "the Company will be subject... to the tributes provided for by the Law of Hydrocarbons..."[52]

The Law considers some minor payments as, for example, a surface tax of Bs. 2.- per hectare. The Law was passed in 1943; then Bs. 2.00 were worth US$ 0.65. At present, they are worth US¢ 1.73, and continue to erode with inflation. Thus, the only relevant payment is the royalty fixed by law at a minimum of one sixth.

Yet when the Law was passed in 1943, natural gas in Venezuela was virtually worthless. Unavoidably produced as associated gas, it was flared off or reinjected, its domestic consumption being insignificant. Thus, the Law establishes the payment of royalties only if the gas is used economically, and even in this case the stipulations are very flexible. The Law authorizes the Ministry to enter contractual agreements on royalty payments for up to fifteen years and, even more, to exonerate companies from paying them "if the gas is used for the supply of towns or for other ends considered of public interest".[53]

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[51] Ibid.
[52] Ibid.
[53] *Extraordinary Official Gazette* No. 1149, September 15, 1967. Article 41.

It seems reasonable to suppose that the associates, arguing the marginal profitability of the project, will claim complete exoneration from royalties, at least for the first fifteen years. -- Regarding the extra-heavy crude projects, the situation is a little bit different. The Law establishes a minimum royalty of one sixth that the Ministry may only reduce temporarily, and then restore at any moment to its former level. In fact, arguing that the profitability of these projects was very low, Maraven already announced that "the Associations will negotiate... incentives for the first years regarding the royalty".[54]

(iii) Rent Payments: Income Tax Law and Other General Taxes. Next, let us have a look at rent payments as traditionally imposed in Venezuela by the Income Tax Law, where the oil sector is subject to special tax levels. Since 1966 the Law classifies the taxpayers in three groups: natural persons, non-hydrocarbon enterprises, and hydrocarbon enterprises. The last ones were subject to the highest tax rate, at present 67.7 per cent. As already mentioned, in 1991 the Law was revised, lowering the 67.7 per cent tax rate to 30 per cent for the projected integrated joint ventures. This was the same rate as applied to non-hydrocarbon enterprises, but the associates in the CC would not conform with that. They asked for a reform of the Income Tax Law:

> such that... [the new company] will be excluded from the provisions... applicable to hydrocarbon enterprises; [and the new company] will be subject to the ordinary regime... applicable to corporations... and, consequently, will be excluded from the system of fiscal reference prices...[55]

Although only tax reference prices were mentioned, there was much more to the reform, as the following clause makes clear:

> The Association Agreement ... will include provisions permitting Lagoven to compensate ... the foreign shareholders for losses in its patrimony ... caused by decisions taken by national, provincial or local administrative authorities, or by changes in legislation implying an unjust discriminatory treatment of the Company or of those shareholders...[56]

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[54] *Informe emitido por la Comisión Bicameral para las Asociaciones Estratégicas*, August, 1993.

[55] *Acuerdo de formación* of the *Informe emitido por la Comisión Bicameral para las Asociaciones Estratégicas.*

[56] *Extraordinary Official Gazette* No. 35.293, September 9, 1993.

What does 'an unjust discriminatory treatment' mean? For example, would an excess profit tax on hydrocarbons be discriminatory? Obviously, this is the purpose of excluding these associations -- in free natural gas, extra-heavy crude oil, and natural bitumens alike -- from the group of hydrocarbon enterprises, ie, including them in the group of non-hydrocarbon enterprises in the new Income Tax Law.[57]

It is worth looking at this in a historical perspective. Some fifty years ago, in 1943, Venezuela realized a radical petroleum reform. One of the central issues then at stake was the concessionaires' denial of the sovereign right of the State to impose taxes on their commercial activities, other than those contractually agreed upon. They were eventually forced to give in. However, in the last Draft of the Law of Hydrocarbons the relevant article was still worded as follows:

> Apart from those taxes provided for in preceding articles, all concession holders will pay general taxes, of whatever sort, ... *that will equally affect all enterprises* ...[58]

But the government did not accept this wording, as the last part of the above quotation was questioning the legality of any tax especially designed to cope with excess profits in oil. The government's viewpoint was then very explicit: it claimed the legitimate right of Venezuela, as the resource owner, to all excess profits that might accrue in its exploitation. In the Law, the last part of the quotation was deleted. Nevertheless, fifty years later a state-owned oil company, Lagoven, agreed with its foreign partners to deny this right of the nation, ie, to deny the very essence of nationalization. Moreover, it enshrined this concession to its foreign partners by agreeing to compensate them if necessary, in the advent of any unfavourable change in the law. Being the guarantor, Lagoven cannot opt out from the partnership.[59]

(iv) International Arbitration. Finally, Lagoven and the foreign partners rounded off these agreements by asking for international arbitration. Though they are subject to Venezuelan law:

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[57] *Extraordinary Official Gazette* No. 4.628, September 9, 1993. -- This new Law was published the same day as the Authorizations of the Strategic Alliances.

[58] Manuel R. Egaña, Personal Papers.

[59] The participation of Lagoven cannot be less than 33 per cent. *Extraordinary Official Gazette* No. 35.293, September 9, 1993.

> Any contention or claim... will be resolved, definitively and finally, by international arbitration, according to the rules of the International Chamber of Commerce of Paris, in the City of New York ... [60]

Again, it is worth looking at this in historical perspective. International arbitration may be quite usual in international commercial relations. However, this Agreement includes references to "decisions taken by national, provincial or local administrative authorities, or by changes in legislation"; the issue is that these decisions or changes may be qualified as "discriminatory" by international arbitration and this may result in an indemnity being paid by the Venezuelan state owned oil company to its foreign partners.

In 1902, Venezuela was a heavily indebted country, in deep political turmoil, and plagued by military unrest. The gunboats of the creditor nations were blockading the coast to enforce payment and, what is more, to force the country to accept international arbitration regarding the claims of foreign investors and concession holders. There was no other way out: Venezuela eventually had to accept the demands. In reaction to this the incumbent government, firmly resolved that this would never happen again, and took appropriate legislative measures. Indeed, the Mining Law of 1905 established that regardless of the nationality of concession holders:

> ... the concessionaire, or the company, will be considered as Venezuelan, subject to the jurisdiction of the Courts of the Republic ... and ... foreign agents will never be allowed to interfere in any contention ...[61]

Up to the present all Petroleum Laws made the inclusion of similar provisions in oil concessions or agreements obligatory. For example, the wording of the present Petroleum Law is as follows:

> The doubts and discords of whatever kind... will be decided by the... courts of Venezuela according to its laws, and will never be subject to foreign claims for whatever reason.[62]

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[60] Ibid.

[61] Quoted by Nikita Harwich Vallenilla: "El modelo económico del liberalismo amarillo. Historia de un fracaso. 1888-1908", *Política y economía en Venezuela 1810 - 1976*. Edición de la Fundación John Boulton, Caracas, 1976; p. 242-3.

[62] Law of Hydrocarbons, Extraordinary Official Gazette No. 1149, September 15, 1967; Article 4.

Moreover, in the Venezuelan Constitution this wording is included in Article 127, which states that it is to be taken for granted in any "contract of public interest", even if it is not expressly written in the contract in question. All Venezuelan Constitutions since 1936 have included this article.[63]

(v) Global Evaluation of the Association Agreements. In the case of the LNG project the natural resource will be extracted rent-free, at least for the first fifteen years of production; in the case of the extra-heavy-crude oil projects, at least for the first few years it will almost certainly be so too. Even thereafter, ground-rent will be at a minimum, and this has been justified by the marginal profitability of those projects. A question however arises: will these projects still be marginal, let us say, by the year 2025? Be this as it may, the contentious issue remains in the explicit, formal denying of the rights of the Venezuelan state as resource owner and sovereign. "The legal mandate of a controlling interest for the state" is interpreted in the most restrictive way: Lagoven or Maraven, state-owned *companies*, though only holding a minority of shares, cannot be voted down. At the same time, however, these companies are constraining the *state* in the exercise of its rights as mineral resource owner and sovereign entity, by guaranteeing the payment of indemnities to the foreign 'partners' in the case of rent claims and subjecting the state to international arbitration in the event of disagreement about legislation or policy decisions. -- There is no historical precedent for these agreements in Venezuela. Any concession granted in this century has been more favourable to the state as it was always subject to national law and national courts.

This happened, however, with the approval of Congress. To understand this, it is necessary to consider the national and international political and economic environment that ruled at the time. Until November 1992, however, things still appeared to be quite different. Indeed, *Petroleum Economist* then reported on Venezuela in the following terms:

> Yet in a country where the internationally accepted form of investment guarantee is unconstitutional... the government insists on announcing frequently that the international oil industry is preparing to invest billions of dollars in high-risk, high-tax, marginally profitable oil development projects.[64]

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[63] See José Herrera Oropeza: "Defensa de la soberanía nacional", *El Nacional*, 28/7/77.

[64] Maria Kielmas: "Venezuela - Little Moves Ahead of an Explosion", *Petroleum Economist*, November 1992, p. 14.

Later on, under the subtitle *Shell's Tough Stance*, the article becomes more explicit:

> Apart from the questionable economic feasibility of the LNG project... the real crunch comes with investment guarantees. An axiom of Shell's foreign investment policy is that there should always be a guarantee of international arbitration, because it has no confidence in a host country's legal system.
> In Venezuela this is totally unconstitutional...
> If Caracas succumbs to Shell's demands there will be a nationalistic uproar in congress that could cut short the Perez presidency....
> PDV is trapped, but Shell has the financial clout to go on talking forever, as it has amply demonstrated in its protracted talks with the Peruvian government...
> Unless this, or any future government backs down on the prohibition of international arbitration, there is no hope that any foreign investors will put billions of dollars into high-risk development of heavy crude or bitumen reserves... until the politics change, these projects are unlikely to progress beyond a theoretical study stage.[65]

By the beginning of 1993, however, PDV and the foreign companies involved decided to move ahead, leaving behind all legal considerations and political doubts. PDV submitted to the Congress a draft agreement for approval complying with Shell's conditions.

Indeed, by 1993 Venezuela was a heavily indebted country. Its economic policy was deeply influenced at all levels of decision making by international financial and banking institutions. The country was reaching the peak of a political crisis and was plagued by military unrest. The presidency of Pérez was cut short not by a nationalist military uprising, but by a Supreme Court decision on corruption charges. There were two serious, if unsuccessful coups d'état in 1992, and there was the persistent threat of a third one which was supposed to take place before the presidential elections, scheduled for December 1993. There was an interim President for a few weeks, and then a new President elected by Congress. Last but not least, there was a climate of political panic: the polls invariably announced that the two big political parties, Acción Democrática and Copei, which had governed Venezuela over the last 35 years, would be the big losers in the forthcoming elections.

The CC project was submitted to Congress on July 27. Edgar Vallée Vallée, Senator of Acción Democrática who presided the Congress Committee in charge of the previous

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[65] Op.cit., p. 16.

hearings and examination of the project, announced that it would be approved without any opposition the same day.[66] This was not to be. Though a clear majority finally approved the project after several weeks of hefty discussions, this majority consisted of only Acción Democrática and Copei; all other parties opposed the decision. Then, the same majority approved without discussion the two extra-heavy oil projects and, finally, empowered the President, by special law, to reform the Income Tax Law classifying those joint ventures as non-hydrocarbon enterprises.

(vi) International Political Environment. The situation in several Third World oil exporters, Russia and the newly independent Republics, seems similar. Their economies are in a general state of bankruptcy; they are subject to IMF adjustment programs and they critically depend on World Bank loans. They are all in deep political turmoil; and a few of them are on the edge of civil war.

Not surprisingly, their national oil companies, the most profitable companies of the world, lack the necessary funds for investment. These are the conditions international tenants want to take advantage of for a come-back, and some of them behave like the Bourbons: *Ils n'ont rien appris, ils n'ont rien oublié.* Even in Russia there is a campaign in full swing to limit sovereign rights contractually and impose international arbitration, with some if not definite success.[67] On the other hand, the political international climate regarding oil has become tougher and tougher. A leading article in the *Petroleum Economist* described the situation under the title *Playing International Football with Oil.*[68] Today, even the possibility of an oil embargo on peaceful Venezuela must be taken seriously. Indeed, the then President of PDV, Gustavo Roosen, at a moment when a coup d'état looked very likely, appeared on an important political television program in November 1993, to confirm what was rumoured in Caracas since the failed coup in February 1992: in the event of a successful military revolt, the United States would impose an embargo on Venezuelan oil.

Algeria recently reformed its petroleum legislation allowing general taxes to be

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[66] Platt's Oilgram News, 20/7/93.

[67] See, for example, Helen Avati: "Russia/Kazakhstan - Elf Acquitaine pioneers production-sharing deals", *Petroleum Economist*, April 1993, p. 15. Thomas W.Wälde: "Recent Development in Negotiating International Petroleum Agreements", *Petroleum Economist*, July 1992, Energy Law. Special Supplement. *Petroleum Economist*, "Overview of Energy Laws in the Former Soviet Union", Special Report, May 1992. *Platt's Oilgram News*, 23/7/93; p. 1.

[68] *Petroleum Economist*, March 1992, p. 4.

contractually established and submitting the whole contract to international arbitration.[69] Ecuador is on the verge of doing the same.[70] Venezuelan newspapers have mentioned both countries repeatedly as examples. It seems that in Venezuela the then forthcoming elections and expected victory of Rafael Caldera, a conservative nationalist, may have been the motive for PDV and its foreign partners to opt for a tactic of *fait accompli*: first to obtain the authorization of Congress for these contracts, in flagrant contradiction with Venezuelan law and the purpose of nationalization, and *then* to bring pressure to bear on the future government for favourable legal reforms. Consequently, within a global strategy conceived by some international tenants, these joint ventures are intended to represent the first step towards denationalization in Venezuela: and they succeeded in entangling the national oil company in the scheme.

(e) PDV, MEM, and OPEC

The president of the shareholder meeting, the Minister of Energy and Mines, the personification of the landlord state, representing 100 per cent of the stocks and thus just meeting with himself, holds the crucial position in the necessarily controversial relationship with its tenant, PDV. Not surprisingly, one by one, every president of PDV, once out of office, would declare publicly their frustration with their relationship with the Minister.

Though the conflicts started as early as one year and a half after nationalization, things became worse with the subsequent Herrera government which cut the tenure of the directorate down from four to two years, and strengthened the position of the Stockholder Meeting, ie, the Minister of Energy and Mines.[71] The pattern has been that every new government has increased in one way or other the degree of political intervention in the affairs of company. Yet neither the Minister nor the Ministry is technically enabled to control the company. The Stockholder Meeting is just another instance of fiscal control and ground-rent maximization. This makes a consistent, long-term *company* policy impossible and, finally, puts into jeopardy the very existence of the corporation as a commercially viable enterprise.

To remedy this situation, Andrés Sosa Pietri, a former president of PDV, has

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[69] *Petroleum Economist*, "Algeria - Welcome to Our War Economy", November 1992.

[70] *Platt's Oilgram News*, 4/6/93; p. 1 and p. 5.

[71] Sosa Pietri, op.cit., p. 63ff. An account of the conflicts between 1976 and 1982 can be found in Gustavo Coronel: *The Nationalization of the Venezuelan Oil Industry*, Lexington Books, Lexington, 1983. Coronel was a vice-president of a subsidiary of PDV, forced out of office as he disagreed with the Ministry.

proposed:

> PDVSA could be transformed into a private entity by placing company shares on certain national and international stock exchanges (particularly in the latter). The Venezuelan state would not lose control of the company, but the company would regain its autonomy. The state would become obligated to grant the company a tax rate more appropriate to an industrial concern where private savings are desirable.[72]

The consequences for the Ministry would be the following:

> The Ministry of Energy and Mines, in this regard, would exercise over PDVSA the same oversight maintained earlier over the concessionaires. An efficient and opportune utilization of assigned areas would be determined, and, clearly, the Ministry would grant any new areas.[73]

There is, of course, a lot one could say about Sosa Pietri's proposition. There are other ways to guarantee an independent Stockholder Assembly than selling shares. Beyond doubt, however, his criticism of the existing institutional framework hits the nail on the head. That he made public his criticism is completely unusual, and can be explained by his personal background: belonging to one of the most notable families of the country, he is a wealthy, private entrepreneur.

The fundamental but typical weakness of Sosa Pietri's proposals is their one-sidedness. There is no understanding of the Ministry and its historical success with nationalization. He never acknowledges the fact that the Ministry fathered PDV, and he simply detests OPEC. He repeats in his books the same prejudices that transnational tenants always held since its very foundation: that OPEC was never successful in its own right and that everything was done by market forces and unforeseen circumstances. Of course, he enthusiastically welcomes the decision of Ecuador to leave OPEC, and indefatigably rants about OPEC production quotas.[74] There is not one word in the book on the history of production control in the USA, the International Petroleum Cartel, and the rationale of Venezuelan long-standing policy stance within OPEC.

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[72] Sosa Pietri, op.cit., p. 76.
[73] Op.cit., p. 87.
[74] Op.cit., p. 83ff.

8 CONCLUSIONS AND OUTLOOK

A different relationship between the proprietors of the natural resource and capital defines the policy space of national oil companies in Third World oil exporting countries. Whereas in developed consuming countries this relationship is characterized by the clear predominance of capital, more specifically of tenant's capital, and the minimization of ground-rent, Third World oil exporting countries claim for a maximum international ground-rent.

However, this claim is not an end in itself, but part of the quest for national development. It is thus subject to the goal of economic development generally and, as part of it, to the development of the oil industry, this being the most important sector in all these countries, even after discounting the oil rent. Hence the contribution of the oil industry itself to economic development is of utmost importance.[75] Consequently, there is a trade-off between rent-maximization and the development of the non-oil sector, on the one hand, and the development of the oil sector of the national economy on the other.

Thus, the policy space for national oil companies is constrained by the need to compromise. They must claim for and create an institutional framework that makes possible the development of the oil sector itself. This involves a framework that recognizes the legitimacy of profit above and before the ground-rent, in the sense that the participation of the owner state, once he has authorized a venture, has to follow the rule: 'profit first, ground-rent afterwards'. However, they must also recognize the legitimacy of ground-rent and not engage in a process of rent minimization. Hence the success of national oil companies depends on a difficult balancing, keeping an equal distance from the rent-maximizing landlord state and the rent-minimizing private tenant.

In other words, there must be a *modus vivendi* between the Petroleum Ministry, the institutional seat of the landlord state, and its tenant, the national oil company, the institutional seat of the producing interests of the country. More generally, this refers to the relationship between the oil and the non-oil sectors of the national economy. Outside the country, the same applies regarding the international tenants and consumers. OPEC countries completely failed to understand this. Their economic performance amidst a superabundant oil rent was poor, frequently combined with the accumulation of a huge external debt, and finally

[75] Mommer: "A Structural Analysis..."

all of them had to face the disastrous breakdown of oil prices in 1986. With the collapse of oil prices, or more precisely, the collapse of the international oil rent, the role of the national oil companies all of a sudden became much more important, and much more difficult too.

To conclude, and to be more specific, let us turn again to the example of PDV. The company took over the Venezuelan oil industry on January 1, 1976. Today, eighteen years later, nobody doubts that from an operational point of view PDV has been a highly successful company.[76] From a political viewpoint, however, things look different. So far PDV has not succeeded in creating and defining a viable institutional and economic environment, ie, to take the necessary distance from the landlord state and to develop new links with the non-oil sector. There is no adequate legislation to define the fiscal contribution of PDV and, by the same token, its profits. The company has been forced into indebtedness to maintain current levels of oil output. It is suffering heavy losses in its second most important market, the domestic market, having failed to develop a solid relationship as supplier to national industries and consumers. On the other hand, however, the company succeeded in strengthening its links with the national producers of services and goods required by the petroleum industry.

PDV's fundamental weakness, like that of the international tenants before it, is its isolation. The only way out is to engage in a truly strategic alliance with the national private sector.[77] The inclusion of national capital in petroleum production is as important for the successful development of a national oil industry as was its exclusion for the success of nationalization. The Venezuelan private sector has huge amounts of savings in foreign banks, and the country's most important human capital is concentrated in the oil sector. All that is required to bring both of them together, in mixed or independent private companies, is to overcome the prejudices of the past.

Of course, the fiscal rules to be applied to those companies must be the same as for PDV itself. This is precisely the importance of the suggested alliance with national private capital as well as with private foreign capital. Therefore, those strategic alliances which PDV intended to establish with foreign tenants were, from the very beginning, misalliances. Indeed, the whole process started with a reform of the Income Tax Law which discriminated

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[76] Ramón Espinasa and Jesus Mora: "Les entreprises publiques des pays producteurs: les trois grandes stratégies de PDVSA", *Revue de l'Energie*, No. 456, February 1994.

[77] Cf. Mohammed A. Al-Sahlawi: "Expanding OPEC Production Capacity: Some Legal and Environmental Aspects", *OPEC Review*, Autumn 1992; p. 251.

explicitly against the national oil company. Then things got worse. PDV, totally inexperienced and under heavy national and international political pressure, ended up in joint ventures where the foreign 'partners' use the national oil company to dodge nationalization. PDV thus finally managed to be too close to the landlord state and to the international tenants at the same time. -- Those joint ventures, based on mistrust, are doomed to generate the same type of conflicts as in the past. The approval of the Ministry and of the Congress notwithstanding, the role of the scapegoat is obviously reserved for PDV.

The most important single lesson to be drawn from the history of oil in Venezuela, and in OPEC countries generally, is the necessity to differentiate clearly between the landlord and the tenant. This differentiation is of vital interest to national oil companies. To be viable as commercial enterprises, there must be a clear delimitation between the shareholder company and the Ministry of Petroleum. But this also works the other way round: the national oil companies must be very careful not to get formally involved in the administration of the natural resource.

Whatever the fiscal arrangement agreed upon for a joint venture between a national oil company and private national or foreign capital, or any combination of the three, this should strictly be the responsibility of the Petroleum Ministry. Only then will there be a true partnership. When they are all subject to the same fiscal rules, their legitimate identity of interests as tenants and producers will create the necessary environment for a process of integrating and reintegrating the oil industry in the national and international economy. It is the difficult political role of national oil companies to achieve such a *modus vivendi*, guaranteeing a steady flow of private investment funds and overcoming the conflicts of the past.

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