The New Governance of Venezuelan Oil

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ABSTRACT

Since 1989 Venezuela has been implementing a new oil policy, known as Oil Opening Policy (*Apertura Petrolera*). Having nationalised the industry in 1976, the oil sector has been re-opened to private investors. This action alone may be considered a historical volte-face, but it is argued in this paper that this would in fact be a partial view. The Oil Opening Policy represents a historical volte-face not only regarding nationalisation but also regarding what has been the fundamental tenet of Venezuela's oil policy ever since exports began in 1917. The state as the natural resource owner considered itself entitled to compensation for every barrel of exported oil. Now, however, a new principle has taken over: oil will be produced and exported by private investors as long as it is profitable to do so, even if this requires the resource owner to give up any claim to compensation.

In the first six chapters the paper provides the essential historical, political, social, and economic background, prior to nationalisation, necessary to the understanding of the ensuing and surprising U-turn. A series of events which took place at the time of, and after, nationalisation in 1976 are considered to be the decisive variables. Firstly, the legitimacy of the traditional government revenue (or ground-rent) oriented oil policy always rested on a successful non-oil economic policy, known as 'sowing the oil'. The latter was successful for decades prior to nationalisation. Yet thereafter the economic performance of the country has been appalling, notwithstanding the tremendous amounts of financial resources provided by the oil sector and the accumulation of a large foreign debt. Secondly, the traditional oil policy itself ran into deep trouble. Oil prices collapsed in 1986 even though Venezuela, and OPEC, had already reduced exports by more than 50 per cent. This failure seriously undermined the authority of the Ministry of Energy and Mines (MEM), the institutional seat of the traditional oil policy. Thirdly, in the middle of the economic, political, and institutional disintegration of the country, *Petróleos de Venezuela* (PDV) emerged as the only profitable, stable, and dynamic institution. Indeed, the company did not suffer from the collapse of oil prices which ultimately reduced the fiscal take and thus impoverished the non-oil sector, but not the company's profit. When world oil demand recovered after 1985, PDV was able to double output over the next decade.

From Chapter 7 onwards, the paper deals with the Oil Opening Policy proper, the U-turn being explained by the fact that PDV displaced MEM as the policy maker. Accordingly, a new contractual, legal, institutional, and political governance structure is being put in place to

anchor the new system and this will make future policy changes very difficult if not impossible. Vast extensions of oil lands are being handed over to private investors with very few conditions attached. A downward flexible fiscal regime has developed reducing the reservation utility of the natural resource owner in exploration and production almost to zero. This has been achieved, step by step, through a combination of judicial, legal, and contractual developments, which are discussed in detail.

Yet the national environment is not by itself sufficient to explain the volte-face. In 1989 Venezuela had to submit to an IMF adjustment programme and World Bank recommended reforms. Regarding petroleum, the so-called 'Washington consensus' also included a governance structure that had been conceived and developed in the consuming countries in response to, and in confrontation with, OPEC. Thus, the U-turn is radical and complete: from assertion of the country's sovereign rights over its natural resource to submission to an international petroleum regime developed by consuming countries and the international oil companies in order to offset them. As is pointed out, the 'new liberal consensus in international oil', to which PDV subscribed enthusiastically, is the mirror image of the 'new international economic order' which was proposed in the 1970s and 1980s.

Venezuela has given the impression of having defected from OPEC, even though the country still remains a member and has participated in the 30 March 1998 agreement. But the new governance of Venezuelan oil is not yet complete. As is argued in the concluding section of the paper, this will only be the case with privatisation, already considered inevitable. However, PDV – the holding company, not the affiliates – will survive as far as required for its new role as the natural resource licensing and administering agency. PDV's bureaucracy, with its strong industry background, has definitively taken over from MEM's ground-rent maximising bureaucracy. In its new role PDV acts as an umbrella for, and hostage to, the private investors.

The paper concludes by assessing the international importance of the new Venezuelan oil policy. Though Venezuela is considered an extreme case, unlikely to be followed to the same extent by other large petroleum exporting countries, it 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'. Then the trend, combined with an increasing scarcity, ended in an explosion of prices. Today the new trend goes in the opposite direction, able to compensate easily for any apparent scarcity. The paper argues that the failure to take into account the

evolution of the governance structure in the determination of prices explains the failure of energy economists to forecast the price explosion of the 1970s, and taking it into account today leads to the conclusion of falling real prices, contrary to usual forecasts which have failed to incorporate this institutional variable.

CONTENTS

1. INTRODUCTION

Since 1989 Venezuela has been developing a new oil policy, known as *Política Petrolera de Apertura* (Oil Opening Policy), or *Apertura Petrolera* for short. With *Apertura Petrolera* the Venezuelan oil sector, nationalised in 1976, has been re-opened to private investors. Inviting private investors back may itself be considered a historic volte-face in Venezuelan oil politics, though the government and the national oil company, Petróleos de Venezuela (PDV),[1] argued that this contingency was anticipated in the Nationalisation Law. But a few years later the leadership of the national oil company was self-confident enough to admit that the ultimate goal was the privatisation of PDV. Hence *Apertura Petrolera* involves, without doubt, a major policy shift in the history of Venezuelan oil.

In this paper we shall show that the shift goes even far beyond the question of public vs. private, or foreign, enterprise. *Apertura Petrolera* will not bring back the pre-nationalisation past. It also entails a U-turn regarding what has been the fundamental tenet of Venezuela's oil policy ever since exports began in 1917: the country considered itself entitled to compensation for every barrel of exported oil. This tenet has now been replaced by a new one: oil will be produced and exported by private investors as long as it is profitable to do so even if this requires the resource owner to give up any claim to compensation. This is a radical change, and it is difficult to exaggerate its consequences given the outstanding importance of oil in the development of the country.

At the beginning of the century Venezuela was one of the most backward countries in Latin America. The foreign oil companies were actually the first outposts of a new and modern society. Yet they were enclaves, foreign companies producing for foreign consumers. They employed native labour, of course, but they were attracted to the country by its natural resource. The latter was the only truly national component in this new world. Hence, it is in its name that Venezuela soon claimed to become part of it. Understood as a *national property*, it would serve as a source of government revenues, an *international ground-rent* paid by the exporting companies, providing the means to create a new and modern non-oil Venezuela. Modern Venezuela was thus conceived as the national counterpart to, or mirror image of, the inaccessible foreign enclave.

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[1] In Venezuela the company is known by the acronym PDVSA (Petróleos de Venezuela, Sociedad Anónima). Internationally the usual acronym is PDV.

The foreign enclave was the ideal to which the non-oil economy was linked, however, in a very peculiar way. The country engaged in a model of development that involved, on the one hand, a confrontational oil policy pressing foreign oil companies and consumers for an international ground-rent and, on the other, a non-oil policy using the oil revenues in promoting national entrepreneurship and consumption. Nevertheless, for decades to come it proved very successful. Venezuela became a modern country at a fast pace.[2] Yet the outcome was not simply capitalism but a peculiar form of it, rent capitalism.[3] Indeed, whatever was the success of the sowing-the-oil-policy, the ground-rent maximising landlord-state was even more successful.

The increasing importance of oil in the world economy and the arbitrariness of geology concentrating the world's most prolific reservoirs in a handful of Third World countries made this overwhelming and long-lasting success of the landlord-state possible. What is more, in the context of decolonisation and growing independence of the Third World, the political bargaining power of these countries increased continuously. Finally, they were strong enough even to alter the rules of the game and to challenge the international governance structure of oil put in place by the consuming countries and the international tenant companies. This was followed by an explosive increase of ground-rent and the nationalisation of the foreign tenants, which in Venezuela took place in 1976.

Nationalisation had two major consequences. On the one hand, with the retreat of the foreign companies, the governance of the country was shaken to its very foundations. The political, institutional, and economic equilibria were all profoundly disturbed. However, left to its own devices the country was unable to find new structures. Rent capitalism collapsed. On the other hand, a new international and national governance of oil had to emerge. As it turned out, the country was not up to this task either. Internationally, the removal of these companies exposed the consuming countries to the unrestrained power of the oil-exporting countries. In the ensuing years Venezuela, and OPEC in general, raised ground-rent and, hence, prices, to the limits of tolerance – and beyond. Once the tide turned, it was the landlord-states who had to endure the counter-stroke of the concentrated forces of consuming countries and former tenants, fighting both for the come-back of the latter and for a new international governance of oil of their making.

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[2] Baptista (1984 and 1997a).

[3] Baptista (1997).

Contrary to what everybody in Venezuela for decades had expected to happen, it was not the decline of the international ground-rent in oil that would cause the demise of rent capitalism. Rather it was the collapse of rent capitalism that would precede and give way to the decline of the international ground-rent. A new governance of Venezuelan oil began to emerge only after 1989, when the country on the verge of insolvency was forced into *Apertura*, the opening of the economy generally. Soon *Apertura* turned out to be *Apertura Petrolera*, and today the new governance of Venezuelan oil – though still not complete – has already reached a degree of development that makes it possible, as we intend to do in this paper, to describe and to analyse its characteristics.

2. LEGAL AND CONTRACTUAL DEVELOPMENT (1900-73)[1]

2.1 THE CONCESSIONARY REGIME

At the time the first important oil concessions were granted at the beginning of the century, the legal framework in Venezuela was essentially modelled on French mining law. A truly liberal law, public ownership was meant to prevent the private landowners, and surface dwellers generally, from obstructing the free flow of investment into exploration and production, and to provide the investors with all ancillary rights efficient mining requires. Yet this modern legislation was hardly in accordance with the country's real stage of development and, not surprisingly, its liberal spirit did not survive the day oil exports began. The transplant was rejected.[2] The government almost immediately spotted the opportunity to collect a ground-rent, and that was soon to become its supreme concern. There followed decades of struggles to transform the liberal petroleum regime into its opposite, a regime no longer at the service of the producing companies but of the ground-rent-collecting national landlord.

This transformation has to be considered from two aspects. On the one hand, it was a protracted tug-of-war and bargaining process between the rising landlord-state and the oil companies. On the other hand, since Venezuela was a sovereign country, it was a process of legal disputes and law-making. Sovereignty was the trump card, a fact of which the country (and Latin America generally) was very conscious. Indeed, according to the 1905 Mining Law, all concession contracts had to include the 'Calvo clause'. In the 1967 Hydrocarbon Law, its wording read as follows:

> Any doubts and controversies of whatever nature that may ensue because of this concession and which cannot be amicably settled, shall be decided upon by the competent courts of Venezuela, and according to its laws, and for no reason nor for any cause shall they lead to foreign claims.[3]

As the tug-of-war became more severe, in 1936 the Calvo clause was included in the Constitution. Accordingly, it is to be taken for granted in any contract of public interest even if it is not expressly written into it.

A major milestone in this process was reached with the 1943 petroleum reform and new Hydrocarbon Law. The last vestiges of the French reference disappeared. The new

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[1] This section is based on Mommer (1983), and Baptista and Mommer (1987).

[2] Mény (1993).

[3] Hydrocarbon Law, 1967, Art. 4°. All translations from Spanish into English are ours.

framework was modelled on the oil regime applied to federal lands in the United States. This was a conciliatory regime, which had developed out of the recognition of private mineral ownership. (The United States is today the only country in the world where oil reservoirs still belong to the surface owners.) Hence, the US oil industry is based on leases, not concessions. After the First World War, the government applied to public lands the typical lease conditions that had developed in the private sector. Outstanding amongst them was the payment of a royalty. One-eighth of the value at the well head was the usual level and, at the same time, the minimum rate in most of the United States, though in some regions it was one-sixth.[4] The one-sixth rate was adopted on federal lands – and, in 1943, in Venezuela. On the other hand, the reform in Venezuela also included the creation of an Income Tax Law. Over the following years its rates were synchronised with the US rates. In other words, in Venezuela the state received the same ground-rent and income tax as the federal government in the United States. Income tax rates soared with, and after, the Second World War, very much to the advantage of Venezuela and other oil-exporting countries, as the new regime eventually applied to them as well.

The fact was that the international oil companies paid basically the same ground-rent and income tax for marginal wells in the United States and for the most prolific oil fields in the world. Hence, though ground-rent and taxes were high in absolute terms, judged by profit-rates (profits on investments), they were very low. In the 1950s and early 1960s the big concessionaires in the Middle East and Venezuela enjoyed profit-rates varying between 50 per cent (Venezuela) and 150 per cent (Kuwait).[5] Not surprisingly, when new concessions were granted, the governments were able to impose better terms. The Venezuelan government, for example, in a licensing round in 1956-7, not only obtained high bonuses totalling US$ 700 million but also royalty rates as high as 25 per cent.

Not surprisingly, the exporting countries also began to look for a better deal for the older concessions. In this respect the Middle Eastern countries were in a much weaker position than Venezuela. Thus Middle East concessions were subject to international law and arbitration, and the contractual relationship also covered general taxation. In sovereign Venezuela, on the contrary, taxes were ultimately a question of legislation. In 1958 the government increased the income tax rate ten percentage points above the US rate then

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[4] Mommer (1997).

[5] Mommer (1983).

applying to petroleum production. This turned out to be a fateful step. It brought to an end the *Trato Hemisférico* (Hemispheric Treatment), under which in the 1950s Venezuela and Canada had become members of the US Interstate Oil Compact Commission. Co-ordinating their oil policies with the US, they benefited from preferential access to US markets. But increasing taxation beyond US levels drove a wedge between Venezuela and the Americans at the very moment the US government was introducing import quotas to protect its domestic production from the effects of falling world market prices. Venezuela lost its preferential access, but not Canada.

Venezuela was now faced with the challenge to develop its own governance structure in oil, and it necessarily needed to be an international one. As a result, Venezuela was instrumental in the creation of OPEC in 1960. The Organisation was forced to confront immediately the fact that high profit levels had finally provoked competition and falling prices, and that the market was working very much in favour of consumers. But from the viewpoint of the landlord-states, things looked quite different. They considered profits to be high not due to high prices but to low levels of ground-rent. Hence, OPEC's problem was to develop devices whereby excess profits would be captured and fixed in order to prevent them from being exposed to, and eroded by, competition amongst the tenant companies. In other words, although OPEC was battling with the tenant companies to impose higher rents and royalties, the Organisation was ultimately aiming at the prices to be paid by consumers, not at the companies' profits. As is usually the case, consumer interests were not represented directly but indirectly, through competition, and it was competition that OPEC wanted to restrict.

Conceptually at least, the machinery OPEC put in place was very simple. Rents, royalties, and taxes were converted into a per-barrel fee no longer dependent on prices or profits. Thus, the floor to current prices was raised above the actual production costs by the amount of the fee. As the landlord's reservation utility, this fee may be called a reservation ground-rent.[6] (In practice, however, things were less explicit since it depended on a system of 'tax reference prices').

The new regime was developed collectively, though it had to be adapted to the different circumstances of member countries. In all of them except Venezuela it was implemented through a protracted process of negotiations. In Venezuela there was also a bargaining process, of course, but with sovereign legislation in the background. Then, with the

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[6] Mommer (1997). Marx (1966) called the landlords' reservation utility *absolute ground-rent*.

upturn of world petroleum markets in 1970, the exporting countries seized the opportunity to negotiate important increases in the reservation ground-rent; in Venezuela, there was new legislation that simply authorised the government to decree them.

The Venezuelan government was now able to siphon off all excess profits. Yet the other OPEC members were still negotiating for another three years. In 1973, in the aftermath of the Arab-Israel war and the Arab oil embargo, all OPEC members finally ended the negotiating process and there followed a dramatic, sovereignly imposed increase in reservation ground-rent and, thereby, prices. There was no questioning any more that the oil countries were free to set their export prices at whatever levels they considered suitable. The international tenant companies had been nationalised *de facto*; and *de jure* nationalisation followed over the next few years.[7]

2.2 Corporación Venezolana de Petróleo

In line with the evolution outlined above, a highly qualified bureaucracy developed in the Ministry of Economic Affairs, growing into a specialised Ministry of Energy and Mines (MEM) in 1949.[8] In 1960, the government set up a national oil company, *Corporación Venezolana de Petróleo* (CVP), an instrument designed to enable MEM to get hold of ground-rent that was out of reach of conventional fiscal instruments. For example, some reservoirs extended beyond the concession areas. CVP took over the neighbouring areas, estimated the drainage, and claimed compensation. There was also the question of transfer prices and discounts. CVP, participating in the world market, could help to set standards.

New Upstream Agreements

Much more important, CVP was an instrument to provide the knowledge, experience, and insight necessary for new and more sophisticated kinds of upstream agreements. They were introduced into the political debate – but not in legislation – under the name of *contratos de servicio* (service contracts), which they were not. Yet the name was a signal. Their fundamentals were embodied in the Hydrocarbon Law, in 1967, reforming Art. 3 (Art. 3 HL 1967). According to the Law, lands would be assigned to CVP for exploration and production. CVP, in turn, was authorised to enter into different kinds of agreements, to participate in, and to promote, joint ventures, provided that the terms and conditions were more favourable to the

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[7] However, in some cases – mainly Abu Dhabi, Libya, and Nigeria – the foreign companies kept minority shares.

[8] At that time the Ministry of Mines and Hydrocarbons.

nation than those foreseen by the Law in the case of concessions.

For reasons which will become clear later, it is necessary to describe in more detail Art. 3 of the 1967 Hydrocarbon Law. This Article was very carefully edited so as not to give rise to any confusion as to the role of CVP. The fact that the state-owned company would enter into a contractual relationship with private parties would not impinge upon the sovereign rights of the state. As expressly stated, these contracts would still be subject to the Calvo clause and sovereign taxation. What is more, the full text of this clause, as quoted above, was rewritten into Art. 3 only to substitute 'agreement' for 'concession'. The basic outlines of any agreement had to be approved by Congress, and the definitive text had to be published in the Official Gazette.

More specifically, in the case of exploration there were precise rules of relinquishment. The area had to be subdivided from the outset into ten pieces of equal size. At the end of the exploration period, the private party would have the first choice, CVP the second, and the private party the third and last choice, with the remaining 70 per cent being relinquished to CVP. This has to be compared with concessions requiring the relinquishment of 50 per cent, leaving it basically to the concessionaire's discretion to decide which part he wanted to relinquish.

The exploration period could last up to five years and the production period up to twenty years, though in exceptional cases – subject to previous approval by Congress – the total could be brought up to thirty years. There was no renewal option. By contrast, concessions had been granted for forty years, and renewal was possible. Moreover, in the case of concessions there was only a 'passive' reversion clause, designed to protect the state against the possible costs of decommissioning. The shortening of the term in the new contracts with CVP, on the contrary, went hand in hand with an 'active' reversion clause designed to take over, at the end of the period, a going concern. All physical assets had to be maintained and finally handed over, free of charge, to enable CVP to continue production.

Art. 3 HL 1967 provided only for minimum conditions. It was up to CVP to negotiate the actual contracts and to obtain better terms. Indeed, five contracts were awarded in 1971. The contracting parties were selected through a complex process of negotiation and bidding.[9] The size of each area was 500 sq.km. The area had to be thoroughly explored. The exploration period was three years, the production period twenty. Signature bonuses totalled US$ 21.2

[9] Royal Dutch-Shell was awarded one block, Occidental three, and Socony Mobil one.

million, and other bonuses would be paid as and when specified developments took place. All bonuses had to be paid to CVP. Moreover, CVP would receive a 0.83 per cent royalty, on top of the legal minimum of one-sixth, and a participation in 'excess profits'. These were defined as profits above 18¢ per barrel after income tax. CVP would get as much as 55 per cent on excess profits above 50¢.

CVP had the option to buy at cost price 10 per cent of output in four cases, and 15 per cent in the remaining one. Moreover, CVP obtained an option to acquire a certain percentage of shares at cost price, without sharing the exploratory risk. In one case it was 20 per cent, in another 10, but only a symbolic 1 per cent in the three remaining cases. Finally, there were some provisions regarding technical co-operation and support to be provided by the foreign contractors to CVP. Although the five areas were considered very promising, as it happens all but one turned out to be outright failures. The (moderately) successful one, on the other hand, fell immediately a prey to nationalisation.

Reversion

Most importantly, however, CVP was supposed to play a central role upon reversion of the existing concessions. Their renewal and, in fact, the granting of any new concession, had been ruled out by all political parties at the time CVP was founded. (Nevertheless, awarding a new concession was *not* formally outlawed. It was still one of the options listed in Art. 3 1967 HL.)

Not surprisingly, as the end of the forty-year concessions granted in the 1940s was approaching, the concessionaires were running down their investment. Actually total output – 80 per cent of which came from concessions granted between 1943 and 1945 – peaked in 1970. Of course, this would weaken the bargaining position of the landlord-state. To prevent this from happening, in 1971 a Reversion Law was passed.[10] It imposed the same favourable conditions for the landlord-state upon the concessionaires as those it had been able to achieve in the new upstream contracts. They were now legally obliged to maintain their concessions in good working order. To enforce the Law, all their activities were subject to close scrutiny and tough supervision by MEM.

The landlord-state had thereby ensured itself an advantageous bargaining position. What the actual bargain would be, was not decided yet. At that time the most likely scenario was some kind of joint venture[11] with CVP playing a prominent role. Reversion of the older

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[10] Ley sobre Bienes Afectos a Reversión en las Concesiones de Hidrocarburos.

[11] This would have been in accordance with what was then happening in OPEC. In December, 1972, the Saudi

concessions would only become effective between 1983 and 1985. Yet whatever the new arrangement, it had to be negotiated a few years ahead of the end of the concession period and, therefore, negotiations had to take place during the next term of government, between 1974 and 1979.

Nationalisation of Natural Gas

Also in 1971, Congress passed the Gas Nationalisation Law.[12] Natural gas had long been an undesirable by-product, but by the end of the 1960s several American companies showed some interest in liquefying natural gas to be exported to the USA, most prominently amongst them Exxon. According to the new Law, the state would be entitled to collect all associated gas for which the concessionaire had not found any economic use so far, at the price of its collection cost. Similarly, reservoirs of free gas, all unexploited so far, were also nationalised. Thereby, again, the landlord-state ensured for itself a strong bargaining position regarding any LNG project.

The government bill included the option, in accordance with Art. 3 HL 1967, to form joint ventures, though conditions were tightened. Now the state would retain a 'decision-making power' at all levels.[13] But President Caldera and his party Copei were in a minority. The majority ruled out the option of joint ventures and, instead, wrote into the Law that CVP would be entrusted with the new industry. On the other hand, on the grounds of conservation and future national needs, the liquefaction of free gas – the only form in which natural gas could possibly be exported – was outlawed. Accordingly, CVP engaged in feasibility-studies for a LNG-project based only on associated gas.[14]

Nationalisation of the Domestic Market

Finally, in 1973, Congress passed the Domestic Market Nationalisation Law.[15] This was the culmination of a policy reserving an increasing share to CVP. Under this legislation the company was granted 100 per cent by the year 1976. The Law considered hydrocarbons 'basic

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Arabian Minister of Petroleum, Yamani, negotiated on behalf of the Arab Gulf countries a participation agreement regarding the older, huge concessions. Starting with 25 per cent in 1973, this percentage was supposed to increase to 51 per cent by 1983. Yamani expressed his belief that by then the new partnership would be as stable as a catholic marriage.

[12] Ley que Reserva al Estado la Industria del Gas Natural.

[13] El Nacional, 2 May 1971.

[14] Vallenilla (1973:637-43).

[15] Ley que Reserva al Estado la Explotación del Mercado Interno de los Productos de Hidrocarburos.

commodities' and authorised MEM to fix wholesale and retail prices. The intervention of the state in the domestic market aimed at lower prices and at protecting national consumers from rising world market prices. As the owners of the natural resource, national consumers would not be subject to the increase of the international ground-rent.

3. LANDLORD-TENANT RELATIONSHIP (1900-75)

In the early years the private landlords claimed, quite successfully, a preferential right to concessions on their lands. The trade in concessions became a most lucrative business not only for the landlords themselves but also for influential personalities and politicians. Yet modernising political forces succeeded in driving them out of business and in directing the whole ground-rent in oil into the coffers of the state. Ground-rent thus became available for economic development, and the concept of rent capitalism was instituted.

These modernising forces, then, competed with the private landlords for the ground-rent in oil but 'the mineral deposits to the miners' was certainly not their slogan. On the contrary, they criticised the private landlords not only for spending their money on luxuries abroad but also for selling the oil cheap. *Una República en venta* (The Sell-out of a Republic) is the title of the first part of Rómulo Betancourt's book dealing with Juan Vicente Gómez; dealing with his own years as President, the title is *La siembra del petróleo* (The Sowing of the Oil).[1] The qualitative difference between the two sides was the way the money was spent not the way it was earned. Yet the quantitative difference was also crucial to the nationalist debate. Betancourt never tired of repeating that democracy was nationalist but dictatorship submissive (*entreguista*).[2] At the same time a veil had to be drawn over the qualitative side since nobody amongst the modernising political forces in Venezuela was prepared to confess to the fact that the issue at stake was an international ground-rent.

The smoke screen became the more impenetrable the more the country developed. Replacing ground-rent with profit as the dominant and legitimate category in the non-oil sector created an all too obvious problem of legitimacy in the oil sector that the landlord-state was eager to repress. Oil revenues were legitimised increasingly on moral grounds. First there was the revolutionary talk about the poverty of the people and the obscene profits of the companies; later, once the revolutionaries had taken over government, there was the socially more moderate but politically as effective discourse on the non-renewable and exhaustible natural resource.[3] In the debate Venezuela was always the victim, and the landlord-tenant relationship became increasingly incomprehensible.

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[1] Betancourt (1956).

[2] Mommer (1989).

[3] Baptista and Mommer (1987: *passim*).

On the other hand, from the oil companies' viewpoint, the more ignorant the landlord, the better; and whatever the information provided by the oil companies, it was suspected of being disinformation anyway. All that bureaucrats and politicians really knew, for decades to come, was that a better deal was possible. They were told so by the market and the unabating demand for new concessions or other kind of upstream contracts, the increasing levels of ground-rent notwithstanding. But the market did not provide them with any theoretical understanding. Unable to develop for themselves such an understanding and rejecting the theories on offer from the other side – the foreign companies and consumers – Venezuelan oil politics became technically more and more sophisticated, economically more and more successful, but politically more and more obscure.

Likewise, the oil industry became politically more of an enclave, not less. The many and varied merits and contributions of the oil industry to development were simply ignored by Venezuelan politicians and opinion leaders. Rómulo Betancourt in his nine-hundred-page-book (1956), did not even deign to look at them. According to him, nationalisation was 'the desire of Venezuela and ultimate aspiration of all Venezuelan patriots' (p.717), the only way of 'liberating the country from the presence in its subsoil of foreign aggressive economic and political forces' (p.740). Nevertheless, Betancourt always excluded from his political agenda the 'integral nationalisation of the oil industry' (p.741) on the grounds of the country's weakness and its dependency on oil. He favoured an evolutionary and reformist ground-rent maximising oil policy, and this policy was successful by any standard. However, the success went hand in hand with reinforcing the oil sector as a foreign enclave.

In his early days as a politician, in the second half of the 1930s, Betancourt had campaigned in favour of private Venezuelan enterprise in oil.[4] He soon dropped the idea. Some twenty-five years later, when Betancourt was President, private Venezuelan enterprise was denied any participation in CVP. It was argued that it would be nothing but a front for the foreign tenants.[5] Another ten years later, a broader public debate on this question arose as reversion approached. Some people suggested that any new arrangement should grant private national enterprise and investors a significant role. However, the oil spokesman of Betancourt's Acción Democrática in Congress made clear that this 'supposed

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[4] Mommer (1989).

[5] Maza Zavala in Manuel R. Egaña (1975:30).

Venezolanisation' of the petroleum industry would not happen,[6] though he did not close the door completely. Acción Democrática, he said, had still not considered officially this 'innovative idea'.[7] However, the Caldera government declared its willingness to consider the participation of private Venezuelan investors in the activities of CVP[8] and, more specifically, it also wanted private Venezuelan enterprise to participate in the LNG projects.[9] Acción Democrática, however, put a stop to it by ruling out joint ventures in LNG generally. At the same time, it should be pointed out that the exclusion of national private investors from upstream activities was actually part of OPEC's most important 'Policy Declaration',[10] approved by all member countries in 1968.

What this intricate manoeuvring made clear is that, on the one hand, it was politically difficult to argue the exclusion of Venezuelan private enterprise but, on the other hand, it did not fit into the picture. The reason was that this would have meant ultimately to acknowledge some kind of legitimacy to the foreign tenants. In the political debate and confrontation the most powerful weapon the landlord-state held in its hands was the isolation and identification of tenants as a foreign enclave. Whatever their arguments, they were suspect and easily disqualified. But what if the same arguments were put forward by Venezuelan oil companies? After all, tenants are tenants, and they would defend – would they not – their legitimate rights. Actually, this is what happened. By the late 1960s, one tiny private Venezuelan oil company, *Mito Juan*, had emerged operating a few marginal wells. In 1971, this company opposed the Reversion Law with precisely the same arguments as the foreign tenants. Too small and too late to cause any trouble, needless to say *Mito Juan* (and two other equally small Venezuelan companies that had emerged in the early 1970s) was nationalised together with the foreign tenants.

The landlord-tenant relationship in oil was certainly not understood (was indeed incomprehensible), involving as it did obscure alien forces, and even on the very day before it happened its denouement was unforeseeable. It was only after the general elections in December 1973, which were won by Acción Democrática and its candidate Carlos Andrés Pérez, that a high-level politician from this party suggested in a toast in *Miraflores* 'to study

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[6] Faraco (1975:132-3).

[7] *El Nacional*, 15 October 1971.

[8] *El Nacional*, 12 October 1971.

[9] *El Nacional*, 3 January 1971.

[10] OPEC Resolution XVI.90.

the nationalisation of the oil companies'.[11] President Caldera, still in office and taken by surprise, intervened spontaneously:

> Until this moment, I believe, nobody in Venezuela had made such a suggestion. So far all the talk has been about nationalising the industry on the basis of the national company, *Corporación Venezolana de Petróleo*... It may be interesting to analyse this because, I have to admit, it never came to my mind that it could be possible or convenient to nationalise Creole, affiliate of Standard Oil, or Shell de Venezuela, affiliate of Shell Petroleum. But by the authority of who proposed the idea, I think it was necessary not to let these words go unnoticed but to present them as an issue of analyses and meditation.[12]

Two days later both the presidents of Creole (Exxon) and of Shell de Venezuela, after a courtesy visit to President Caldera, confirmed to the awaiting press that nationalisation was imminent. With a hint to the international situation – the Arab oil embargo and the doubling of prices – they confirmed that radical changes were unavoidable, and expressed optimism regarding their future role in the new governance of Venezuelan oil.[13]

3.1 Conclusions

Over the period considered, new contracts were always more advantageous to the government than older ones. They were, too, harbingers of changes that would ultimately also apply to the latter. *Ultimately*: this was the real issue in the ongoing tug-of-war. Because if contracts were signed, say, for forty years, but modified after twenty or even ten years, it still made sense to sign them for forty years in the first place. It could still add to the contractor's bargaining power. But if changes could be enforced at any moment disregarding the circumstances under which the contracts were signed – and this was what the 'permanent sovereignty'[14] claimed by OPEC was about – it made no sense any more. Under these conditions the old contractors having already sunk their investments in the ground were in an even weaker position than the new ones who, after all, still had the option not to invest. Hence, there was a point beyond which the landlord-tenant relationship had to disappear. This point was reached in 1973, in the middle of an extraordinary boom in world petroleum markets and in the aftermath of the Arab-Israel war. The national and international governance structure of oil collapsed.

This collapse came as a surprise. All of a sudden the Venezuelan government was not confronted with negotiating another step in its evolutionary and reformist policy, the only

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[11] *El Nacional*, 28 December 1973.

[12] Ibid.

[13] *El Nacional*, 29 December 1973.

[14] OPEC Resolution XVI.90.

event it was prepared for. In its excitement about the ongoing tug-of-war the country never expected that the other party would suddenly let go of the rope. Now it would have to struggle to recover its equilibrium and to put up its own national governance structure of oil. Internationally, it would have to face the development of a new one, its most outstanding new feature being the direct involvement of consuming countries.

4. OIL AND DEVELOPMENT (PRIOR TO 1973)

By the end of the 1960s Venezuelan rent capitalism showed clear signs of fatigue, fundamentally for two reasons. On the one hand, in the 1960s investments in oil, by far the country's most important industry, had come to a sudden halt with the developing confrontation over reversion. On the other hand, the country had already been through two major oil booms.[1] Over five decades it had maintained a fast pace of development and economic growth with exceptionally high levels of consumption and investment, and its capital absorptive capacity was approaching exhaustion.[2]

Yet 'dependency' on oil had not diminished but increased. Though this was essentially due to the extraordinary success of the ground-rent collecting landlord-state, Venezuelan politicians and opinion leaders reached an opposite conclusion. As the counterpart to the bewildering landlord-tenant relationship in oil, an objective analysis of the sowing-the-oil-policy was repressed and buried under a deep layer of moralising brooding. The alleged moral foundations of fiscal oil revenue were applied similarly to their transfer back to private hands. Nobody applied them more consistently than Juan Pablo Pérez Alfonzo, the most outstanding of Venezuelan oil politicians and intellectuals.[3] Accordingly, any Venezuelan who was considered to be a beneficiary of the distribution of oil revenues,[4] was suspected to be a sponger. Suspicions turned into certainty as the distribution of money went on undiminished, the exhaustion of the capital absorptive capacity of the country notwithstanding. Even worse, the process intensified and the state became slowly but steadily indebted. Of course, according to Pérez Alfonzo, corruption was to be blamed, that ever-present variable in Venezuelan political and economic thought. Significantly, Pérez Alfonzo in the end had nothing to offer but the proposition to reduce oil revenues as the only way to put an end to the easy life of a nation of parasites. Conceived as parasites, of course, not of the world economy but of the sub-soil, they were also deemed to be allies of the foreign oil companies, the parasites of oil par excellence.[5] Both should be confronted by reducing production ... though Pérez Alfonzo could not resist pointing out that this should be, of course, another opportunity to get a higher

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[1] Espinasa and Mommer (1992).

[2] Baptista and Mommer (1985).

[3] Pérez Alfonzo (1971).

[4] Mommer (1991).

ground-rent.

Unable to find a way out, Pérez Alfonzo was lost in a maze of his own making. He wanted the problem to go away. It would not. The economic, geological, and political conditions were all too favourable. The landlord-state was doomed to success. There was a third boom ahead entailing even higher fiscal revenues.

[5] On unequal exchange theories, ground-rent and oil, see Mommer (1981).

5. NATIONALISATION AND THE COLLAPSE OF RENT CAPITALISM

Despite its long experience as an oil country the spectacular increase in oil revenues associated with nationalisation once more inflamed the hope they might provide, at last, the big push to economic growth and development. The oil industry, on the other hand, was imagined to have been definitively tamed and subordinated to the political design of the nation. However, the nationalised industry kept its distance from the outset and distanced itself further as rent capitalism collapsed over the next fifteen years.

5.1 Non-Oil Sector

In parallel with oil, iron-ore concessions – the second most important item in Venezuelan exports – were nationalised in 1975. The importance of foreign enterprise was also reduced, by law or by spillover effects, in banking, manufacture, and commerce. Although in the latter cases foreign enterprise gave way to private Venezuelan enterprise backed by generous public credits and subsidies, it was still weakened. Its entrepreneurial and political strength had largely depended on the foreign associates. With a long history of despotism and a short experience of democracy, there was no cultural background, no political tradition, and no institutional framework in place strong enough to allow private national enterprise, on its own, to counterbalance the suddenly enriched landlord-state.

The political parties and Congress did not even pretend to play their part. Overwhelmed, they bestowed President Carlos Andrés Pérez with extraordinary powers to channel the flood of money (US$ 1.3 billion in 1970; US$ 3.0 billion in 1973; US$ 9.3 billion in 1974). In spite of the poor quality of public administration and the disappointing experience with state enterprises in the 1960s, especially in petrochemicals and steel, the government decided to press ahead with an ambitious resource-based public industrialisation programme minimising the participation of transnational companies. Consequently, there were no international checks and balances in place either. On the contrary, although massively overspending their budgets very quickly, government and state enterprises were able to obtain foreign credits without much difficulty. For the time being, there was no doubt about their credit-worthiness.

Abundance of money and scarcity of public and private organisational and entrepreneurial capacities, is *the* characteristic of rent capitalism. As pointed out earlier, by the end of the 1960s the growing gap had become an acute problem. Nevertheless, in 1974, in the

middle of financial super-abundance, the government adopted a policy whereby the capital absorptive capacity of the country was actually reduced. Foreign enterprise was forced back at the very moment its managerial capacities, though not its money, would have been more useful and necessary than ever. Similarly, neither Venezuelan entrepreneurs nor unions were really committed to this programme. It was primarily a decision of the government, and it was a public sector programme. Considering itself the sole legitimate owner of oil revenues, the landlord-state not only was to be drowned in its money but to be torn to pieces by all those international and national forces who did not believe in its legitimacy at all.

The boom was short-lived. Even during the few years it lasted (1974-1978), growth rates were only high in absolute terms but low compared with the enormous amount of money spent. Private investment peaked in 1977. (Eighteen years later, in 1995, the falling trend of gross private investment as a percentage of GDP was just about to bottom out.) From a maximum of 31 per cent in 1977, it felt to an all-time low of 5 per cent in 1990, and recovered only slightly thereafter.[1] The landlord-state, however, continued to spend as long as there was money left and foreign credits were available. There was nobody able to stop it, nor was there anybody really interested in doing so. The change of government in 1979, from Acción Democrática to Copei, and a second peak of oil revenues (US$ 13.5 billion in 1981), made no difference.

At the end there was the currency-crisis of February 1983, triggered by the refusal of foreign banks to grant new credits. The importance of this event is difficult to exaggerate. Until then the bolívar had been an extraordinarily stable currency, more comparable to the Swiss Franc than to the US Dollar. It was the symbol of Venezuelan prosperity. However, it was also one of the two most important devices for transferring the international ground-rent in oil from the government to Venezuelan consumers.[2] Foreign currency and, hence, imported goods, had been cheap for decades. But now the government imposed control over foreign exchange. It was a multi-tier system, known as RECADI,[3] according to which foreign currency was sold at preferential rates for purposes ranging from importing basic consumer goods, raw materials and investment goods, to the payment of private foreign debts. Even under the most favourable political and administrative conditions this system would have been

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[1] Baptista (1997:155).

[2] Mommer (1991). The second, and more important device, was the low level of non-oil taxation.

[3] Acronym of Régimen Cambiario Diferencial.

very difficult to handle. Given the omnipresence of imported goods at all levels of the economy in those years, it required no less than the monitoring of the entire economy and a process of political decision-making about who was, and was not, to receive a part of the shrinking ground-rent. (Free market rates were twice to three times as high as the preferential rates.) Yet the crisis had been triggered precisely by the fact that the Venezuelan government was no longer able to monitor and control its own budget and enterprises.

RECADI would last six long years. The government had successfully restructured the foreign debt in 1985, but with the collapse of oil revenues in 1986 (US$ 4.4 billion) it was clear that it was going nowhere. The government was not only unable to get the situation back under control, but also it could not even react to the price-crash. It carried on spending as if nothing had happened until all foreign exchange reserves had gone. There was simply no system of checks and balances in place to control what was happening. The new government that took office in February 1989, again headed by Carlos Andrés Pérez, had no other choice but to admit the debacle. Insolvent and at the brink of bankruptcy, Venezuela had to submit to an IMF adjustment-programme and World Bank-ordained reforms. The new economic policy became known, as everywhere else in Latin America, as *Apertura*.

To sum up the debacle in a few numbers (see Table 1). Non-oil GDP peaked in 1978 at constant 1984 US$ 55.6 billions. In absolute terms this level was maintained over the following decade with some ups and downs and an overall increase of 5.6 per cent to constant 1984 US$ 58.7 billion in 1995. Yet in per-capita terms it fell from constant 1984 US$ 4032 in 1978 to 2644 in 1995, a fall of 34.4 per cent, which brought it back to the mid-1960s. Real wages fell from constant 1984 US$ 6204 per year in 1978 to 2404 in 1995, a staggering 61.2 per cent, bringing them back to the year 1950. The disproportionate decrease of real wages reflects the ruin of the landlord-state. Once setting high standards, but now impoverished and struggling with a foreign debt of US$ 30 billion, wages in the public sector were the first to suffer.

TABLE 1: Non-oil GDP and Real Wages. Selected Years

	*Non-oil GDP (Billion US$)**	*Population (Million)*	*Non-oil GDP/ cap (US$)**	*Real wages (US$/year)**
1950	9.5	5.0	1881	2402
1960	18.0	7.5	2399	3591
1970	31.4	10.7	2932	4161
1978	55.6	13.8	4032	6204
1989	50.5	19.0	2655	2798
1995	58.7	22.2	2644	2404

* Constant 1984-dollars, converted at Bs. 7.016/US$.
Source: Baptista (1997a). Own calculations.

5.2 Oil Sector

Investment in oil had been low, with some ups and downs, since 1960; in 1970, with a time lag of ten years, output started to decline. Not surprisingly, investment levels remained low until nationalisation, and only started to increase in 1977. Hence, for seven years the country's most important industry, holding its most qualified human capital, did not react at all to the favourable changes of world markets. Venezuelan oil policy was only concerned with maximising ground-rent.

Then, at last, PDV launched a massive investment programme to stop the decay of the ageing fields of conventional oil and to pioneer development of the Orinoco Belt with its gigantic accumulation of extra-heavy crude.[4] However, the company was soon forced to cut output given the flagging call for OPEC crude. With the fall of the Shah of Iran and the ensuing war between Iraq and Iran, panic-driven consumers pushed spot prices higher than ever, and OPEC carried on with its policy of transforming higher spot prices into normal market prices through its reference price system. Prices finally rose far above what the market could possibly sustain, and OPEC was forced into a quota system. With declining demand, PDV's investment programme was scrapped. Venezuelan crude oil production, which had peaked at 3.7 million in 1970, was by 1985 down to 1.7 mb/d – to no avail. Oil prices finally collapsed in 1986. The cartel of ground-rent maximising landlord-states had completely missed its target.

[4] For a history of PDV see Boué (1993, 1998).

5.3 CONCLUSIONS

Both the oil and the non-oil sectors were in serious difficulties by 1986. In output terms, no sector had been more seriously hit by the crisis than the oil sector. Nevertheless, no sector was better poised for recovery. Firstly, the non-oil sector was in deep disarray whereas the oil industry had preserved its managerial integrity. Secondly, as a consequence of the crash of oil prices, fiscal revenues collapsed not profits. Hence the negative effect would fall entirely on the non-oil sector which would have to adjust to a much lower income. Its prospects were bleak. Things looked very different for the oil sector. Rent capitalism by its very nature had to put some strain on the oil industry, and this strain had increased continuously culminating in nationalisation. Finally, it was an excessive ground-rent which brought down demand even in absolute terms. But 1985 was the worst year the Venezuelan oil industry would have to endure. In the following year the oil industry, with lower prices and demand recovering, resumed a path of sustained growth. Between 1985 and 1997 output doubled.

6. LANDLORD-TENANT RELATIONSHIP (1976-89)

By December 1973, the oil companies had agreed to their nationalisation. To this end, the incoming Pérez government appointed in early 1974 an all-party Presidential Committee that included representatives of trade unions (Confederación de Trabajadores Venezolanos), the private sector (*Fedecámaras*), and professional associations of lawyers and economists. The Presidential Committee was not only in charge of drafting a Nationalisation Law but also of elaborating the organisational structure of the nationalised industry. According to President Pérez, nationalisation should be based on a truly national consensus. Thus, from the very start of nationalisation, MEM lost its traditionally dominant role in oil policy and law making. The country considering nationalisation its ultimate success, MEM was to be downscaled and demobilised.

6.1 Legal Framework

Art. 1 of the 1975 Petroleum Nationalisation Law (PNL)[1] reserved for the state the industry and commerce of hydrocarbons at all levels. Petroleum exports would be under the exclusive administration and control of the state, directly by the government or through state entities (Art. 2), in order to maximise the economic benefits in accordance with the requirements of national development (Art. 3).

Art. 4 recommended that the foreign commerce of hydrocarbons to be based, preferably, on a direct relationship with consumer governments or other state entities. Art. 5 (subsequently Art. 5 1975 PNL) defined the space left to private enterprise. The public debate centred almost exclusively on this article. It started with pointing out that the reserved activities would be exercised directly by the government or state entities which would be authorised, however, to 'enter into operating agreements to the best fulfilment of their duties, but without affecting the essence of the reserved activities'. Yet beyond this point there was no consensus on Art. 5 in the Presidential Committee. The representatives of *Fedecámaras* also wanted to authorise associations with private investors:

> In special cases and if it suits the public interest, the government or state entities may enter into association agreements with private entities, in all the reserved activities, for a definite term and maintaining a participation that guarantees the control of the state. The signing of these agreements requires the previous authorisation of Congress...

[1] Ley Orgánica que Reserva al Estado la Industria y el Comercio de los Hidrocarburos.

All other members of the Presidential Committee rejected this. Nevertheless, the government took on the proposition of *Fedecámaras*. Given its majority in Congress, it became part of the Law, albeit after a lengthy debate.

One of the new state entities would be in charge of co-ordination, supervision, and control. Possibly, the central agency would also be the shareholder of all the other state entities (Art. 6). The latter would be subject to the same fiscal regime as the concessionaires before them but with one exception. Ten per cent of export profits of the operating companies would be transferred to the holding company free from income tax 'to provide the company with the resources for the development of the national petroleum industry' (Art. 7). Finally, these entities were supposed to operate as commercial enterprises and their personnel were not public employees (Art. 8).

The day after the Petroleum Nationalisation Law passed Congress, PDV was created as a public limited company with the state as its sole shareholder. The Minister of Energy and Mines represented the state as shareholder, and presided over the shareholder meeting. In other words, the Minister now represented both the landlord and the shareholder state. The President of the country was to appoint the eleven members of the directorate.[2] The affiliates, being PDV the holding company, maintained the original structure of the former concessionaires, operating the same areas, exercising the same activities, and with the same personnel except that the foreigners at the highest executive-levels were replaced by their Venezuelan deputies. This resulted in fourteen affiliates. Eventually their number was reduced to three: Lagoven, the successor of Creole (Exxon); Maraven, the successor of Shell de Venezuela, and Corpoven, the successor of Mene Grande (Gulf Oil) swallowing most of the smaller companies.

As soon as nationalisation had become an inevitable fact, the Venezuelan executives of the industry – who had always opposed nationalisation – began an intensive lobbying to prevent its 'politicisation'. They argued that disaster would threaten if the high standards of efficiency of private enterprise could not be maintained. This, and the continuity of operation, could best be guaranteed by preserving as far as possible the existing structure. The Law and its implementation responded to their claims. The Venezuelan government, suddenly confronted with nationalisation, opted to keep its distance. It would control PDV, the holding

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[2] The President and Directors of PDV were originally appointed for a four-year-term. In 1979, the Luis Herrera government cut down this period to two years.

company, but it would not become involved with the affiliates where the real management decisions were taken. What is more, the old national oil company, CVP, once supposed to play a crucial role with reversion and the only company the Venezuelan government ever really controlled, was dissolved within Corpoven.

The legal framework after nationalisation was fragmented and confusing. The PNL, giving birth to PDV, was grafted onto a legislation that had evolved supporting MEM against the foreign concessionaires. Moreover, bestowed with the rank of an Organic Law, the PNL would prevail over previous Laws if there were any contradictions. Hence, the new roles of MEM and PDV had still to be sorted out. Probably in response to pressures from MEM, President Pérez appointed in 1976 a committee of outstanding lawyers (*Comisión Egaña*), all of them with a long history associated with MEM, to draft a new and comprehensive Organic Hydrocarbon Law. One noteworthy feature of the final draft this committee delivered, was that it ruled out once more the possibility of associations.[3]

PDV consistently refused to co-operate with the *Comisión Egaña* and succeeded in convincing the government to file the draft. PDV was actually already busy interpreting in its own way the existing legislation. In a study *The Law of Petroleum Nationalisation*, completed in October 1976, Román J. Duque Corredor, then 'a lawyer employed by the industry',[4] concluded that the whole 1967 Hydrocarbon Law had been repealed by the Petroleum Nationalisation Law,[5] notwithstanding the fact that its Art. 28 repealed only those parts 'inconsistent with the present Law'. He thus considered null and void most, if not all, of the legislation that had developed in confrontation with the foreign companies that strengthened the ability of the state to maximise ground-rent.

In April 1985, the Lusinchi government launched another serious attempt to reform the legal framework. The Minister of Energy and Mines appointed a new committee, now including representatives of PDV. In February 1986, the committee presented its draft. However, there had been no agreement. Both sides held to their viewpoints. PDV wanted its *de facto* monopoly of the reserved activities written into the Law, replacing references to 'government or state entities' by 'PDV or its affiliates'. Moreover, oil prices should be fixed by PDV without being subject to the approval of the Ministry. Last but not least, regarding

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[3] Egaña (1981).

[4] Duque Corredor (1978:9).

[5] Duque Corredor, *op.cit.*, p.11.

association agreements PDV suggested a deletion of the restriction 'for a definite term and maintaining a participation that guarantees the control of the state'.[6]

No action followed. The stalemate continued. But in the real world things were changing radically, and all in favour of PDV. As to the determination of prices, for example, OPEC's reference price system was collapsing at that very moment so that PDV, after all, would not need any legal change to shake off the control of MEM.

6.2 The Government's Take and PDV's Internationalisation Policy[7]

It took a few years after nationalisation to turn around the industry from decay to recovery by designing and implementing a new investment programme. Meanwhile PDV accumulated an investment fund of US$ 5.5 billion. Yet when the programme was finally under way, in 1982, the government found itself short of money for the first time since nationalisation. Without any serious consideration PDV was ordered to withdraw its funds from American banks and to deposit them in the Central Bank of Venezuela. A few months later they fell prey to devaluation. Subsequently PDV was obliged to underwrite public debt certificates, to pay taxes in advance, subject to disadvantageous differential exchange rates, and so on.

All this happened without any serious opposition in Congress. As the crisis within the country worsened, there was obviously not the slightest hope that a regulatory framework might be developed that would have allowed the company to play a proper role. The industry's claim, hinting at the Petroleum Nationalisation Law, that it should have a say about its after-tax profits, went unheard. Although the incumbent Minister of Energy and Mines, Humberto Calderón Berti, later claimed that he opposed the decision within the cabinet, the fact is that in his dual role representing the landlord and share-holding state he subjugated the latter to the former.

The oil industry, left on its own, began to take precautions not to be buried under the rubble of the collapsing landlord-state. It closed ranks. 'In a very real sense 1982 marked the birth of PDV as a corporation proper'.[8] Over the next few years the affiliates integrated into one national oil industry, in a parallel process to the disintegration of the rest of the country. Until then the affiliates had continued to operate independently, to compete with, and even to

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[6] Trotta de Godoy (1995:48-56).

[7] This section is based on Boué (1998).

[8] Boué (1998:206).

fight each other, caring very little about the holding company. The President of PDV was still General Rafael Alfonzo Ravard, appointed in 1976, who had no previous history in oil, largely because the affiliates had been unable to agree on any candidate from their ranks. But now careers in PDV were redefined and high executives could, or had to, move from one affiliate to another.

At the end of 1983 the outgoing Herrera Campins government (Copei) appointed Minister Calderón Berti as General Alfonzo Ravard's successor. This was unacceptable to the incoming Lusinchi government (Acción Democrática). The industry, in unison, did not accept the appointment either. As a result, Calderón Berti was replaced a few months later by Brígido Natera, an experienced oil man and vice-president of Lagoven. Whatever the importance of party politics in this episode, the winner was PDV.

The company would never again accumulate cash. The lesson had been learnt that money should be spent in illiquid assets and out of the reach of the government. Spending had to be justified politically, of course, but for the time being this was impossible within the country as all investment projects were cancelled or delayed. By far the largest of these was Lagoven's US$ 8 billion-project to upgrade extra-heavy crude from the Orinoco Belt, and a US$ 2 billion-project the company had already been negotiating with Veba Oel. PDV succeeded in turning the tables and in convincing the government that it should purchase immediately, at a price of US$ 250 million, a 50 per cent stake in Veba's refinery in Gelsenkirchen (Germany). Thus, PDV argued, a market outlet for Venezuela's heavy crudes, always more difficult to sell, would be ensured at a critical moment of flagging demand.

There was strong protest from the incumbent opposition, then Acción Democrática. Its leadership was worried about PDV using internationalisation and transfer pricing to convey profits abroad. It can be readily deduced that this was indeed the purpose of the manoeuvre though, of course, it was always denied by PDV. Anyway, a permanent link with Veba Oel had been created and resources were transferred, possibly with an eye on the postponed common project. Prices agreed upon with Ruhr Oel, the joint venture, were definitely lower than those charged to third parties. The balance turned positive only in the years of the exceptional and unforeseen circumstances of an unexpectedly strong Deutsche Mark.

Not surprisingly, then, the incoming Acción Democrática government stopped PDV's internationalisation programme, just as it began. However, PDV was allowed to consolidate its association with Veba by buying minority shares in another two Veba-refineries in Germany. The situation changed completely however with the crash of oil prices in 1986 – for

which OPEC and MEM were to be blamed. In the subsequent price war to recover market shares, PDV was able to shake off control by MEM in the matter of prices. What is more, the company also succeeded in convincing panicking politicians and the government of the virtues of its internationalisation programme. Starting in 1986 PDV bought refineries and even retail outlets, most of them in the USA. At present, the company proudly proclaims that it is competing, through Citgo, for the first place in retail sales in the USA where it controls an important network of refining and transportation. Through its association with the German Veba Oel and the Finnish Neste Oy, PDV also enjoys a solid position in Europe. Indeed, PDV now controls international market outlets of 700 000 b/d in excess of its exports.

This was achieved by spending very little cash. The assets were mainly paid for by transferring untaxed crude oil for storage, and by long-term supply contracts at high discounts. Since after 1986 PDV was in control of prices, there can be no denying that the transfer of profits was the main purpose of, and driving force behind, those acquisitions. It is a fact that the crude sold to associations abroad is generally of better quality than the crude sold to third parties, contrary to PDV's official claim that it provides, because of its internationalisation, market outlets for the country's heavier crudes. Moreover, though transfer-pricing formulas have become deliberately more and more opaque since 1986, apart from their usually being confidential, there is hard data available for the years 1995 and 1996.[9] Notwithstanding the quality difference in favour of the crude transferred to associated refineries, prices were on average US$ 2.50 lower, and taking into account the volumes involved, in these two years the price difference amounted to about US$ 1.5 billion. It is not surprising that the foreign affiliates have never transferred back to Venezuela one single dollar in dividends. Lastly, PDV's short-term supply contracts do not involve definite commitments to lift specified amounts of crude but simply options to lift. Thus, the control centres of all these arrangements are beyond the reach of the government in Caracas.

In 1989, the year in which the knell of the landlord state rang, PDV was already strong enough to defy even the President of the country. PDV wanted to buy the remaining 50 per cent of Citgo, still in the hands of Southland. Carlos Andrés Pérez opposed the deal. But PDV had its way arguing exceptional circumstances, claiming that Southland was about to sell its share to an unsatisfactory partner, and promising it would retain the additional 50 per cent only for the time necessary to find a satisfactory partner. With the benefit of hindsight there

[9] Personal communication.

can be no doubt that PDV never intended to keep its word. After two years President Pérez, as a last resort, ordered the company to sell. PDV dragged its feet. Even if Pérez had not been impeached in 1993, he would have been out of office long before the refinery could have been sold.

6.3 Reference Prices, OPEC Quotas, and Orimulsión

OPEC had been very successful in the 1970s in forcing up market prices with the help of fiscal reference prices. Too successful as it turned out. By 1982 the Organisation was running into trouble. Demand was flagging. OPEC, alongside a price cut, resorted to quotas. Yet in 1986, after having curtailed output by some 50 per cent, prices finally collapsed.

In Venezuela, as already mentioned, this was the opportunity PDV seized to strengthen its position. It was obvious that MEM, and OPEC generally, had seriously failed in their assessment of world petroleum markets. So far prices had still been controlled by MEM in accordance with the reference price-level set by OPEC. In the 'free for all' of the year 1986, the role of MEM was reduced to that of confirming ex-post prices negotiated, in the first place, by PDV; OPEC quotas, however, were still enforced. But PDV had already taken aim at the quota system, using Orimulsión as a spearhead. The new fuel, invented by PDV, was to be produced from extra-heavy crude from the Orinoco Oil Belt, arguably the biggest hydrocarbon province in the world. A mixture of 70 per cent of extra-heavy crude with 29 per cent of water and 1 per cent of an emulsion, this was a cheap fuel. PDV argued, on the one hand, that Orimulsión should not be included in the country's OPEC-quota since GATT defines, and OPEC has always accepted, that crude oil is a liquid at 14 °C, which was not the case for Orimulsión. On the other hand, as a kind of 'liquid coal' it would not compete in power generation with fuel oil but with conventional coal, and be priced accordingly.

The crux was, of course, that there was no way to justify the export of Orimulsión if it were to displace conventional crude or fuel oil. But this was precisely the message PDV wanted to bring across. OPEC quotas were spoiling business opportunities. And in spite of the opposition of the Ministry, in 1988 PDV succeeded in getting the government's approval to create a new affiliate, Bitúmenes del Orinoco (Bitor), to produce, to promote, and to market Orimulsión.

6.4 The Domestic Market

Prices in the domestic market, however, continued to be the exclusive domain of the

government. They had been dissociated from the international market just in time to allow domestic consumers to continue to enjoy low prices. Politically, the Venezuelan consumers in their capacity of resource owners felt entitled, rightfully, not to pay a ground-rent. Economically, in a country with abundant energy resources, low prices were supposed to foster the development of energy-intensive industries. All this made sense. But there remained the practical question regarding the level at which prices should be set; the range of possibility being given by production costs – including capital costs – and the international price level.

Successive governments proved unable to give any reasonable answer to that question. What is more, the fiscal regime was never adjusted to the dual price structure. Hence, the domestic market was a burden to PDV. Not surprisingly, the company invested very little in petrol stations, and high quality products were for export only. Unfortunately, from this viewpoint too, PDV was steadily alienating itself from the country. Instead of enjoying the advantage of a captive market, PDV was its prisoner.

It was worse than that since during the period under discussion, the industry was first short of production capacity and then subject to quota. In both cases, domestic consumption was a direct loss to PDV, as was clear even to the Ministry. Worst of all, after 1983 the government turned out to be politically unable, or unwilling, to handle the question of devaluation and inflation. Eventually prices fell even below technical costs. And the domestic market was very important: properly adjusted for the distortion of prices, in 1989 it represented about 34 per cent of production, second only to the US market which absorbed 40 per cent of output.[10]

In a way the government's behaviour regarding the domestic market was a mirror image of its behaviour regarding the world market. It was unable to apply reasonable limits in either case, respectively a minimum and a maximum. Having lost its sense of direction, those limits were ultimately imposed from outside, as we shall see, even in the case of the domestic market where all the parties involved – the natural resource owner, the producing company, and consumers – were Venezuelans.

6.5 Conclusions

The political enclave character of the industry disappeared with nationalisation, and MEM lost its monopoly as the institutional seat of oil nationalism. It was no longer in a position to

[10] Mommer (1996:132-58).

dismiss, or to isolate politically, the arguments coming from the industry. PDV was seen as the current power and the symbol of past success. Its arguments were heard, and had to be heard, at all political levels. In fact, most of MEM's highly qualified personnel left within a few years of nationalisation, many of them to join PDV.

The ability of MEM to control PDV weakened continuously with the country's decline. After 1986, the decay of the Venezuelan state and the non-oil sector generally gathered momentum whereas PDV, on the contrary, emerged as the only stable, efficient, and dynamic institution. Thus, for example, in the 1960s the accusation that foreign tenants were manipulating transfer prices united the country against them. In the early 1980s the same accusation against PDV still had, at least, some effect. But after 1986, it had no repercussion at all beyond a few political and academic circles around the Ministry, whatever the evidence presented.[11] If it were true, so what? Did it really matter? Was it not, possibly, to the advantage of the country? The extent of mismanagement and failure had been such that there was no perceptible link any more between fiscal oil revenues and development. On the contrary, it was now argued that the link was actually a negative one.[12]

By early 1989 the coffers of the government were empty. The country had no alternative but to face the consequences of the 1986 collapse of oil prices. Conversely the position of PDV was further strengthened.

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[11] Mendoza Pottellá (1995).

[12] This is the gist of the World Bank-promoted 'Dutch disease' debate.

7. OIL OPENING POLICY

In 1989 the incoming government, in a state of insolvency, had to submit to an IMF adjustment-programme and World Bank-ordained reforms. It had to confront, too, the disastrous legacy of RECADI. Due to the severe shortage of foreign exchange and its unfortunate administration combined with price regulations, Venezuelan consumers were facing a critical shortage even of basic goods. But the first thing the government did, bearing in mind the Letter of Intent that it was to sign in Washington with the IMF on 28 February, was to double petrol prices. It did so without addressing the critical domestic situation. In fact, it did not even bother to address the immediate issue of transportation fares which were, of course, subject to regulation. Hence, petrol prices doubled, but there was no adjustment to the fares, which were already too low anyway. The army of owners and drivers of (mini-)buses, which provide most of the transportation services in Venezuelan cities, could no longer tolerate the situation and increased their tariffs on Monday 27 February without waiting for official approval. They triggered a chain reaction. Having already endured falling real wages for ten years and by the end of the month out of money, passengers could no longer accept their situation. There followed days of riots extending over all major cities, with hundreds of people killed.

Only three months after the general election the extent of the crisis of the country had suddenly become plain. The political and administrative organisations and institutions were failing and falling apart. Two coups d'état attempts followed in 1992. Though defeated, they were seen with sympathy, at least, by a very significant part of the armed forces and the population. Then followed, in 1993, the impeachment and demise of President Pérez. In the general elections at the end of that year, the two principal parties of the country, Acción Democrática and Copei, just 'managed' to retain a combined majority in Congress. Apart from the traditional third party Movimiento al Socialismo (MAS) which gained some seats, two new significant parties entered Congress: Causa R and Convergencia. The latter was essentially a division of Copei whose only purpose was to support presidential candidate Rafael Caldera, the historic leader of Copei, who had become increasingly estranged from his party since the previous general election.

The new Caldera government, in turn, immediately had to face the collapse of the Venezuelan banking system at a cost of US$ 8 billion, in which most of the traditional major Venezuelan private companies vanished. Those that managed to survive generally did so with

the help of new foreign associates. The emergency also forced the government into another foreign exchange control for two years.

The 'good news' in Venezuela was that elsewhere in the world things were even worse. The invasion of Kuwait by neighbouring Iraq brought in a much-needed windfall and increased the call on Venezuelan oil immediately and also in the longer term. Whereas generations of Venezuelans had dreamt of a country independent from oil, they now realised that there was no future without it. They actually discovered the oil industry as the only bright spot in an otherwise gloomy picture.

7.1 Landlord-tenant Relationship

Opening the economy involved also, and most importantly, the privatisation of state enterprises. Nevertheless, in the oil sector things were somewhat different. The Pérez government was willing to allow private capital back but only within the limits defined by Art. 5 of the 1975 Petroleum Nationalisation Law (PNL). Accordingly, there were two possibilities, namely operating agreements and associations. The first form would be used for marginal fields and the second for joint ventures in extra-heavy crudes. The latter were, indeed, the 'exceptional cases' everybody had in mind when Congress discussed and approved Art. 5 1975 PNL. There was also the LNG-project which Lagoven had kept alive. Acción Democrática had blocked it in Congress in the early 1970s, but now in government they accepted it. Low-priced Orimulsión, however, did not have the blessing of this government.

On the other hand, Pérez was well aware, and worried, about PDV's alienation from the government. For this reason, in March 1990, he appointed an outsider, Andrés Sosa Pietri, president of the company.[1] As he belonged to one of the most distinguished families of Caracas, an entrepreneur and ex-Senator, President Pérez expected him to bridge the gap.

However, Sosa, a self-confident man with the courage of his convictions, as soon as he had been appointed started to act accordingly and, more significantly, to say what PDV executives had been thinking and discussing internally but still could not afford, or did not dare, to say publicly. First of all, Sosa did not believe, and never had believed, that MEM or OPEC were, or had ever been, important players in world petroleum. The price increases in the 1970s were coincidental, as had been all past achievements of Venezuelan oil politics:

[1] President Pérez never actually appointed an oil man as president of PDV.

'OPEC is a myth, and Rómulo Betancourt and Pérez Alfonzo are legends'.[2] He considered nationalisation itself only a passing phase and, with nationalisation:

> the creature is born that, not too long thereafter, would escape its creators and, even more, bury the old petroleum policy and the stellar role played by Venezuelan politicians in the country's petroleum policy.[3]

The only thing that really mattered in Venezuelan oil, then, was the success of PDV. According to Sosa, this success could best be guaranteed by allowing the company to act 'with the same freedom as any other commercial corporation – as if it were, for all legal purposes, a private company, and not a part of the state' (1993:63). Yet 'despite the changes of such importance [i.e. nationalisation]... MEM was retained, with the same powers it had in the concession era' (p.64). Given his disdain for the Ministry this, in itself, was not a problem. What is more, even the fact that the Minister became the president of the shareholders' meeting was not a problem either as long as he acted properly in accordance to his role, to do 'nothing but to moderate its sessions' (pp. 64-5). Sosa also made short work of OPEC: 'if OPEC were to be maintained', it should be converted into a 'research centre' co-operating with the International Energy Agency (IEA) (p.87). According to Sosa (1994), Venezuela should leave OPEC and join the IEA.

Unfortunately things had gone the wrong way. Taking over the presidency of PDV, he found that

> the administrative and financial autonomies ... had been violated. Investment and operational budgets are no longer PDV's responsibility, but that of the shareholders' meeting; more precisely, of the Minister. ... Plans and programmes without exceptions ... are subject to the 'guidelines' ... of the 'Minister'. ... The 'Minister' considers even the internal administrative organisation to be his prerogative. The 'Minister' controls oil production by using OPEC, and participates actively in setting prices, which are not definitive without his express consent.[4]

Sosa was absolutely determined to do something about it. He drew up an ambitious plan to transform PDV into a big, global company. Crucial to the plan was to produce at full capacity, expanding fast. Accordingly, output would grow from 1.9 mb/d, at the time of his arrival, to 3.3 mb/d in 1997. Minister Celestino Armas ordered him to stick to the OPEC quota. But then came the Iraqi invasion of Kuwait in August 1990. The government hesitated and wanted to consult OPEC first. Yet for the first time since its foundation, OPEC was not in a position to exploit an emergency in world petroleum markets. The Arab Gulf states, and Saudi Arabia in

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[2] Sosa Pietri (1993:90). Also published in (poor) English: *Oil and Power*, Barrows, New York, 1993. Always quoted according to the Spanish edition; own translation.

[3] Sosa Pietri (1993:63).

[4] Sosa Pietri (1993:77-8).

particular, were willing to supply whatever they were able to. They had hardly any other option. Venezuela – Sosa moving heaven and earth – followed suit. For the time being, at least, the problem of the OPEC quota was defused.

Next, there was the question of financing the expansion plan. Here, too, he found much to complain about:

> PDV's depositing of its foreign exchange in the Central Bank in 1982 was based on a peculiar concept of public finance, completely contrary to the legislature's intention when it established PDV's financial autonomy. According to this theory, PDV's operational budgets ... are part of public expenditures, and the corporation's investments are part of public investments. The main implication of this theory is to assimilate PDV with the general disorganisation of public administration.[5]

In practice the point was the determination of tax reference prices which, after the nationalisation of the domestic market, had been renamed 'fiscal export values' (FEV). Legally, the government had the power to fix a mark-up on (actual) export prices up to a maximum of 20 per cent. This was the machinery the government used to skim off the profits, in lieu of dividends. (PDV had never paid dividends up to this time, a fact Sosa does not mention in his book). At the time he took office the mark-up was 15 per cent. With the Gulf War and higher prices, MEM increased it to 20 per cent, very much to the dismay of Sosa. His demand was that the mark-up should be phased out over the next few years to provide the means for his expansion plan. Meanwhile PDV started to finance its plan, partially, by borrowing, ignoring the strong opposition of MEM.

Sosa consistently opposed any move that he believed might weaken PDV. One of them was the decision of MEM to hand over marginal fields to private investors through operating agreements, and he even questioned their legality:

> Leaving to third parties the portion of oil production that PDV could undertake with its own human and technical resources was to condemn PDV to a secondary role. ... In lieu of a strong ... PDV, we would have a small, weak corporation, a government agency that really carried out the responsibilities of the Ministry.[6]

He considered that the administration of the natural resource had always been, and still was, the responsibility of MEM, not of PDV. Though for him this involved not more than 'to ensure the efficient and adequate exploitation of the areas assigned' (1993:90). But the government charged PDV with everything, from organising the bidding rounds and elaboration of the contracts to their administration.

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[5] Sosa Pietri (1993:78).

[6] Sosa Pietri (1993:154).

Sosa did not oppose private investment *per se*. He was actually quite enthusiastic about associations in extra-heavy crudes which, because of their importance, he christened 'strategic associations'. What is more, he even viewed with sympathy the idea that there might be independent private investors in oil. The assignment of the areas, however, he considered should be the responsibility of MEM, not of PDV, and in this case 'MEM would also be the institution the foreign companies would have to deal with' (1993:90). As to the legal framework, he proposed to return to the concessionary regime and to reinstate the 1943 Hydrocarbon Law (Sosa Pietri 1994).

Last but not least, he considered private investors to be allies that PDV could not do without:

> PDV can be transformed into a private-law-company by placing 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, and the state would be obliged to apply to the company a tax rate more appropriate to an industrial concern that wants to attract private investors.[7]

Not surprisingly, Sosa found that 'this idea was not to the liking of the political leadership' (*ibid.*). In fact, the political leadership was engaged in a desperate struggle to control PDV. For example, when Congress reduced the income tax rate for extra-heavy crude projects involving some manufacturing within the country, from 67.7 per cent (the rate for hydrocarbon enterprise) to 30 per cent (the rate for non-hydrocarbon enterprise) as they would not be profitable otherwise, the reduction was restricted to associations. This was meant to prevent PDV from going ahead on its own – especially in the case of Orimulsión – the shareholders' orders to the contrary not withstanding. The point was that associations had to be approved by Congress.

At the same time PDV was also on a collision course with the government about Citgo, as referred to earlier. Finally, to complete the story, it should be mentioned that Sosa, whenever there was an opportunity, rubbed the government's nose in the losses the company was suffering in the domestic market, not only in hydrocarbons but also in petrochemicals. No wonder that very soon the Minister of Energy and Mines and the President of PDV were no longer on speaking terms. Sosa, however, did not lose his job and was only finally replaced at the end of his two-year-term.

Looking back at those years, there is a striking symmetry with the pre-nationalisation past. At that time Venezuelan politicians, most outstandingly Betancourt and Pérez Alfonzo,

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[7] Sosa Pietri (1993:79).

were unwilling and unable to concede any credit to the foreign tenants. Now things have changed. The new tenants, the national oil company and their high-level executives, most outstandingly Andrés Sosa Pietri, were equally unwilling to concede any credit to the memory of Betancourt and Pérez Alfonzo, their present-day successors, or to the institutions they had developed and created, MEM and OPEC. The pendulum has swung to the other extreme.

7.2 The New Liberal Consensus in International Oil

It was not only the Venezuelan government that considered PDV to be part of the state; so did the IMF and the World Bank. Consequently, lowering PDV's costs and expenses, or its investments, was a way to reduce the fiscal deficit.[8] Of course, from the viewpoint of these institutions the proper way to do that was to privatise the activities in question. And there cannot be any doubt that the fiscal deficit had already served as a powerful lever to re-open the oil sector to private investors, and not only in Venezuela. To bring the private oil companies back into business everywhere was an essential part of what has been labelled the 'Washington Consensus'.

In the case of oil, though, the question was not only private vs. public enterprise. Most importantly, there was the question of ground-rent. After 1973, and more radically after 1979, consuming countries had moved exactly in the opposite direction to OPEC. They, too, questioned the US-based compromise, albeit from a liberal perspective. Nowhere was this done more radically than in the British North Sea, the new petroleum producing region. The government privatised the British National Oil Company and sold its share in British Petroleum (BP). Sufficient acreage was offered in successive licensing rounds, in plots of 250 sq.km., to allow for a steady and unhampered flow of investment. The successful exploring company was awarded, as far as possible, the reservoirs discovered. Relinquishment did not aim at proven reserves but only at unexplored, or unsuccessfully explored, areas. (Nor is reversion an issue: when the first licences run out early next century, still producing, they will be renewed as a matter of course). There was no bonus bidding and the usual royalty of one-eighth was abolished in 1982 albeit, for the time being, only for new fields. The reason for this was that the imposition of royalties would make some prospects sub-marginal, and some reservoirs might be discovered but not developed because of the royalty. Even if developed, the recovery factor would be lower as a marginal well would have to be abandoned earlier.

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[8] Sosa tried to convince the President of the IMF, Michael Camdessus, to exclude PDV from these accounts, but to no avail. Sosa Pietri (1993:76).

(For this reason, it is to be expected that royalty will be abolished for older fields later, when they approach exhaustion).

For the licences granted between 1983 and 1993, only a Petroleum Revenue Tax (PRT) remained in place, an excess profit tax never meant to be a reward to the natural resource owner. Bonuses are paid even before a project is under way. A royalty is paid as soon as there is some production even if there are no profits. PRT is only paid if there really is an excess profit in the first place.

The resilient feature of excess profit taxes is their downward flexibility. In the case of PRT, excess profits are defined over the *lifetime* of a field. PRT is calculated yearly according to special rules, which do not distinguish between investment and current expenditure. The former is treated like the latter. Once the accumulated balance turns positive, PRT has to be paid (since 1993 at a 50 per cent rate); but if the accumulated balance decreases later, PRT is repaid, interest included.

However, even PRT may be too much on lands that, according to expectations, are really marginal. Indeed, if without PRT, expectation would just match the reservation utility of the potential investors, with PRT it will not. This, because PRT would collect ex-post excess profits where there are none ex-ante. Hence, the expected average would fall below that level. Therefore, in 1993, the British government, considering that what remained was basically marginal lands, abolished PRT for new licences.[9]

In other words, in the United Kingdom Continental Shelf (UKCS) reservation ground-rent is zero. What is more, when excess profits do appear, the producer still has the option to plough them back into the reservoirs to increase the recovery factor thereby reducing his PRT-liability. Even then, if he runs into trouble later, he still may recover PRT paid earlier.[10] The only variable in the government's objective function is output.

Displacing the USA, whose system is now considered out of date, the UKCS has become the new reference that is spreading slowly but steadily all over the world. Even on public lands in North America – in Alaska, Alberta, or the US Mexican Gulf deep waters – royalties, the reservation ground-rent *par excellence*, have now come under attack. Once fixed at one-eighth or one-sixth, they are now being transformed into downwards flexible,

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[9] Martin (1997).

[10] Due to the generous criteria in the determination of excess profits, the UKCS is the most profitable oil producing region in the world. Ian Rutledge and Philip Wright: 'The Windfall that Got Away? Profitability and Taxation in the North Sea Oil and Gas Industry', *Energy Studies Paper no.1*, University of Sheffield, June 1997.

profitability-linked, sliding-scale royalties.

7.3 Petróleos de Venezuela, The New Licensing Agency

The new liberal consensus in international oil was the package that international oil companies, consultants, IMF, and the World Bank wanted to be implemented with *Apertura Petrolera*. Aimed at minimising ground-rent, it was exactly the opposite to Venezuela's traditional ground-rent maximising oil policy. At the international level there was no inclination to compromise, and the so-called Producer-Consumer-Dialogue (confusingly, the landlord-states are usually referred to as 'producers') promoted by the Venezuelan and the French governments in 1991, was a complete failure. OPEC had much to offer by compromising in the 1970s, much less in the 1980s, and very little in the 1990s. The cartel of landlord-states, the antithesis of liberalism, became weaker on all fronts, internally and externally. To cap it all, came the collapse of the USSR and socialism; liberalism seemed to be triumphing everywhere.

Even nationally, as we have seen, there was no wish to compromise. The liberal package was very attractive to PDV, the producing company, notwithstanding the fact that it questioned politically its very existence. But so did PDV itself. After all, nationalisation had been forced upon the industry. PDV was not only open to, but keen on, private investors. By the same token the international oil companies, consultants, IMF, and the World Bank were considered political allies that the company, and the country, could not do without. It never entered PDV's mind that it could strengthen its position as a national oil company by playing them off against the landlord-state. PDV was all too eager to get rid of it or, more precisely, of MEM, the institutional seat of the ground-rent maximising landlord state.

Hence, there was no question of re-instating the concessionary regime and the 1943 Hydrocarbon Law. The days of the American compromise were gone forever. Sosa was an outsider. PDV itself would take over the role of the licensing agency, displacing MEM, in order to implement the new liberal consensus in international oil.

In its new role PDV continued consistently to maintain its position not to engage in major legal reforms and, thereby, in political debates. On that level its position was weakest and its international allies were, arguably, more of a liability than an asset. PDV preferred to interpret 'creatively' the existing framework, and in this the company had powerful machinery, abundant financial sources, and the backing of its international allies was an inestimable asset. On the other side, the government, Congress, and its Committee of Energy and Mines, had

traditionally been dependent on the Ministry. Since nationalisation, however, it had been dismantled piece by piece. No more than a nudge was needed to clear MEM out of the way.

The first and most important steps PDV took in its new role were consulting the Supreme Court and the parliamentary Committee of Energy and Mines. Then followed partial reforms to the fiscal regime in oil. Taken together, it is at these levels that the legal framework of nationalisation was dismantled. The new governance of Venezuelan oil emerged mainly from the contracts, piecemeal from one contract to the next, and from one kind of contract (working agreements) to the other (association agreements). This was not only a complex process but also a deliberately confusing one, as PDV's salami-slicing, zigzagging step-by-step policy aimed at averting as far as possible any public policy debate.

Consulting the Supreme Court

Private investment in LNG, as outlined earlier, was blocked in 1971 with the Gas Nationalisation Law. This Law ruled out the use of free gas for liquefaction, the only form in which it could possibly have been exported. But Lagoven gave a new life to the idea after discovering several fields of free gas in the east of the country in 1978. A decade later Lagoven officially started to examine the commercial feasibility of a LNG project, christened *Cristóbal Colón*. A pioneering project, highly capital-intensive, it was conceived from the beginning as a joint venture and a test case for Art. 5 1975 PNL.

The legal advisors of Lagoven maintained that the prohibition of liquefying free gas had been repealed, implicitly, with the Petroleum Nationalisation Law. To dispel any doubts, so it is recorded, Lagoven agreed with its foreign partners – Exxon, Shell, and Mitsubishi – on obtaining 'a Supreme Court pronouncement with respect to the supremacy of the 1975 Nationalisation Law'.[11] According to newspaper reports, that was it. Yet this was not the real issue. Lagoven, apart from questioning the Gas Nationalisation Law also asked the Supreme Court to repeal the *entire* Art. 3 1967 HL. It did this on the grounds that in one of its sections concessions were still considered a possibility, but concessions had been abolished explicitly with nationalisation. Hence, argued Lagoven, as the other forms of contracts had co-existed with concessions, they could certainly not have been upheld after nationalisation, which was conceived as a totally new beginning. In other words, there was no prior history to nationalisation and no legal precedents of any kind. Art. 5 1975 PNL, then, should be the only

[11] *Proyecto Cristóbal Colón*, Lagoven, Caracas, March 1993; p.F-3.

norm to apply to any Association Agreement (AA). By that very fact – a conclusion never made explicit either by the Court or by PDV – it would also be the only norm to apply to the other variety of contracts, i.e. working agreements.

The Supreme Court in its Ruling answered positively all the questions put forward by Lagoven. Particularly, as to Art. 3 1967 HL, the Supreme Court argued that with nationalisation and Art. 5 1975 PNL 'a totally new general norm'[12] had been created, an entirely fresh start invalidating previous laws and regulations which had parted from the concession system. This reasoning, to say the least, was not very convincing. Yet it was hardly surprising: the pronouncement was the work of Román J. Duque Corredor who had become a Judge of the Supreme Court. More than a decade previously, as a lawyer employed by the industry, he had submitted that the whole Law of Hydrocarbon had been repealed by the Petroleum Nationalisation Law. This explains, too, why it took only four months to elaborate the Ruling.[13]

For the following developments, it is convenient to summarise and compare the conditions established by these articles (see Table 2). Art. 3 1967 HL had been very cautious in circumscribing the rights of CVP in negotiating upstream contracts. This was not the case in Art. 5 1975 PNL. Nevertheless, it could have been argued quite convincingly, both legally and politically, that Art. 3 was circumscribing the rights of PDV; in addition to which in Art. 5 1975 PNL the 'control of the state' was required as well as the approval of the actual contract by Congress, not only of its foundations for the purpose of negotiations. With the Supreme Court Ruling, however, this was no longer the case.

Furthermore, in his Rationale Justice Román J. Duque Corredor expressed his viewpoint on the meaning of 'a participation guaranteeing the control of the state'. According to him, it was 'more of a legal concept than an economic or patrimonial one'.[14] The state did not necessarily have to participate as a majority shareholder, not even as a shareholder at all, in order to comply with the requirement of control.[15]

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[12] Corte Suprema de Justicia, 23 April 1991.

[13] Jesús Mora, a Venezuelan lawyer, believes this to be a speed-record in the modern history of the Supreme Court. See Domingo, Fargier, Mora *et al.* (1996).

[14] Corte Suprema de Justicia, *ibid.*

[15] For a detalled legal analysis, critical of the Supreme Court Ruling, see Vallenilla (1995).

TABLE 2: Minimum Conditions in Upstream Agreements. Hydrocarbon Laws 1943, 1967, and Petroleum Nationalisation Law 1975

Issue	*1943 HL (Concessions)*	*1967 HL (Art. 3)*	*1975 PNL (Art. 5)*
Royalty	16.67%	16.67%	16.67%
Area, Exploration, Relinquishment	Maximum 100 km^2, divided into blocks of 5 km^2. Exploration 3 years. Concessionaire entitled to 50% of blocks forming one connected area.	No maximum, area divided into at least 10 blocks. Exploration up to 5 years. Alternate selection of blocks, contractor entitled to 20% of blocks.	Not mentioned
Contract Term (Exploration and Production)	40 years, extendable.	30 years maximum	Definite term
Reversion	Passive	Active	Not mentioned
Tax sovereignty	Explicitly attested	Explicitly attested	Not mentioned
Jurisdiction	National Courts	National Courts	Not mentioned
Approval of Congress	No	Foundations of contract	Contract
Publication of contract	Official Gazette	Official Gazette	Not mentioned
Participation of National Oil Company	No	More advantageous to the nation than concessions	Control of the state
Better Conditions	Through negotiations and/or bidding by MEM	Through negotiations and/or bidding by CVP	Not mentioned
Income Taxes	Fiscal reference prices since 1967. Special income tax rate for hydrocarbons since 1970.	Fiscal Export Values. Special income tax rate for hydrocarbons.	Fiscal Export Values. Special income tax rate for hydrocarbons at 67.7% since 1976.

Art. 5 1975 PNL was now open to all kind of interpretation. Yet nobody in MEM, in the government, or in Congress, was aware of the fact that the ground had been cut from under the legal edifice of nationalisation. Everybody believed the newspaper reports according to which the Supreme Court had just ruled out some obsolete dispositions of the Gas Nationalisation Law. Nobody bothered because it was not a foreign oil company who had gone to Court but PDV.

Consulting the Committee of Energy and Mines

The next step was to explore the option of operating agreements, now officially called operating services agreements (OSAs). PDV, in 1991, elaborated a draft for the reactivation programme of inactive and abandoned fields, as required by MEM. The draft was submitted to some lawyers (amongst them Román J. Duque Corredor who had already switched back to the private sector) and law firms. Finally, together with the expert opinions, it was sent for approval to the Committee of Energy and Mines of Congress. The Committee delivered a positive verdict. The draft was deemed to fulfil the legal requirements of an OSA, in accordance with Art. 5 1975 PNL, 'not to affect the essence of the nationalised activities'.

The verdict was based on two criteria. Firstly, the ownership of the product would remain at any time with PDV. Secondly, for this reason the contractors are deemed to be paid for their services, not for the product. One may wonder what the first criterion is worth in today's world with its highly developed oil spot markets. It seems to depend on the formality that the contractor hands over the oil to PDV at the well-head when receiving a service fee, and that PDV then sells the same oil to the same contractor at the border. This is what actually happened in some instances. PDV was careful to inform the Committee of Energy and Mines that those OSAs might be linked to additional advantages for the nation such as, for example, long-term supply contracts. Although only heavy oil was mentioned as an example, because it was difficult to sell, it was only as an example that it was used.

Regarding the second criterion, one may wonder what is the difference between paying a service fee for, or buying a barrel. As these contracts were to last for twenty years – yet an extension may be granted at any moment – there had to be a deflator. In a service contract one would expect, typically, the deflator to relate to costs, to input, not to output. In the draft that PDV submitted to the Commission, however, the deflator (to be found in a footnote) is the 'Special Index Energy' of the 'Consumer Price Index' for all 'Urban Consumers' in the United States – which obviously correlates very highly to oil prices, i.e. to output and not to input.

The draft was only meant, of course, to be a starting point. As we shall see, it would be subject to 'creative interpretation' from one bidding round to the next.

Sovereign Hydrocarbon Taxation[16]

The OSAs were classified as non-hydrocarbon enterprises, in accordance with the fiction that they were not producing, but only providing services. Their profits, therefore, are subject to sovereign taxation like any other non-hydrocarbon enterprise (then essentially an income tax of 30 per cent), but not to sovereign hydrocarbon taxation (then an income tax of 67.7 per cent combined with the device of FEV). PDV, according to the same fiction, is not providing the services of a licensing agency but is the actual producer. Therefore, it is PDV who is subject to sovereign hydrocarbon taxation. Hence, PDV operates as an 'umbrella' to the private contractors protecting them from the so-called 'sovereign risk', the risk of any sovereign change in assessing their tax liabilities in accordance with what they really are, producers of hydrocarbons.

Regarding AAs, as already mentioned, in 1991 Congress approved a reform of the Income Tax Law lowering the hydrocarbon income tax rate from 67.7 per cent to 30 per cent in the case of LNG, Orimulsión, and upgrading extra-heavy crude, i.e. the normal rate for non-hydrocarbon enterprise. Yet the reduction took place within the section of the Law dealing with hydrocarbon enterprises. In other words, the AAs were still subject to sovereign hydrocarbon taxation. They were definitely conceived of as producers of hydrocarbons.

The problem was to bring hydrocarbon taxation into the realm of the contractual relationship for these cases. Legal technicalities apart, the solution as we shall see would be basically the same though less 'elegant': PDV as an associate would actually assume the role of a hostage.

[16] For the sake of simplicity, we omit any reference to state, municipal, or other local taxes, though they are an important issue.

8. EVOLUTION OF CONTRACTS

8.1 First and Second Bidding Round of Inactive and Abandoned Fields (1992-3)[1]

The first upstream contracts were OSAs for inactive or abandoned fields, awarded in two bidding-rounds in 1992-3. The bidding parameters, in the first round, were the work programme and the operation fee per barrel. In the second round the only bidding parameter was the operation fee per barrel with a minimum work programme attached to it. Contracts would last twenty years, but there is a *force majeure* clause which allows for a five-year extension. The definition of *force majeure* includes 'compliance with any request, ruling, order or decree of governmental authorities, substantially impeding the performance of the work as provided hereunder'. The same *force majeure* clause is to be found in all later upstream contracts. OSAs may be extended indefinitely at any time.

The total fee per barrel is the sum of the operating and capital fees, the latter being the depreciation charge divided by output. The total is subject to a cap, basically the market price of oil less a certain margin. If the cap becomes effective, this means that the operator will have delayed the recovery of its investment. The margin itself is intended to allow for hydrocarbon taxes, rents, and royalties (apart from a small fee to cover administrative costs). Indeed, being classified as service contracts and not as producers of hydrocarbons, it is PDV that pays rents and royalties, not the contractors.

Regarding rents, the Hydrocarbon Law provides for some payments as, for example, surface taxes. At the time these payments were established, in 1943, the exchange rate was Bs. 3.09 per dollar. In 1992-3 the exchange rate was down to Bs. 80 per dollar, and depreciation of the bolívar was accelerating (to Bs. 500 per dollar in 1997). Thus, the only relevant payment is the one-sixth royalty. However, the Law authorises the Ministry to lower that rate, but only in order to extend the lifetime of a producing well threatened by increasing costs or falling prices. Even then the government is not allowed to enter into any contractual agreement in that regard; on the contrary, it is empowered to restore the one-sixth royalty whenever the motivating circumstances for the reduction, in its sole judgement, had ceased to exist. In other words, the reduction of royalty, according to the Law, is conceived as a discretionary decision which never creates any kind of vested interests or acquired rights, and

[1] Ministerio de Energía y Minas: *Modelo de Convenio de Servicios de Operación*, mimeo, Caracas, 1992.

which is certainly not intended to make a project profitable. The one-sixth royalty was meant to be a reservation ground-rent.

However, some of the inactive and abandoned fields PDV put forward for auction were deemed to be profitable only at a reduced royalty-rate of 1 per cent. It may be questioned whether a reduced rate could be applied to these cases, arguably new projects, and it was certainly impossible, legally, to guarantee such a rate for twenty years. Nevertheless, PDV signed the contracts assuming that the reduction conceded by MEM would last for twenty years thus acting, also in the context of royalties, as an umbrella.

In practice, this meant that PDV was able to agree to a higher cap, closer to market prices. At the same time a precedent was created. Paying initially a one-sixth royalty in all the other cases it seems more than likely that PDV will later, when the fields approach exhaustion, ask for a 1 per cent royalty to be passed on to the contractors, thus increasing their price cap.

Hence, as far as royalty is concerned, the reservation ground-rent has been reduced to 1 per cent. But there was still the problem of FEV. The mark-up, at that time, was at its 20 per cent maximum. This meant that even if PDV was making no profit out of a barrel of oil produced by an OSA, after paying royalty, nevertheless the company would have to pay an 'income tax' of 67.7 per cent on 90 per cent of the mark-up (10 per cent of exports being income tax free). As a result, PDV would still have to pay the equivalent of an additional royalty of 12.2 per cent.[2] In other words, PDV would still have to allow for a margin, as a minimum, of 13.2 per cent off market prices to be sure not to incur losses. This seemed to be at that time, the level of reservation ground-rent. However, a few months later PDV succeeded in convincing Congress to phase out and abolish FEV (see below). Thus, the reservation ground-rent was reduced to 1 per cent, and PDV is now able to lift the cap for the total fee per barrel in all OSAs to 99 per cent of market price, whenever the company considers it convenient to do so.

Another major step in the same direction was taken with the second bidding round. In the first round the fields had still been properly defined in three dimensions, but in the second deeper strata were included for exploration without any clause referring to relinquishment. One may safely assume that this precedent has been applied, retroactively, to the first round.

All in all fourteen OSAs were concluded. PDV originally estimated their potential at

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[2] 12.2% = 20%*67.7%*90%.

125 000 b/d. In fact, five years later, in early 1997, they were producing already about 260 000 b/d, of which one-third was subject only to a 1 per cent royalty.[3] They are now expected to produce 500 000 b/d within a few years. PDV grossly underestimated their potential for several reasons. In the first place, there is PDV's lack of experience in handling small fields and its isolation, after nationalisation, from new technologies in exploration and production (which were particularly important in relation to small fields). In the second place, the original forecast was based on the fiscal regime as it was still in place in early 1992. Finally, at that time the deeper strata were not yet included.

Settlement of Disputes

Given the creative interpretation of the existing Law, the settlement of disputes was a point of major importance. The OSAs established that doubts and controversies were to be settled by national arbitration, according to the rules of the International Chamber of Commerce, and not by national courts as had always been required by Venezuelan Law and Constitution. Though arbitration would be based on national law, there was still the fact that the parties – the contractors and PDV, not the government – could choose their judges. Most importantly, however, international treaties entered into by Venezuela, and international law, would carry much greater weight in a tribunal of arbiters than in national courts. Yet from the viewpoint of the foreign company the ideal would have been international arbitration. Indeed, Shell refused outright to accept national arbitration. This company had been awarded the Pedernales field in the first round, but it was finally granted to British Petroleum as PDV could not then comply with Shell's request for international arbitration. According to the *Petroleum Economist*, Shell's 'tough stance' in this regard was a matter of principle:

> 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 Pérez presidency.[4]

By the end of 1992 PDV was negotiating associations in LNG and upgrading extra-heavy oil, all of them multi-billion projects. According to the *Petroleum Economist*, these negotiations had reached deadlock due to the question of arbitration. Finally, in early 1993, the government succumbed to Shell's demands and, indeed, Pérez's presidency was cut short one month later – albeit for very different reasons.

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[3] Personal information.

[4] Kielmas (1992:16).

8.2 Association Agreements in LNG and Upgrading Extra-heavy Crude (1993)

Cristóbal Colón[5]

In March 1993, the Pérez government approved Lagoven's *Cristóbal Colón* to be submitted to Congress, though President Pérez was removed before it actually went there. Congress was asked to approve only the foundations, or guidelines, of the contracts (*Marco de condiciones*), which were subsequently published in the Official Gazette.[6] Regarding the contract, presented simultaneously, Congress only acknowledged that it was consistent with those guidelines.

The joint venture was to be named *Sucre Gas*, the distribution of shares being Lagoven 33 per cent, Shell 30 per cent, Exxon 29 per cent, and Mitsubishi 8 per cent. However, the four parties had agreed that the association would only materialise if Congress complied first with reforming the Income Tax Law such that Sucre Gas

> will be excluded from the provisions applicable to hydrocarbon enterprises, and subject to the ordinary regime ... applicable to [non-hydrocarbon] corporations and, consequently, [Sucre Gas] will be excluded from the system of fiscal export values.[7]

This condition was fulfilled immediately after approving the Project. In fact, not only LNG but also Orimulsión and upgrading extra-heavy crude were moved to the section of non-hydrocarbon enterprise.[8] What is more, taking advantage of the virtual absence of any government, PDV succeeded in broadening the reform: the FEV was to be phased out, and abolished, over the next three years. Hence, the AA in LNG would only be subject to sovereign non-oil taxation, like the OSAs. To make this change irreversible, PDV had to act once more as an 'umbrella' or, more precisely, as a hostage. According to the guidelines:

> 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.[9]

Regarding royalties, the agreement simply states that Sucre Gas will pay 'the tributes provided for by the Law of Hydrocarbons'.[10] At the time this Law was passed, in 1943, natural gas was more of a nuisance than a blessing. Therefore the Law authorised the Ministry to exonerate

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[5] Lagoven: *Proyecto Cristóbal Colón*, mimeo, Caracas, Marzo de 1993.

[6] *Official Gazette*, 9 September 1993.

[7] Lagoven, *op.cit.*, 'Acuerdo de formación'.

[8] *Official Gazette*, 9 September 1993. This new Law was published the same day as the Authorizations of the Strategic Alliances.

[9] *Official Gazette*, 9 September 1993.

companies from paying any royalty 'if the gas is used for ... ends considered of public interest',[11] and even to enter into contractual agreements for up to fifteen years. Though the issue was never mentioned publicly, given the marginal profitability of the project, on the one hand, and the general context of the royalty debate, on the other, it can be taken for granted that the associates will never pay any royalty.

In order 'to comply with the legal mandate of a controlling interest for the state',[12] Lagoven's shares are 'privileged', the privilege consisting 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, Lagoven has a veto-right regarding certain important decisions, in the sense that unanimity, or at least 70 per cent of the votes, are required. On the other hand, Lagoven's 33 per cent was a guaranteed minimum, but there was also a maximum: 49 per cent (except, of course, 100 per cent).

The project remained, however, an option for the private partners to enter into an association, not a commitment. The associates were committed only to an economic and technical feasibility study of the US$ 4 billion-project, to produce, and export to the USA, 5.7 million tonnes of LNG yearly (about 140 000 b/d). A final decision had to be taken by December 1996, though Lagoven, in its sole judgement, was authorised to concede an extension without any limit or penalty payment attached.

The project would 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 came first (plus, possibly, another five years according to the *force majeure* clause). At the end of this period, all shares would be 'fully transferred to Lagoven without cost',[13] though it must be said that there would be no gas left either.

Last but not least, this arrangement was underpinned by international arbitration (the governing law, however, is Venezuelan Law). Any contention or claim will be resolved, definitively and finally, 'according to the rules of the International Chamber of Commerce of Paris, in the City of New York'.[14]

Cristóbal Colón was submitted to Congress on 27 July 1993. Edgar Vallée Vallée,

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[10] Lagoven, Proyecto..., *op.cit.*

[11] Hydrocarbon Law, Art. 41.

[12] *Official Gazette*, 9 September 1993.

[13] *Official Gazette*, 9 September 1993.

[14] Ibid.

Acción Democrática senator and then president of the Committee of Energy and Mines, expected the project to pass the same day without discussion.[15] This was not to be. A year of general elections, splinter groups – predictably of importance in the next Congress – seized the opportunity for a debate which lasted several weeks. Finally, Acción Democrática and Copei, still a large majority, approved the Guidelines and the Contract without any change.

Upgrading Extra-heavy Crude (1993)

PDV also succeeded in pushing through Congress without debate two extra-heavy crude projects. Both would produce about 100 000 b/d of synthetic crude each. In one of them, Maraven-Conoco (US$ 2.2 billion investment), PDV-affiliate Maraven would hold, initially at least, 49.9 per cent, as no other partner had been found yet to take a stake. In the second joint venture, with Total-Statoil-Norsk Hydro (US$ 2.6 billion investment), Maraven-Total for short, PDV would participate initially with 30 per cent.

The guidelines were basically a carbon copy of the LNG project but with some improvements for the private partners. Once more they were committed to nothing but to study the feasibility of the projects. There was no pretence any more of a deadline. The contracts would last not 30 but 35 years after the first commercial shipment (+ 5 years *force majeure*). The participation of Maraven was defined as 'initial', without any minimum being established. Regarding royalty, according to PDV these ventures were not viable at the rate of one-sixth. Congress was informed that the potential associates would negotiate 'incentives for the first years regarding the royalty', but no reference to royalty was yet included in the guidelines.[16] Finally, there was nothing but those guidelines as Maraven was still engaged in preliminary talks.

Conclusions

The natural resource owner, in the case of Sucre Gas, obtained nothing and agreed to a contract according to which he would never get anything. As to investments, over the following three years Sucre Gas spent as little as US$ 50 million. Then Lagoven granted a five-year extension though the project was actually shelved. It was, and had been so from the very beginning, sub-marginal. This was its major political advantage in being used as a spearhead: it was definitely not profitable if the resource owner insisted on any ground-rent.

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[15] Platt's Oilgram News, 20 July 1993.

[16] "Informe emitido por la Comisión Bicameral para las Asociaciones Estratégicas", Caracas, August 1993.

On the other hand, the option can be renewed indefinitely by Lagoven at no cost. It is difficult to imagine, therefore, why the associates should ever give up. After all, one day gas prices in the USA may be high enough to make the project viable.

In the case of the two upgrading extra-heavy crude-projects the foreign investors also received an open-ended option, at no cost, without any commitment. Thus, it is to their advantage to formalise the association only after all the preliminary work, including the engineering and design of the plants, has been done in order to postpone the beginning of the contract term. Moreover a new precedent was created since no draft of a contract was even presented. Hence those general and imprecise guidelines were wide-open to creative interpretation, the government and Congress *de facto* being committed to approve whatever PDV might finally submit.

Of outstanding importance was the elimination of FEV. This was a real break-through in the process of minimising ground-rent, in the same way as the introduction of tax reference prices in the 1960s had been a break-through in the process of maximising ground-rent. As already announced, a downwards flexible royalty would follow.

8.3 MARAVEN-CHEVRON OSA (1995)

In December 1995 Maraven entered into an OSA with Chevron of a somewhat different sort. The objective was to boost output of a producing but declining field of heavy crude (Boscan). Accordingly, the fee varies with the additional output defined by a base line scenario of declining output, as forecast by Maraven, and the output actually achieved by the contractor. As to the base line output, Chevron only recovers costs, whereas fees for the additional output were linked to world market prices for similar crudes and typical products.

It is expected that the output of the Boscan field, about 80 000 b/d at the moment of signature, will be boosted to 115 000 b/d by 1999. The contract term is twenty years with an option for a ten-year extension with identical conditions (plus the usual *force majeure* clause). Chevron has the right at any moment to renegotiate the contract if 'there is a significant change in the economic or operational circumstances which would make it unreasonable to continue with the agreement'. If re-negotiation fails, Chevron has the right to opt out from the agreement recovering the full amount of its investment.

OPEC Quota

Interestingly enough, in this agreement the OPEC quota was mentioned for the first time.

Production may be curtailed, on request of Maraven, if the country's OPEC quota would be reduced below the level of December 1995 (2.359 mb/d), a most unlikely event. Even then only the percentage of the quota-reduction would obtain. No compensation was attached to curtailment.

Conclusions

This OSA set several new precedents. Firstly, it was a producing field. Secondly, fees were linked directly to market prices. Thirdly, it was linked, formally and officially, to a supply contract of the same duration, of all the oil produced, to Chevron's refineries. This was justified, of course, on the ground that heavy Boscan crude was difficult to sell. The whole arrangement was verbally and publicly 'upgraded' to an alliance, the Maraven-Chevron Alliance. Finally, it should be pointed out that curtailment of production was linked to official OPEC quotas, which requires not only the agreement of the Venezuelan government but of all member countries.

8.4 Profit-sharing Agreements

The new (second) Caldera government took office in the middle of a major bank crash, in February 1994. This was a weak government from the very outset, with an alliance (MAS-Convergencia) representing less than one-third in Congress. Regarding PDV, Caldera had pledged during his campaign to appoint an oilman as its president. His choice was Luis Giusti, vice-president of Maraven, who had been in charge of the Strategic Planning Department at the time of Sosa Pietri.

Under Giusti PDV pressed ahead, more determined than ever, with *Apertura Petrolera*. All of a sudden it was not limited any more to marginal fields, LNG, and upgrading extra-heavy crude. Ten blocks, totalling 18,000 sq.km., were offered for exploration and production of hydrocarbons, be it conventional crude, heavy crude, or natural gas. The guidelines were approved by the government in December 1994 and by Congress in July the following year. The delay was due to the only significant policy debate that would ever take place on *Apertura Petrolera*.[17] Not only was the government in a minority, but also Congress was split into five parties all of them important for different reasons. As a result the government or, more precisely, PDV, had to agree to some modifications. There follows a

[17] For a good selection of important contributions to the debate see: *Revista Venezolana de Economía y Ciencias Sociales*, Universidad Central de Venezuela, no.2-3, 1995, and no.2-3, 1996. See also Mommer (1995) and

more detailed account of these so-called Profit-sharing Agreements.

A Special Case

The government gave three reasons for arguing that there were, indeed, ten special cases suiting the public interest, as required by Art. 5 1975 PNL. Firstly, according to the PDV forecast, demand would be increasing strongly by the turn of the millennium. The country would not be able to take 'complete' advantage of the situation if the discovery and development of new prospects were not speeded up 'exceptionally'. Secondly, this was deemed to be the precise moment to attract to the country foreign technology and investment 'before the attraction of potentially competing areas would increase'. Thirdly, given the exploratory risk in these high-cost prospects, 'the [financial] resources of the country are necessary to meet more urgent national needs'.[18]

Controlling Participation of the State

A crucial argument in the public debate was that the exploratory risk, allegedly high, would be taken on by the foreign companies. Hence, according to the proposition of the government, the controlling participation of the state would be, in its best interest, a Control Committee (CC), a purely bureaucratic device. The government even quoted Duque Corredor's study on *The Law of Petroleum Nationalisation* to underline that it had not to be a joint venture in order to comply with the legal requirement of state control. After the quote the government added, moreover, that 'this interpretation has been endorsed by the Supreme Court in its sentence of 23 April 1991'.[19] Once a commercial discovery was made, PDV would have the option, but no obligation, to acquire up to 35 per cent of the shares in the developing and producing company.

Yet Congress modified the government's proposition in two ways. CVP – the resuscitated PDV-affiliate in charge of these contracts – would hold 35 per cent of the shares in the 'Management Companies' to be founded immediately upon signing. These companies were meant to be service companies, which would actually explore the prospects, develop the discoveries, and operate the fields. But as service companies they would not share in the risk, being entitled to a conventional profit. If there was a commercial discovery, a Consortium was

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Rodríguez Araque (1977).

[18] Ministerio de Energía y Minas: Consolidación del Desarrollo – Sector Petrolero Venezolano, Anexo B: Circunstancias pertinentes, Caracas, Diciembre 1994. (Thereafter quoted as Circunstancias pertinentes).

[19] Circunstancias pertinentes.

to be created, the profit-making producing company, in which CVP would also have a stake of 35 per cent. Nevertheless, PDV succeeded in preserving the option to reduce its share, though not to zero per cent but still to 1 per cent, 'according to the commercial attractiveness of the discovery' and 'in order to optimise its portfolio of projects'.[20]

CVP's 35 per cent in the Management Companies and the minimum 1 per cent in the Consortia were 'golden shares'. PDV obtained most of what it wanted as ultimately the 'controlling participation of the state' remained with the CCs. These CCs have four members, two from each side. CVP has the right to appoint the President whose vote, in the case of a tie, is decisive. In other words, any decision must include, at least, one vote of the two CVP representatives. It plays the role of a court of appeal for the Management Company and, for example, it has to approve the Consortia's 'Development Plan' for any discovery.

The contracts but not the decisions of the CCs are subject to international arbitration. This guideline was then implemented in the contracts but amended with a remarkable definition of what the 'control of the state' meant:

> The members of the Control Committee appointed by CVP shall vote any matter or subject ... taking into account if the proposition is consistent or not with the national interest of the Venezuelan state in the exploration, development, and exploitation of its hydrocarbon reserves, and with the national interest of the Venezuelan state to attract and to maintain private investment projects important to the national economy.[21]

If the representative of CVP dares to oppose any proposition of the 'Investors' (as the private 'partners' are called), then they are obliged to deliver

> as soon as possible a written declaration to the representatives of the Investors containing the reason why they voted against the proposition, identifying the way the proposition is deemed inconsistent with the national interest of the Venezuelan state. The Investors are entitled to submit the said decision to the Supreme Court ... or to any other competent Venezuelan court, by whatever action deemed appropriate, to determine if the representatives of CVP took into account the national interest of the Venezuelan state casting their votes.[22]

The 'national interest of the Venezuelan state' was thus re-defined as the development of the oil industry with the help of private investors. The maximisation of economic benefits in petroleum exports according to the needs of national development, as stated by Art. 3 1975 PNL, no longer played any part.

Relinquishment, Contract Term, Reversion

The companies obtained up to nine years to explore, twenty years to produce, and a renewal

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[20] *Official Gazette*, 17 July 1995.

[21] Convenio de Asociación, Art. 4.7.

option, in identical conditions, up to a total of 39 years. This total is maintained even against the *force majeure* clause. Nevertheless, in the contracts the possibility of negotiating an extension beyond this limit is mentioned though this would require the approval of Congress.

At the end of the exploration period only those areas have to be relinquished where no commercial discovery has been made. Regarding reversion, 'the Investors' are required to conduct their business with due regard to the fact that CVP might continue production after the end of the contract. Yet in the last five years CVP will have to finance any investment.

Excess Profit Levies and Royalty

These AAs were called Profit-sharing Agreements, as the bidding parameter was the minimum level of an excess profit levy called Participation of the state in Profits (PEG, according to the Spanish acronym of *Participación del Estado en las Ganancias*). This minimum is to be paid on profits after royalties and before income tax, and for the first billion dollars of gross income of each 'development area'. Thereafter PEG may vary upward according to the Rate on Assets (ROA), the maximum being 50 per cent. In practice, therefore, the contractors would be subject, on aggregate, to a variable income tax rate from 67.7 per cent (PEG = 0%) to 83.85 per cent (PEG = 50%), the maximum being reached with ROA equal to 750 per cent.

Although 750 per cent seems very high, this level of profitability would probably be reached as soon as the initial investment has been depreciated. This would be the case, moreover, after only seven years, as the Income Tax Law had been reformed, once more, to shorten the depreciation period of the new upstream contracts. Yet there is a minimum to the net book value (NBV), on which ROA is based, given by 15 per cent of the 'cumulative Allowable Capital Costs'. In other words, uplift is granted to keep ROA down even after all investment has been recovered. In the guidelines no such safeguard was mentioned.

Regarding royalty, PDV had sustained the thesis since 1989 that the one-sixth royalty was a legal maximum. It could be less but not more. This was intended, on the one hand, to rule out royalty as a bidding parameter as has happened in the past. On the other, the way was smoothed towards a downwards-flexible royalty, a royalty not conceived any more as part of a reservation ground-rent but as an excess profit levy. Now, in the guidelines MEM was authorised to lower the royalty rate if it was satisfied that otherwise a discovery could not be

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[22] Convenio de Asociación, Art. 4.7.

developed at the investors' usual minimum level of profitability.

Next, in December 1995, a month before the bidding-round took place, MEM and CVP signed a Royalty Agreement (*Convenio de Regalía*) which established a rather sophisticated sliding-scale royalty. First, a minimum royalty-rate is established according to the *expected* internal rate of return of a discovery. If E(IRR) is lower or equal to 12 per cent, a 1 per cent-royalty obtains; the full one-sixth obtains if E(IRR) is equal to, or higher than, 20 per cent. In between the minimum-rate would vary linearly. The Ministry is entitled to ask for an update, at any time, on E(IRR) of a development and then, if appropriate and upon approval by the CC, to adjust the minimum rate. On the other hand, if ROA/15 is higher than that minimum, ROA/15 will be used instead up to the maximum of one-sixth. In other words, a one-sixth royalty will be paid whenever ROA exceeds 250 per cent. Obviously, if it were not for uplift, this would always be the case once investments had been depreciated.

Moreover, the Royalty Agreement states that 'in accordance with the Law, royalty will never exceed 16 2/3 per cent',[23] thus endorsing the position of PDV in that respect. Finally, it will last as long as the Profit-sharing Agreements to which it is linked, i.e. for up to 39 years.

This Royalty Agreement has some noteworthy features. To begin with, MEM depends entirely on PDV and its associates in order to estimate the E(IRR). One has to bear in mind that this requires forecasting, for several decades, the cash flow dependent not only on investments, costs, output, but also on price scenarios. Moreover, the estimated E(IRR) has also to be approved by the CC of the association. Finally, the more gloomy the outlook, the lower the royalty, and there is no machinery for back payments if the IRR later turns out to be higher than expected. Pessimism pays.

The Royalty Agreement was later confirmed indirectly by Congress as the Contracts refer to it, even though, it must be said, Congress was never provided with a copy.[24] The same procedure would be followed in all later AAs.

The way the Agreement is really meant to work is to set royalty rate, of course, initially at 1 per cent. Later it will simply vary with ROA/15. Royalty has finally been transformed from a reservation ground-rent into an excess profit levy.

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[23] *Convenio de Regalía*, December 1995, Art. 4.

[24] It took Alí Rodríguez Araque, then President of the Committee for Energy and Mines of the House of Representatives, one and a half years to get a copy from the Ministry. Personal information.

Bonuses

Practically speaking, PEG at its maximum would result in a marginal income tax of 83.85 per cent, 16.15 percentage points above the usual 67.7 per cent rate. Yet, on the other hand, adjusting royalty-rates downwards to 1 per cent entails a relief of 15.67 percentage points on gross income. Hence, the relief granted through the Royalty Agreement is potentially much more important than PEG. It was to be expected, then, that in the ensuing bidding round the upper limit of PEG would be reached at least in some cases. But PDV, on the one hand, did not want to remove the upper limit. The reason was, it is believed, the unwillingness of its foreign partners to go beyond the 50 per cent rate recently established for PRT in Britain. On the other hand, the company could not afford to follow the example of the British Department of Trade and Industry (DTI) and its discretionary procedure of licensing. In Venezuela, with corruption running high, nobody could take the political risk to award, or to have awarded, these bids except by using a completely transparent device.

Reluctantly, PDV opted for a bonus as a tie-breaker. A bizarre situation arose. In order to minimise bonuses, PDV did not allow the participants to bid at once a PEG-rate of 50 per cent plus a bonus, but only after there was a tie at 50 per cent. As a matter of fact, out of eight plots awarded, five received a 50 per cent PEG-bid. In four cases there was a tie and, therefore, bonuses were offered in a second bid (totalling US$ 245 million). But in one case there was no tie. Due to the over-zealous liberal aversion of PDV for a cash bonus, the country will never know what this bidder was willing to pay.

Stabilisation Clause, Re-negotiation

According to the guidelines approved by the government and in line with the precedents created with the AAs approved by Congress in 1993, there was a stabilisation clause:

> In the case of unforeseen circumstances that affect the economic equilibrium of the Agreement to the disadvantage of one of the Associates, both parts shall re-negotiate the economic terms of the Agreement such that the economic equilibrium will be restored... If re-negotiations fail, the affected party may opt out of the Agreement and/or put an end to the Association...[25]

Of course, a full indemnity would be paid in this case. But Congress did not approve this clause. Nevertheless, in the Contract there is a *Force Majeure* clause according to which, as usual, the event of *force majeure* is defined by a list including earthquake, terrorist acts, etc., and 'acts of the state or of any governmental authority'. In the latter case, 'the Event of *Force*

[25] Ministerio de Energía y Minas: Consolidación del Desarrollo – Sector Petrolero Venezolano, Anexo C: Marco de condiciones propuestas, Caracas, December 1994.

Majeure does not exclude a lawsuit for damages against CVP'. On the other hand, the contract is not only subject to international arbitration but, in a kind of inverted Calvo clause, CVP actually relinquishes any immunity it might have as a public company.

Regarding re-negotiations, Congress introduced in the guidelines a vague reference to natural gas and extra-heavy oil. This point was further developed in the contracts. Accordingly, in the case of a discovery associated, in one way or another, with natural gas or extra heavy crude and not being commercial 'under the terms and conditions set forth in this Agreement', a separate agreement with new terms may be negotiated. The 'Investors' were granted five year-options, and CVP was committed to negotiate in 'good faith'.[26]

Curtailment of Production

Curtailment of production was subject to 'international treaty commitments' of the country – not specifically to OPEC – and limited to 'the national average'. It was linked, moreover, to the possibility of extending the contract up to five years in order to recover foregone production. Yet the overall limit of 39 years was maintained and, therefore, this device may become, and probably will become, ineffective, as the contract term will be extended to 39 years anyway.

On the other hand, the new downwards-flexible fiscal regime automatically awards the companies some compensation through lower rates of royalty and PEG. But in five cases out of eight, the latter is completely downwards-inflexible due to the 50 per cent-bid, and even in the remaining three cases there is not much leeway either, as the bids were 41, 40, and 29 per cent.

Conclusions

The bidding-round was held in January 1996. Eight of ten plots were awarded. The contracts were submitted to Congress, approved, and signed a few months later. According to PDV these Profit-sharing Agreements should produce, by the year 2006, some 500 000 b/d. Yet PDV has also estimated the reserves to be discovered at 7 billion barrels. This would imply a reserve/production ratio of 38 years. This is far too high a ratio. If the expected reserves were effectively there, they would sustain a much higher output, about 1.3 mb/d, which would bring down the reserve/production ratio to a more reasonable fifteen years.

Several new precedents were created. The requirement of 'special cases', according to

[26] Convenio de Asociación, Art. 17.2.

Art. 5 1975, has been broadened up to the point where it has become meaningless. Though Congress forced PDV to participate in exploration and production – the core of the 'reserved activities' – it is only significant at the level of the operating companies, with 35 per cent, whereas in the Consortia a modest 1 per cent has been deemed acceptable. In practice, Congress has acknowledged the role of PDV as the new licensing agency. If we compare the role of CVP in the 1960s and early 1970s with the role of the PDV-affiliate CVP in these contracts, the difference could not be more extreme. The old CVP was a window, an instrument granting insight to the ground-rent maximising landlord-state. PDV, on the contrary, has been building up a thick, high wall, in order to keep the landlord-state out. What the Control Committees really control is the state.

There is one outstanding aspect, however, that does not seem to fit into the picture: the fiscal regime. Although we have shown that it has become downward-elastic, the fact remains that royalty, PEG, and income taxes combined, in the event of high profits, result in a marginal rate of 86.5 per cent. This is very high and, in fact, far too high a rate to be applied directly on profits. Such high rates create strong incentives not to minimise real costs but taxes, which may be very difficult and costly, if not impossible, to control. This well-known incentive problem has been addressed, traditionally, with fiscal regimes where bonuses, relinquishment, royalties and shareholding play major, and direct levies on profits minor, roles. In my opinion, the poor design of the fiscal regime is deliberate. The stage is set for conflicts that will force the government to reform it. It can be taken for granted that the marginal rate of 86.5 per cent will disappear before ever being applied. What is more, the way the contracts are drafted seems to indicate that the next step will be to scrap the hydrocarbon section in the Income Tax Law altogether. The income tax rate to be applied would then be the normal non-hydrocarbon rate, at present 34 per cent. Thus, the marginal rate would come down from 86.5 to 72.5 per cent. Directly based on profits, this is still a very high rate.

Similar reasoning obtains for other aspects of these contracts. They involve ambiguities and inconsistencies to be dealt with later, in more favourable circumstances. There cannot be any doubt about the trend and the fact that, with this bidding-round, PDV has achieved a major break-through.

8.5 Association Agreement in Orimulsión (1996)

Orimulsión turned out to be a difficult business. It was cleaner than coal, competitively priced, but it bumped into what has come to be known in Europe as the 'dash for gas'. In 1997 Bitor

only exported 4.2 million tons (about 80 000 b/d), nowhere near the expected volume. Nevertheless, after years of set-backs Bitor has at last succeeded in putting together its first project to be presented to Congress. The initial distribution of shares is Bitor 40 per cent, Conoco 30 per cent, Statoil 20 per cent, and Jandis 10 per cent. Bitor's participation cannot be less than 10 per cent nor higher than 49 per cent (with the exception, as always, of 100 per cent).

We will concentrate in what follows on the new features. The associates are supposed to invest US$ 320 million in the first 'module' to produce 5.8 million tonnes of Orimulsión yearly. However, two additional modules were also authorised, to produce between 5.8 and 8 million tonnes. With regard to the first module, the contract will last for 33 years, beginning with the official registration of the association, or for 30 years beginning with the operating of the plant, whichever happens first. The 30-year term obtains also for the second and third modules. Typically, however, there is no timetable attached to it. In other words, options have been granted for decades ahead. Finally, in this AA, as in all the following ones, there is a re-negotiation clause to compensate the private partners for adverse changes in the fiscal regime or in other ways, deemed to be 'unjust and discriminatory'.

On the other hand, PDV got its way as to the OPEC-quota. It is expressly stated that Orimulsión is not subject to quotas which might apply to crude oil. But PDV does not claim any more that this coal-priced fuel does not compete with oil. Indeed, Congress was informed that the association would enter into a long-term contract of 4 million tonnes yearly with a power station in the USA (Florida Power & Light, Manatee, Florida). In extensive press reports the country was informed that the plant was at present burning fuel oil, not coal, paying (in 1997) about US$ 91.50 per tonne. The price of Orimulsión, linked to coal, would have been US$ 45 per tonne. However, adjusting for its 30 per cent component of water, the comparable price would have been US$ 64. In other words, Orimulsión would undercut the price of fuel oil, of which Venezuela produces a large volume, by US$ 27.5 per tonne (about US$ 3.90 per barrel). All in all, over the twenty years of the contract consumers are expected to save 4 billion dollars.

Nevertheless, Orimulsión has still to convince consumers in the USA (and in Europe), especially on environmental grounds. A definitive decision in Florida is expected early this year (1998). If it is finally approved, the project will go ahead, and this would constitute a major break-through.

8.6 UPGRADING EXTRA-HEAVY CRUDE (1996-7)

It was only in 1997, and after the royalty-issue had been settled,[27] that the Maraven-Conoco and Maraven-Total projects finally went ahead. Production is supposed to start in the year 2002 or 2003. The association Maraven-Conoco was named Petrozuata. We comment on this contract only since the other is very similar. It specifies English as the official language of international arbitration, though Venezuelan Law and the contract are written in Spanish. Nevertheless, it is stated that both sides accept as 'authentic' the English translation attached to the Spanish version.

A noteworthy fact is that the contract contains a definition of what could possibly be considered excess profits. A 'base price' is defined for North Sea Brent crudes of US$ 18 (1994), to be adjusted thereafter according to the 'implicit price deflator for gross domestic product' in the USA. If in a given fiscal year the average price is lower than this 'base price', then in the case of 'discriminatory and unjust measures' taken by the government, Maraven will pay full compensation. However, if the average price exceeds US$ 25 (at constant 1994 dollars, to be adjusted following the same rule), no compensation has to be paid. In between, a percentage obtains. In other words, there is a contractual defined boundary for excess profit taxation.

Other new projects have also gone ahead. One, named Cerro Negro, an association between Lagoven, Mobil, and Veba, also has a capacity of about 100 000 b/d of synthetic crude, and requires an investment of US$ 1.8 billion. A second one, called Hamaca, is an association between Corpoven, Arco, Phillips, and Texaco. This is large, estimated at 200 000 b/d and with an investment of US$ 3.5 billion. We will comment only on Cerro Negro. This new contract includes the same provisions for production curtailment as the Profit-sharing agreements (not so the first two Maraven-associations), but in this case the contract term can be extended to 45 years. Moreover, the definition of excess profits has been tightened. Firstly, the 'base price' is now US$ 27 (1996). Secondly, a 'triggering event' has been defined: If this (inflation-adjusted) price level has been exceeded, uninterruptedly, for six months and, thereafter, the average price is still higher than this base price for a full fiscal year, *then* there are excess profits which might be taxed.

Most interestingly, this contract contains a clause specifying conditions under which

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[27] The signing of a Royalty Agreement for all projects in extra-heavy crude was announced by the government in September 1997. *El Nacional*, Caracas, 26 September 1997.

Lagoven could be released from its role as a hostage: *if* Lagoven reduces its initial participation of 41.67 per cent to less than 12.5 per cent, *or* if at least 50.1 per cent of Lagoven itself is privatised.

A fifth US$ 2.2 billion-project, an association of Corpoven (30 per cent) with Exxon (70 per cent), is in the making. Total investment in these five projects for upgrading extra-heavy crude are forecast at US$ 11 billion, to produce 628 000 b/d of synthetic crude by the year 2007.

8.7 Third Bidding Round in Active Marginal Fields (1997)

A third bidding round for marginal but active fields was held in June 1997. For the first time, surrounding areas for exploration have been added. The average size of the awarded blocks was 390 sq.km. The contractors obtained five years for exploration, after which 50 per cent of the area outside the discovered fields has to be relinquished. There are another two years to explore the remainder. Then the contract will be limited to the discovered fields. Initially, the contract term is twenty years. Regarding newly discovered fields, the twenty-year period starts from the date of the development decision. Following the precedent of the Alliance Maraven-Chevron, PDV announced that the contractors would be given the opportunity to buy the oil they produce.

The contractors are no longer paid a per-barrel-fee but a lump sum, called a stipend, varying with the additional production at world market prices. They are entitled to the full market value of the additional output, net of the one-sixth royalty and some administrative costs, until they have recovered their investment, which is treated, in this context, as current expenditure. Thereafter, and according to a rather complex formula (a modified internal rate of return), they are entitled to a percentage of the net incremental value above costs, varying from 100 per cent to 30 per cent, declining with volumes and increasing over time, the idea being that with the decline of the fields the contractors get a higher percentage.

There was one interesting aspect to this round. For reasons already mentioned, PDV fell back on a bonus as the only bidding parameter, despite its liberal objections. To make it more bearable, however, it was renamed Valorisation Factor (*Factor de Valorización*) which, according to the President of CVP, was not a bonus but just a machinery for decision making. It was expected to be low. Yet this would have required some fine-tuning regarding the base line scenarios or the fiscal arrangement. Since the base line scenarios were worst-case scenarios, and the fiscal arrangement (including relinquishment conditions) was extremely

favourable, bonuses, expected to be low, turned out to total US$ 2.2 billion. At the time of the bidding the eighteen awarded blocks were producing 70 000 b/d. PDV forecast an increase to 328 000 b/d over the next five years. According to the award-winners, however, output will be much higher, significantly above 500 000 b/d.

In section 9.2 we will examine two new aspects to these OSAs. The Venezuelan public was offered an option to acquire a participation, up to 10 per cent, in all the ventures, and the five smallest fields were reserved for private national companies.

Conclusions

From the First to the Third Bidding Round for marginal fields, an astonishing development had taken place. The concept of 'marginal fields' was stretched to include fields and prospective lands which will produce, according to forecasts, one million barrels daily around the year 2005. The concept of 'operating agreement', supposed 'not to affect the essence of the nationalised activities', was stretched to cover full-blooded concessions, and very liberal ones. Indeed, the exploring company is awarded the full prize for its efforts, and PDV is not interested in reversion. The producing companies are only subject to non-hydrocarbon taxation, whereas hydrocarbon taxation, rents and royalties are looked after by PDV, the national oil company acting as an umbrella. Precedent has been established according to which even royalty is now considered an excess profit levy to be reduced, if deemed appropriate by PDV, to 1 per cent. Last but not least, Shell's 'tough stance' in the first round finally paid off: these contracts are subject to international arbitration.

8.8 Conclusions

The PDV policy has proved extraordinarily successful in putting the screws on, and ultimately breaking, the political, legal, and institutional framework of nationalisation. At its heart was the question of reservation ground-rent, which was brought down in three ways. Firstly, and most importantly, there is a continuous flow of new lands in which to explore for, and produce, hydrocarbons. Large extensions are now opened to private investment every year as a matter of course. Secondly, hydrocarbons will be produced as long as it is profitable to do so, ground-rent being almost completely downwards elastic. Only a 1 per cent royalty is left as reservation ground-rent. Thirdly, at the end of the exploratory period the contractors only need to relinquish the land they are definitely not interested in, and in the production period excess profits are defined very generously. Moreover, excess profit levies and taxation have been

linked to profits as directly as possible, in a way that gives investors considerable leeway to minimise their fiscal liabilities. Last but not least, accelerated depletion and tax holidays (exemption from VAT for five years) have further increased profitability for private investors.

In these upstream contracts PDV has assumed the role of a licensing agency, a new role to which its old role as a national oil company has been ruthlessly subordinated. The national oil company has been turned into a hostage, only to be released with privatisation.

TABLE 3: Current Minimum Conditions in Association and Operating Services Agreements

Issue	*Art. 5 1975 PNL*	*OSA*	*AA*
Royalty	16.67%	1%	1%
Area, Exploration, Relinquishment	Not mentioned	Huge areas. Exploration seven years. Only those parts, where no commercial discoveries are made, to be relinquished.	Huge areas. Exploration nine years. Only those parts, where no commercial discoveries are made, to be relinquished.
Contract Term (Exploration and Production)	Definite term	20 years, indefinitely extendable.	45 years
Reversion	Not mentioned	None	Passive
Tax sovereignty	Not mentioned	PDV acting as umbrella.	PDV acting as hostage.
Jurisdiction	Not mentioned	International arbitration	International arbitration
Approval of Congress	Contract	No	Foundations of contract, contracts confirmed later.
Publication of contract	Not mentioned	Not required	Foundations of contract only, Official Gazette.
Participation of PDV	Control of the state	Licensing and administering agency	Control committees and 1% golden shares
Income taxes	FEV apply. Special income tax rate for hydrocarbons at 67.7%.	FEV abolished. Usual income tax rate for non-hydrocarbon activities.	FEV abolished. LNG and upgrading ex-heavy crude pay non-hydrocarbon income tax rates. Conventional crude pays hydrocarbon rate at 67.7% (+ PEG).

9. THE NEW GOVERNANCE OF VENEZUELAN OIL

In 1997 Venezuela produced 3.3 mb/d of oil, approximately 10 per cent of which was the contribution of private investors. In 2007, according to the PDV forecast, Venezuela will produce 6.2 mb/d, of which roughly 30 per cent will be produced privately (OSAs or AAs). These figures do not include Orimulsión, which will add – so PDV hopes – another 400 000 b/d, 75 per cent of it under AAs.

This forecast may be accurate regarding volumes, but it does not reflect the rapidly changing governance structure. PDV has already announced new bidding rounds for the near future which, as usual, will be used as a vehicle for political, legal, and institutional changes. What is more, PDV feels strong enough to tackle a thorough legal reform and ultimately privatisation. Invited to the Acción Democrática party conference in July 1997, the incumbent president of PDV, Luis Giusti, expressed his belief that the role of the state was to provide the natural resource, create infrastructure, and promote development policies, but 'the state should not be an actor in the business'.[1]

In fact, at that very moment a major organisational shake-up of PDV was already under way. The old affiliates – particularly Lagoven, Maraven, and Corpoven, popular symbols of past success – disappeared on 1 January 1998. PDV was reorganised into PDV-Exploration & Production, PDV-Manufacturing, and PDV-Services. According to PDV, the reorganisation was aiming at making the company more competitive internationally. Yet the shake-up was also an opportunity to neutralise those (few) high-level executives who have expressed some kind of criticism about *Apertura Petrolera*. Some of them went into early retirement, others were moved to positions where they do not wield real power. The important positions in PDV were filled with people loyal to its incumbent leadership and its policy, a guarantee for continuity beyond the present government.

On the other hand, by breaking up the integrated structure of PDV the government and Congress will be forced into reforming the fiscal regime in oil. The new one is likely to concentrate on the upstream, releasing the downstream into the fiscal regime of non-hydrocarbon activities. It may safely be assumed that an outstanding characteristic of the new upstream regime will be its downward flexibility, thus bringing down reservation ground-rent near to zero also for PDV.

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[1] *El Nacional*, Caracas, 9 July 1997.

Finally, then, the stage will be set for privatisation – probably piecemeal and beginning with the downstream – of PDV affiliates, but not of PDV, the holding company.[2] In one way or other, the new governance structure requires the holding company to survive in its new role as the licensing agency and as a kind of Supreme Control Committee in charge of preventing the landlord-state from rising from the dead.

9.1 The International Environment

After 1993 Venezuela gave up any pretence to abide by OPEC quotas and, on average, in 1997 'overproduced' in the OPEC sense some 900 000 b/d. The situation will be basically the same for the year 1998, in spite of higher OPEC quotas.

If, and when, Venezuela leaves OPEC, is a matter of speculation and ultimately irrelevant. The fact is that the New International Economic Order (NIEO) that OPEC once promoted has failed completely and definitively. At its heart was the quest for 'permanent sovereignty over natural resources', which basically meant two things. First, the sovereign right to an international ground-rent providing funds for non-oil development and, second, the right to make investment in oil conditional on creating and promoting related economic activities within the country.[3] The new liberal consensus in international oil is the mirror image of the NIEO, and its successful implementation world-wide is already advanced. A milestone in this development was, of course, the breakdown of the Soviet Union. The European Community was quick in responding with the European Energy Charter (1991), and with the Energy Charter Treaty (December 1994). This is an instrument designed to create a complete legal framework – and, of course, a liberal one – for hydrocarbons in the former Soviet Union, where so far there was none. Within this treaty, international arbitration plays a crucial role to enforce the new order.[4]

Although the USA participated actively in the negotiations, at the last moment the government decided not to sign the treaty. Instead, coincidentally also in December 1994, at the meeting of Head of States of the Americas in Miami it renewed its initiative for a hemispheric treatment of energy (within the broader framework of a Free Trade Area of the Americas to be created over the next ten years or so). The Venezuelan government and PDV

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[2] See Duque Corredor (1994).

[3] See OPEC Resolution XVI.90.

[4] See Wälde (1996).

supported the initiative enthusiastically.[5] In fact the Caldera government, to stress its commitment to the idea, approved the bidding-round for the Profit-sharing Agreements just a few days before the meeting. Since then three meetings at ministerial level followed, the last one in Caracas in January 1998. In 1997, Venezuela became a member of the Energy Council, a body of representatives of oil-producing states in the USA and the Canadian Province of Alberta.[6] Moreover, Venezuela and the USA are at present negotiating a bilateral investment treaty. The US Ambassador in Caracas, John Maisto, has praised the draft as the most ambitious the USA ever negotiated with any South American country, since it includes international arbitration in the case of investment-related disputes.[7] As a matter of fact, Venezuela already signed, and Congress approved recently, such a bilateral investment treaty with Canada, which gives private investors the right to take the host government to an international arbitration court.

Through international arbitration those treaties acquire an importance they would never have in national courts, in practice replacing rather than complementing national law. And this is happening in a country where, as everywhere else in Latin America, but unlike the former Soviet Union, there is a strong legal tradition. The new trend is already acknowledged in those recent Profit-sharing Agreements. As usual, Venezuelan Law is defined as the governing law but a few paragraphs later it is stated that:

> The Parties also acknowledge the applicability of any international treaty relating to the mutual protection of investments, to which both Venezuela and any country of which the Investor is a national, may now be or hereafter become parties. (Art. 25.5)

The same provision, broadened even more, is also included in the OSAs of the third bidding round of marginal fields. International investment treaties will be a crucial part of the new governance of Venezuelan oil. This explains the characteristics of all upstream contracts since 1989: they do not fit into the Venezuelan legal system because they were never meant to. They are building-bricks of a new international system.

9.2 National Investors in Oil. The Domestic Market

Within the new liberal governance structure, no special support is given to local suppliers of inputs and services to the oil industry. In all contracts they are required to compete and to bid,

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[5] Grisanti (1998).

[6] *El Universal*, Caracas, 26 September 1997.

[7] *El Universal*, Caracas, 30 October 1997.

but they are only favoured in the case of a tie. Nor did PDV support private national investors in oil. Nevertheless, there was some minimal national participation, in association with foreign investors, in the first two bidding rounds of OSAs. But as experience in production was required in order to qualify, Venezuelan companies were automatically disqualified. For many years the Venezuelan private sector has provided inputs and services to the oil industry which, taken together, cover everything an oil company can possibly do. Yet, by virtue of the Nationalisation Law, there was no Venezuelan oil company. In fact, Venezuelans were not supposed to invest in oil at all.

In 1995, however, there was some reaction in Congress. In the guidelines for the forthcoming Profit-sharing Agreements a provision was introduced according to which PDV had to put up an investment fund. It was argued that if PDV was not interested in exercising its 35 per cent option then private Venezuelan investors should be given a chance. As a first step, PDV in 1997 set up SOFIP (Sociedad de Fomento de Inversiones Petroleras), an investment fund which issued US$ 20 million in fixed interest bonds to the Venezuelan public in February 1997. SOFIP, in turn, set up EPIC (Exploración y Producción Inversiones Colectivas), which will issue variable interest bonds. Indeed, the OSAs of the third bidding rounds include a provision according to which EPIC may become a partner with a participation up to 10 per cent. The only aspect excluded from the partnership is the bonus payment, to be covered exclusively by the bidding companies. EPIC is expected to issue these bonds by April 1998. EPIC will also acquire participation in other OSAs or AAs, which are so far in the hands of, or reserved to, PDV. SOFIP will retain a participation of 10 per cent of EPIC, 90 per cent being sold to Venezuelan citizens, institutional investors, and pension funds. Of course, the 'partnership' is controlled by PDV.

Beyond this, in the third bidding round for marginal fields PDV was obliged to reserve five fields, out of twenty on offer, for Venezuelan companies, though they were allowed to associate with foreign companies. Being the smallest fields they represented only about 5 per cent of the total estimated investment for that round. Nevertheless, without support from PDV, the Venezuelan companies even in these fields play only a modest role. In the end they obtained only a significant participation as operators. Moreover, their contracts are identical and also provide for international arbitration in New York.

Regarding the domestic market, the government announced that it intends to repeal the Domestic Market Nationalisation Law in 1998, the first of the nationalisation laws to be repealed. Before this has happened, however, the international companies have already been

allowed to open petrol stations, starting in January 1998. Thus, it seems that national enterprise, in this case also, will probably be left with a minority share.

9.3 Conclusions

As we have seen, abolishing FEV in 1993 was part of a long-term strategic move. But it had one immediate major consequence: PDV obtained the resources to finance its expansion plans. Although the disappearance of FEV also meant that the company would pay dividends from 1996 – it had never done so before – PDV was now strong enough to retain large profits for investments.

In 1997 hydrocarbon exports generated about US$ 18 billion of foreign exchange, roughly half of which went into the coffers of the government, and one-third was absorbed by investment in oil. Prior to 1990, the government's share had been over 80 per cent, a percentage the government will never see again. In absolute terms, however, the percentage fall has been more or less compensated for, by the increase in volumes and by relatively high prices. The national economy, of course, benefited from the massive investment in oil and its multiplier effects, especially at a time when all other activities were in decay.

However, the fiscal regime has already become much more downward elastic, and it will probably become even more so in the near future. This means that with the next downturn in the world petroleum market – and one seems to be in the making at the very moment of writing – government revenue will fall sharply and so will investment in oil. The government will then discover that there is very little it can do about it. If it were to return to OPEC quotas, which is most unlikely, this would basically affect PDV and its high-taxed output. Low-taxed private production would be largely exempt.

Currently the national economy is more dependent on the ups and downs of the oil industry than ever before and every slump in the world petroleum market will have a major negative impact. Thus sooner rather than later, the country will be faced with the privatisation of PDV as the only remaining option.

10. CONCLUSIONS

Venezuela was the world's largest oil exporter from 1928 to 1970. Then, however, the ageing fields entered into decline. Only massive new investments in exploration and development could have contained and reversed the trend. Instead, in the 1960s investments in oil came to a complete halt, due to the controversy about reversion. Hence, the first task PDV had to confront was to revive an industry in decay. To measure its performance, we use the concept of non-rent oil GDP (Table 4). What this concept essentially does, is to measure the performance of the oil industry as a *service*, according to inputs and not to outputs.[1] Thus, there was a first attempt to revive the industry after nationalisation, which lasted until the early 1980s. By then PDV had succeeded in containing the fall of output. With the OPEC quota, however, a new period of decline followed. Only in 1986, fifteen years after output had started to decline, the industry re-entered a path of sustained growth.

TABLE 4: Oil Industry and Non-rent GDP. Selected Years

	Crude Oil Production (mb)	*Non-rent Oil GDP (Million US$)**	*Non-oil GDP (Million US$)**	*Non-rent Oil/Total GDP (Per Cent)*	*Non-rent Oil-GDP/b (US$)*
1930	135	565	2893	16	4.2
1935	149	651	2918	18	4.4
1940	184	810	3821	17	4.4
1945	323	1063	5533	16	3.3
1950	546	2431	9473	20	4.5
1955	787	2622	13689	16	3.3
1960	1041	3089	17980	15	3.0
1965	1267	3327	22797	13	2.6
1970	1353	2938	31427	8	2.2
1975	856	3169	44935	7	3.7
1980	793	4027	52547	7	5.1
1985	613	3807	47414	7	6.2
1990	780	5097	52284	9	6.5
1995	1076	7407	58692	11	6.9

* Constant 1984-dollars, converted at Bs. 7.016/US$.
Source: Baptista (1997a). Own calculations.

[1] Baptista and Mommer (1986). See also Mommer (1990).

Non-rent Oil GDP per barrel can be used as an indicator for productivity. In increased steadily from 1930 to 1970, but it has been decreasing ever since. At present, it is about three times as costly to produce a barrel of crude oil as it was in 1970. Most of the decline has to be attributed to nature and, in the 1980s, to the impact of OPEC-quotas. But part of the decline is without doubt due to managerial problems of PDV, as is made plain by the surprising current success of private investors in marginal fields. Nevertheless, there is a consensus in Venezuela that PDV succeeded in maintaining relatively high standards. This view is shared by the international trade press which considers PDV the most successful amongst the large national oil companies in the Third World.

The importance of the oil industry reached its height in 1950. In that year, non-rent oil GDP was 20 per cent of non-rent GDP (defined as the conventional GDP minus the international ground-rent in oil). Thereafter its importance declined, first because of higher growth rates in the non-oil sector and later because of the industry's decay. In 1975 its importance had reduced, with the ratio of non-rent oil/total GDP having fallen to 7 per cent. However, after nationalisation the industry began to recover its importance, slowly until 1985, and at a faster pace thereafter. In 1995 it was up to 11 per cent and this percentage is still increasing.

Regarding the excess profits in oil and fiscal revenues, the picture is different. They peaked in absolute and relative terms in 1980, representing 23 per cent and 24 per cent of non-oil GDP (Table 5). However, regarding the percentage of excess profits, there was one strong upswing (after the Second World War) and downswing (in the 1960s) before the peak in 1980 was reached. In terms of the percentage of fiscal revenues, this movement was compensated for by an increasing level of taxation. Since 1980, both percentages declined, but more so fiscal revenues since PDV was able to retain an increasing part of excess profits for new investments in oil. Only in years of strong prices, as in 1996 and 1997, did petroleum fiscal revenues represent more than 10 per cent of non-oil GDP. (In 1998, it will certainly represent much less again).

Finally, considering excess profits, fiscal revenues, and the industry together, the importance of the former two was paramount at the time of nationalisation when they were about three times greater than industry (Table 6). Yet in 1995 it was the industry that was more important than excess profits and the importance of fiscal revenues returned to the level of the early 1950s.

TABLE 5: Excess Profits[1] in Oil, Fiscal Revenues, and Non-oil GDP. Selected Years

	Exports (mb)[2]	*Price US$/b*[3]	*Exports (Million US$)*[3]	*Excess Profits (Million US$)*[3]	*Fiscal Rev.*[4] *(Million US$)*[3]	*Fiscal Rev.*[4]*/ Excess Profits (%)*	*Excess Profits/ Non-oil GDP (%)*	*Fiscal Rev.*[4]*/ Non-oil GDP (%)*
1930	134	6.98	939	291	53	18	10	2
1935	139	5.11	707	240	92	39	8	3
1940	157	6.28	986	330	226	69	9	6
1945	318	5.33	1693	907	555	61	16	10
1950	520	7.38	3835	1351	1071	79	14	11
1955	739	7.30	5393	2696	1651	61	20	12
1960	983	6.27	6166	2626	2332	89	15	13
1965	1187	5.30	6290	3616	3092	86	16	14
1970	1266	4.57	5792	3509	3457	99	11	11
1975	761	15.98	12166	8849	10102	114	20	22
1980	679	25.46	17295	12081	12547	104	23	24
1985	495	24.57	12167	8969	9428	105	19	20
1990	679	15.97	10844	9084	8187	90	17	16
1991	764	12.86	9816	7831	7217	92	14	13
1992	743	12.38	9151	6481	6376	98	10	10
1993	784	11.30	8975	5775	4846	84	9	8
1994	846	11.78	10067	6366	4828	76	11	8
1995	915	11.54	10682	6249	4134	66	11	7
1996	995	13.95	13190	N/A.	7428	N/A.	N/A.	12

[1] 'Excess profits' are defined as profits in excess of a 15% rate of return on net fixed assets.
[2] Crude oil and products.
[3] Constant 1984-dollars converted at Bs. 5.75/US$, the exchange-rate for petroleum exports.
[4] The reader should be aware that a minor part of fiscal revenues stems from normal profits.
Source: Baptista (1997a); Ministerio de Energía y Minas: *Petróleos y otros datos estadísticos 1996*, Caracas, 1997. Own estimates for 1996.

The increasing percentage of excess profits between 1930 and 1960 illustrates the tension that was building up between the price-determining high-cost US production and the low-cost oil from the exporting countries. This tension finally caused the rupture of the international price structure, leading to the foundation of OPEC. Already engaged in a protracted process of ground-rent maximisation, the exporting countries were not willing to allow their fiscal revenues to be downward elastic. Finally, the explosive growth from 1970 to 1975 is accounted for by the qualitative change the 'OPEC revolution' brought about.

Venezuela was lucky since the success of OPEC coincided with the decay of its industry which otherwise would have provoked a fiscal crisis at that time. Yet the attention of the country continued to be centred, almost exclusively, on the financial resources that its ground-rent-oriented oil policy was providing for non-oil development. Then, with nationalisation and the withdrawal of the foreign companies, the economy collapsed. On its own, the country was unable to find a new political, economic, and institutional equilibrium. One by one all the important sectors of the country were shaken by crises with lasting consequences. First there was stagnation and the crisis of public finances and foreign debts in 1983. In 1986, the crisis worsened significantly with the collapse of oil prices and in 1989 there followed a major social explosion. In 1992 there were two important coups d'état attempts. Though they failed, President Pérez was removed by impeachment in 1993. In the general elections of that year the political party system fell apart. The bank crash in 1994 wiped out a significant part of Venezuelan enterprise. In the midst of this rubble, however, there was PDV; successful, upright, and dynamic.

TABLE 6: Excess Profits and Fiscal Revenues as Percentage of Non-rent Oil GDP. Selected Years

Year	*1930*	*1935*	*1940*	*1945*	*1950*	*1955*	*1960*	*1965*	*1970*	*1975*	*1980*	*1985*	*1990*	*1995*
Excess Profits	51	37	41	85	56	103	85	109	119	279	300	236	178	84
Fiscal Rev.	9	14	28	52	44	63	75	93	118	319	312	248	161	56

Source: Tables 4 and 5.

Nationalisation was accepted unwillingly by the people in the oil industry, at least at executive levels. They had been keen to remain at arm's length from the world of rentier politics and economics. The subsequent events proved their mistrust to be right and strengthened their attitude of rejection. However, the collapse of rent capitalism brought inevitably PDV into the realm of politics. Almost by default, Venezuelan oil policy had to end up in its hands. Consistently – surprisingly consistent since the very day of nationalisation – the company held on to the only policy it ever had: to keep the oil *industry* going. As a result, once in charge there was a shift from one extreme to the other, from maximising fiscal

revenues whatever the consequences for the industry, to maximising volumes whatever the consequences for fiscal revenues. The company did not believe and really never had believed in its role as a national oil company with the objective of integrating oil into Venezuelan society, legally, politically, and economically. Instead, with *Apertura*, PDV immediately seized the opportunity of joining the new liberal consensus in international oil, which the country now has to accept. Looking to the future, PDV, the producing company, will be privatised. PDV 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.

However, the implementation of the new governance of Venezuelan oil is not yet complete. This process will take at least another few years. On the one hand, there are large multi-billion-dollar-decisions to be taken, a procedure must be agreed on and, most importantly, the distribution of the spoils must be sorted out. On the other hand, the country has still to accept the unavoidable, including the further impoverishment of the country given the foreseeable losses of fiscal revenues. The fact is that nationalisation has already been defeated, definitively, radically, and irreversibly. Nationalisation was the beginning of the end of rent capitalism and its already long-lasting agony will only come to an end with denationalisation.

10.1 The Price of Oil

The *de facto* defection of Venezuela from OPEC straight into the opposite camp is an event of major significance in international oil. Restricting investments in their area and building up a fiscal regime defining a high reservation ground-rent, were the tools that OPEC used to bring about high prices. Its success in the 1970s came as a surprise, because energy economists did not recognise the importance of these variables to prices.[2] Generally speaking, modern economics relies on David Ricardo and his denial of the relevance of landlord-tenant relationship to prices. This situation has not changed. The complete failure of price forecasts over the last thirty years is still not understood. The re-opening to private investment of many oil-producing regions, combined with downward elastic fiscal regimes, herald much lower price levels than conventionally forecast. Forecasts now err on the high side.

Scarcity – that means increasing (technical) production costs – is only one element in

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[2] Mommer (1977:*passim*).

the formation of oil prices. But even if scarcity increases over the next decades, this does not necessarily entail that landlords will get higher ground-rents. Increasing costs and high ground-rents are more likely to provoke a systematic answer from producers (the companies) and consumer governments by which they overhaul the governance structure of the sector. This is what actually happened after the 'OPEC revolution'. The outcome, hardly surprising, was an agreement on a new governance structure designed to bring down the landlords whether they were inside or outside OPEC. This means not only that more potential oil acreage comes on offer combined with a downward elastic fiscal regime; but it also implies that the Ricardian rents which the landlords cannot collect any more will be available to be ploughed back into the reservoirs in order to increase recovery and productivity. These improvements will compensate for increasing (technical) costs. Hence, the outcome is a long-term fall in price in real terms, even though there may be increasing scarcity.

Of course, the outcome in quantitative terms depends on the dynamism of the new liberal consensus in international oil beyond the core of the large and developed consuming countries. To this dynamism Venezuela has given a considerable push, especially in Latin America. Nevertheless, it seems unlikely that the example of Venezuela will be followed in the near future by any of the large Third World oil-exporting countries. Venezuela is an exceptional case on several grounds. On the one hand, there is its economic and political collapse and its openness to external influence, exceptional even by Latin American standards. On the other hand, there is the resource base of heavy crude, costly to produce and even more costly to upgrade and refine. Hence, Venezuela is able to attract a high volume of investment in oil. Although this will not make up for the loss of fiscal revenues from a macro-economic viewpoint, nevertheless it is important enough to create a strong alliance of winners, both individuals and regions within the country. This would not necessarily be the case for other large and low-cost Third World oil exporters.

Therefore the liberal trend is to be expected to progress world-wide, but with those large exporting countries forming 'pockets of resistance'. If they open up their oil sectors they may lose too much, a lesson they can learn – if there is any need – precisely from the example of Venezuela. Since even at much lower prices their fiscal petroleum revenues will continue to be all-important to them, these 'pockets' are likely to endure for many years.

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