A National, Popular and Revolutionary Oil Policy

Full Sovereignty Over Oil Serie # 1

MINISTERIO
DE ENERGÍA Y PETRÓLEO

Full Sovereignty Over Oil Serie

A National, Popular and Revolutionary Oil Policy

An address to the National Assembly
of the Bolivarian Republic of Venezuela by
Rafael Ramírez Carreño,
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and President of PDVSA

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1 Introduction

The close relationship between oil and politics in Venezuela is a well known fact, as attested from the very beginnings of the Twentieth Century by events such as the setting up of the fierce dictatorship of Juan Vicente Gómez in order to place the exploitation of oil in the hands of transnational enterprises, the toppling of Medina Angarita in the wake of the promulgation of the Hydrocarbons Law of 1943, the dictatorship of Marcos Pérez Jiménez, the period of representative democracy, the nationalisation of 1975, the collapse of the Fourth Republic and the coming of the Fifth. Even though almost one hundred years have transpired since the beginning of the commercial exploitation of oil in our country, we have to say that in the present time the relationship between politics and oil has become even more closely knit than it used to be. The *coup d'etat* of April 11th, 2002 and the sabotage of the oil industry which took place during December of the same year both provide ample proof of this.

What is more, I would even go so for as to some say that the very collapse of the Fourth Republic, and the profound crisis into which it plunged the country, are both intimately related to oil. Indeed, during the decade of the 1990s, the policy of Apertura amounted to a veritable assault on Venezuelan oil, an assault coordinated by some international institutions in oil consuming countries together with the big multinationals of yesteryear, all of whom, with the complicity of the self–styled oil meritocracy, and the ruling oligarchy and its political representatives, conspired against the Venezuelan state, prompting the crumbling of the latter and bringing about an economic and social crisis for our country.

As we shall see, this was not a case of a succession of isolated or fortuitous incidents. On the contrary, it amounted to a strategy that was deployed from the very onset of the nationalisation of oil, and which was oriented in first instance towards the capture and control of PDVSA by transnational interests, then towards the minimisation of the value of our resource and its subtraction from the control on the part of the State and its institutions, and culminating in the open and direct confrontation against the Nation and against the Venezuelan State.

In this thoroughly planned and designed strategy, Petróleos de Venezuela was assigned the role of a Trojan horse, a role which the transnationalised meritocracy was more than willing to assume. Thus, the essence of the Apertura can be summed up in a few words: the globalisation of the natural resource, oil. This would no longer be a national resource but would, instead, be made freely available to the powerful consuming countries, in their guise as undisputed masters of the globe. With the Apertura, foreign capital aimed at expropriating from the Venezuelan people the sovereign management and use of their main resource: oil.

This explains the collapse of oil fiscal income during the decade of the 1990s, a collapse that we will be dealing with in greater detail in due course. This collapse gave the Fourth Republic the coup de grace. The Republic might have been gravely wounded and in an advanced stage of decay, but Petróleos de Venezuela did not come to its assistance. Quite the contrary: not only did it apply pressure in order to eliminate the last vestige of state control over oil but it was also prepared to hand over our energy resources to foreign capital and to progressively withdraw from many of its own spheres of activity through their privatization, all this in the context of the maelstrom stemming from the privatizing and globalising diet which the Venezuelan people were forcibly fed, but which they ultimately succeeded in rejecting, first with the Caracazo, then with the military rebellions of 1992 and finally through to the overwhelming electoral victory of President Hugo Chávez during in December 1998.

The old PDVSA, before being anti-Chávez, sought to resist the control of the State. Even though it co–existed with the State institutions and maintained alliances with the traditional political parties, the reality was that PDVSA despised them all and strove to displace them. The old PDVSA was quintessentially anti–national, and this fact was no secret to anybody. The company's globalising and antinational discourse was a public discourse, with very clear political expressions. What is more, the origins of this discourse can be traced back all the way to the very act of nationalisation and creation of PDVSA.

1.1 Nationalisation, the Corporación Venezolana de Petróleo and the Ministry of Energy and Petroleum

It is worth recalling that, before the creation of PDVSA, the operating company of the Venezuelan state had been the Corporación Venezolana de Petróleo (CVP). This company was created in 1960 as an autonomous institute, with some traits of a commercial enterprise. Ultimate decision–making authority was vested in its Directive Council, which was presided by, as he was called then, the Minister of Mines and Hydrocarbons. To this Directive Council was subordinated an Executive Board presided by a Director General. This was our national scheme for the oil industry, and through trial and error experimentation we successfully developed it throughout the fifteen years which followed the creation of the company. This scheme, incidentally, was also the one found in the oil industries of all the other petroleum producing countries that were members of OPEC. However, with the nationalisation of Venezuela's oil — a nationalisation that Juan Pablo Pérez Alfonzo correctly decried as having stemmed from a pact – a new company, Petróleos de Venezuela, was created and given the

legal status of a mercantile corporation, while CVP was dissolved within PDVSA's new corporate structure. In this way, from the very onset of nationalisation, the transnational scheme was grafted onto the structure of the industry, whose leadership moreover was entrusted to the executive cadres that had served the foreign multinationals all their lives. The discourse that became the norm in this company from the very first day can hardly be seen as surprising: its managers professed to be wedded to the idea of "maximising shareholder value" and, as in any private corporation, they pretended that this value had to be determined after the payment of taxes, rents and royalties. In assuming such a position, they wilfully ignored the fact that their shareholder was the State itself, which also happened to be the recipient not only of general taxes in the country but, even more importantly, the recipient of rents and royalties generated not by entrepreneurial initiative or investment, so much as by its ownership of a bountiful natural resource. In other words, they wilfully ignored the essence of nationalisation: the maximisation of the value of that natural resource (a non–renewable, depleting, valuable natural resource that was the property of the Venezuelan people). And as this were not enough, it has to be said that, in reality, all the talk about "maximising shareholder value", as well as the later slogan about the "global energy corporation", never amounted to anything other than a bombastic and empty discourse. If one goes over all the well–publicised and supposedly "good businesses" of the old PDVSA, one by one, one always reaches the same conclusion: there were no such "good businesses". What there was, invariably and consistently, was a policy to minimise the national fiscal contribution of the oil industry and, by extension, to minimise the value of the natural resource. The truth is that the old PDVSA preferred to pay taxes outside rather than inside Venezuela, with the argument – underpinned by profound financial engineering analysis – that foreign taxes were lower than the domestic ones. This attitude is understandable in a foreign multinational, but totally unacceptable in a national company, owned by the Venezuelan state.

In sum, an antinational and perverse meritocracy was entrenched in PDVSA and its affiliates, always on the lookout to attack whenever an opportunity presented itself, perhaps because it was going through a delicate political juncture, or else because the country was faced with adverse economic circumstances.

2 Internationalisation

2.1 Market prices and transfer prices

The first of these opportunities arose when, at the beginning of the decade of the 1980s, global oil demand fell in response to the very high prices prevailing then. In 1981, the Venezuelan crude and export basket averaged around 30 dollars per barrel, which in 2004 money is the equivalent of 75 dollars per barrel. At that point, in an effort to stabilise the market, OPEC first implemented its system of production quotas.

PDVSA, for its part, took advantage of the opportunity to set in motion is policy of internationalisation, which supposedly was motivated by the need to secure outlets for Venezuelan oil. This policy began in earnest in 1983 with a joint venture with Veba Oel (called Ruhr Oel) in West Germany. In this first transaction, the most notorious characteristic of all deals undertaken under the aegis of internationalisation is already very much in evidence: the Veba Oel agreement implied significant discounts in the prices of Venezuelan crude, as pointed out at the time by Rafael Guevara in his book (1983) Petróleo y ruina: La verdad sobre el contrato firmado entre PDVSA y la Veba Oel.

At that point, demonstrating the existence of discounts was still a relatively straightforward matter, because the Ministry of Mines and Hydrocarbons was still in charge of fixing official sales prices. But two years later, amidst ever more difficult market circumstances that foretold the price collapse that would come about in 1986, the Venezuelan government gave in to PDVSA's pressure and conceded to the latter's demand that official sales prices should be eliminated. PDVSA's argument in support of its position was that it needed all the leeway possible to deal with an increasingly competitive market environment. But the fact was that matters went way beyond the Ministry of Mines and Hydrocarbons no longer fixing official prices, because it was resolved through a joint resolution involving

this ministry and the Finance ministry that, with retroactive effect to January 1st 1984, henceforth all “prices declared by the taxpayer” (that is, PDVSA) would be accepted for tax purposes (Gaceta Oficial No. 33.142, January 11th, 1985). As a result of this, all throughout the next fifteen years, there would be no control whatsoever in terms of the prices applicable either for royalty payment purposes, for income tax assessment purposes or, indeed, for any other purpose. This was the beginning of the dismantling of the control mechanisms of the Venezuelan state.

PDVSA therefore went ahead with its policy of internationalisation and price discounts, which it was now in a position to hide systematically. The existence of discounts was an insistent rumour, but time and time again (and until its ultimate demise) the Meritocracy would deny that there was any substance to such rumours. It would also succeed in swatting off successive requests for information on the part of the Ministry of Energy and Mines in 1999 as well as a couple of reports by Lic. Rafael Ramírez Coronado (PDVSA’s statutory auditor in 1999 and 2000), which not only denounced the existence of discounts but actually estimated their magnitude on the basis of the scant available information.

After 1986, the focus of the internationalisation programme shifted to the United States, with the partial acquisition of Citgo’s refining system (leading to a full takeover some years later). Between 1986 and 1998, Petróleos de Venezuela acquired stakes in eight US refineries, for a total outlay in direct investment costs and equity contributions of 4,500 million dollars, a massive capital transfer abroad which took place precisely at a moment when the Venezuelan economy underwent one of its worst crises ever, the product –among other things– of the collapse in oil prices, the stagnation of investment, foreign indebtedness and capital flight.

The internationalisation process was built around a complex system of more than 70 enterprises, and it was underpinned by an organisational, accounting and financial structure designed to evade state control over these investments. For the State, it became impossible to get to the bottom of the audited statements, the treatment of dividends, the payment of taxes and the indebtedness on the part of these companies, thanks to the existence of an iron–clad “Corporate Veil” interposed between these international businesses and the control of the Venezuelan state. This is PDVSA’s black box.

Behind this corporate veil, all sorts of things went on, to wit: discounts in the price of crude oil supplies, liquidation of royalties on the basis of these discounted prices, contracting of external indebtedness by placing our oil export income as a collateral to Citgo’s debt (evidently compromising our sovereignty and doing violence to the principle of the unity of the treasury). From 1989 onwards, PDVSA consolidated its accounts on a global basis, which led to all the financial costs of internationalisation being treated as deductible costs for Venezuelan income tax purposes.

To make a long story short, studies undertaken recently by the Ministry of Energy and Petroleum both confirm and delineate with greater precision the warnings contained in the 1999 report of the statutory auditor. Full access to the relevant information, itself the product of the retaking of PDVSA, revealed that in the twenty years betwen 1983

to 2004, the opportunity costs of the discounts granted by PDVSA to all of its overseas affiliates averaged 1.03 dollars per barrel, for a grand total of 7.5 billion dollars. In today's money (2004 dollars), these 7.5 billion dollars are equivalent to 11.4 billion dollars! These discounts worked out to the great advantage of PDVSA's private partners in Citgo and other ventures, and they also generated unnecessary foreign income tax obligations (because the discounts swelled the affiliates' taxable base). Moreover, the chain of discounts does not end at the refinery gate: Citgo sells its gasoline at the lowest prices in almost every market across the Eastern Seaboard of the United States.

Another study on Citgo's tax affairs for 2003, conducted by the Minister of Energy and Petroleum during the last year, produced the following results: a total of 193 MBD of crude were sent to Citgo's refineries (including Lyondell–Citgo) at an average unit price of 2 dollars under true market value, for a total discount of 394 million dollars. Thus, the total loss for the Venezuelan exchequer, made up of foregone royalties and income tax, came to 253 million dollars. In contrast, the US treasury benefited to the tune of 89 million dollars, thanks to the income tax levied on the profits generated by the artificially low transfer prices. Finally, the balance in favour of the "global energy corporation" came to 164 million dollars, thanks to its systematic avoidance of taxes and royalties in Venezuela.

The new PDVSA, about whose Venezuelan birth certificate no one can harbour any doubts, is currently putting an end to this perverse structure. But it has to be borne in mind that this is not easy, even in the case of affiliates which are 100 per cent owned by PDVSA. This is because the old PDVSA turned the Long Term Supply Contracts over as collateral to its debts, which means that restructuring the contracts requires restructuring the covenants of the debt first. This task is presently underway, and will be completed in a few months. We are also about to receive the results of a study that will quantify the discounts on a cargo by cargo basis from 1999 to the present. This will not only allow SENIAT to draft the appropriate fiscal claims, but also open up the possibility that Citgo request the restitution of at least part of the taxes paid in excess throughout the last six years, in accordance with the prevailing clauses of the US–Venezuela Double Taxation Treaty.

We must also inform that, thanks to the extraordinary current circumstances in the world oil market, for the first time in twenty years the prices generated by these Long Term Supply Contracts are finally throwing off favourable results for the Nation.

Before the year is out, the Minister of Energy and Petroleum will once again be in position to control export prices. A formula pricing system, analogous to those used by Mexico and Saudi Arabia for example, will be put in place. This system guarantees that, within a given geographic area, PDVSA will sell crude to all its clients – whether or not they are affiliated – at a uniform price. And this price will always reflect fair market value in each one of these markets! And these prices, moreover, will be in the public domain! In this way, we will throw light on the mechanisms for fixing final sales prices, which constituted one of the blackest black boxes in the old PDVSA. And, in passing, the instruments that are being developed in the Ministry of Energy and Petroleum will be useful for SENIAT to control from a fiscal viewpoint the internal transfer prices of the associations in the Orinoco Oil Belt.

2.2 Dividends

Together with the goal of minimising the fiscal contribution of the oil industry in Venezuela, the old PDVSA also sought to minimise the repatriation of dividends from its international operations. In fact, throughout the best part of twenty years, the internationalisation programme did not pay any dividends to PDVSA's ultimate shareholder. Consider, as an example, what happened when in 1999, president Chávez demanded that Citgo declare dividends for the 1998 fiscal exercise. One could have supposed that, finally, some justice would prevail and the profits derived from price discounts would be repatriated. But no! Granted, Citgo did declare 486 million dollars in dividends – three times as much as the total amount of dividends declared since 1990, when PDVSA had taken over the whole of this company – but, in accordance with the structures devised by the Meritocrats, these funds were actually remitted to Citgo's parent company, PDV America. This company, in turn, declared dividends to its own parent, PDV Holding Inc., but not before reducing the amount from 468 million dollars to only 268 million dollars. And PDV Holding then proceeded to reduce this amount even further: to zero, to be precise. What happened was that the funds were simply recycled to PDVSA's various US businesses. But that was not the end of the story, because PDVSA itself, from Caracas, extended an interaffiliate loan to PDV Holding Inc., to the tune of 40 million dollars. That is to say that the net result of a direct instruction that the government was hoping would lead to the influx of 468 million dollars that were sorely needed to face an acute financial and economic emergency was actually that 40 million dollars left Venezuela. And all the Venezuelan public got to read in the press about this affair was that Citgo had, in fact, declared the dividend that the government had requested.

Throughout the best part of twenty years, the internationalisation programme did not pay any dividends to PDVSA's ultimate shareholder.

We shall now move on from this topic to deal with the Operating Contracts and the Associations in the Orinoco Oil Belt but first it is necessary to analyse, however cursorily, the dismantling of the post–Nationalisation legal regime.

3 The Oil Apertura and the Dismantling of the post–Nationalisation legal regime

3.1 Article 3 of the 1967 Hydrocarbons Law

In this context it is opportune to recall once again that, before PDVSA, our national operating company was the CVP, created in 1960 as an autonomous institute, with a Directive Council presided by the Minister of Mines and Hydrocarbons, and an Executive Board presided by a Director General. This was the national scheme for the oil industry, which was further consolidated in 1967 with the only substantial reform to the 1943 Hydrocarbons Law, focusing on article 3rd of this piece of legislation. This article, by the by, was the immediate predecessor to OPEC's Resolution XVI.90 of 1968, the extraordinary Declaration on Petroleum Policy in Member Countries.

This reform sanctioned explicitly the possibility that the State might carry out all of the petroleum sector activities by means of Autonomous Institutes and Companies of its exclusive property, and also authorised these entities to enter into *"agreements and promote mixed enterprises in which they could take a share, so long as the terms and conditions stipulated in each contract are more favourable toward the Nation than those set out for concessions in the present Law"*. In other words, with the CVP an attempt was made to build a second story over the ground floor of the concessions defined by the 1943 Hydrocarbons Law, a second story that would be more advantageous for the Nation.

But the Sovereign Congress did not limit itself to legislating and establishing this general rule: it had every intention to supervise and control as well. That is why it was stipulated that "the Chambers of Congress, in joint session, and properly informed by the National Executive of all germane circumstances, will approve the contractual terms within the overall conditions that they have determined". Also, and quite prudently, the same article 3 proceeded to define certain minimum obligatory conditions that all agreements and mixed enterprises had to satisfy. For instance (i) the maximum duration of the agreements was 30 years, whereas concessions were granted for 40 years; (ii) the agreements expressly excluded the possibility of international arbitration, just as the concessions had done, which meant that private parties were therefore prevented from undermining the sovereign rights of the State, even in an indirect manner through the medium of CVP; and (iii) the agreements would be published in their entirety in the Gaceta Oficial.

PDVSA promoted associations in which it henceforth would act as a minority partner. Indeed, in all association contracts it was explicitly stipulated that under no circumstances would PDVSA be allowed to become a majority partner.

It should be pointed out that in 1971, CVP signed five agreements of this type. In economic terms, they established conditions that were significantly more advantageous for the Nation than the established concessions; however, the announcement of the nationalisation of the entire oil industry barely two years after they were signed meant that they were never able to prosper.

3.2 Article 5 of the 1975 Nationalisation Law

The aforementioned makes it clear that, in order to undermine the control of the Venezuelan state over oil, it was not enough to get rid of the Corporación Venezolana de Petróleo and to create Petróleos de Venezuela as a corporation led by the management inherited from the multinationals; it was also necessary to eliminate article 3 of the 1967 Hydrocarbons Law. The first step in this direction was taken through an ameadment of article 5 of the bill for the Law Reserving to the State the Industry and Commerce of Hydrocarbons –popularly known as the Nationalisation Law– a bill that was approved, almost by unanimity, by the Presidential Commission entrusted with drawing it up. The only dissenting vote came from Fedecámaras, among whose members were counted all the multinationals that operated in our country. In its original formulation, article 5 read as follows:

"The State will carry out the aforementioned activities … directly through the National Executive or through entities of its sole property, but it will be allowed to sign all operating agreements necessary to better discharge these functions, although in no case are these arrangements to affect the essence itself of any reserved activity."

To this paragraph, which was sensible, reasonable and rather on the innocuous side, there was added a second paragraph (under direct instruction from the President of the Republic, Carlos Andrés Pérez) drafted by Fedecámaras representatives:

"In special cases, and when it is convenient to the Public Interest, the National executive or the … aforementioned entities will be allowed to sign association agreements with private entities, albeit with such a participation that state control is guaranteed, and for a limited duration only. The Entering Into such agreements, will be subjet authorization by both chambers of Congress in joint session, within the conditions that they determine, and once they have been informed by the National Executive of all pertinent circumstances".

In this way, the door was kept open for private investment in oil, albeit only in association with the state oil enterprise. This was a door that all other political forces in the country wanted to shut. Nevertheless, and to carry on with a simile presented beforehand, it can be argued that article 5 of the Nationalisation Law is a third story to the institutional framework, mounted atop article 3 of the 1967 Hydrocarbons Law. In the end, article 5 did reinforce the presence of the state enterprise, which was supposed to hold a controlling participation and this was taken to mean at the time a majority shareholding stake. In reality, though, the intention of the authors of this article was not this one. Their true intention would only become evident with the Apertura. In the meantime, both this article and article 3 of the 1967 Hydrocarbons Law would be devoid of any practical relevance, because during the following years there would be no private investment whatsoever. But when PDVSA – or more precisely, Lagoven – began promoting the first association, the Cristóbal Colón project, the partners in the venture (that is, Lagoven, Shell, Exxon and Mitsubishi), agreed that Lagoven should seek to obtain "a Supreme Court pronouncement in relation to the legal primacy of the 1975 Nationalisation Law".

And this was indeed, done. In November 1990, Lagoven presented before the Supreme Court of Justice a Plea for Interpretation. This plea, national public opinion was informed (or, more precisely, misinformed), was prompted by inconsistencies between the Natural Gas Nationalisation Law of 1971 and the Oil Nationalisation Law of 1975, which it was imperative to clarify. In reality, behind this smokescreen there lurked the true motive for the plea: the request, almost en passant, for the annulment of article 3 of the 1967 Hydrocarbons Law. This article, from the perspective of the old PDVSA, was a veritable straightjacket.

The President of the Court displayed an exceptional diligence: barely 4 months after the plea was tabled, the verdict was ready, and article 3 of the 1967 Hydrocarbons Law was duly annulled. All that remained in the path was article 5 of the Nationalisation Law, whose overtly broad statements lent themselves well to deconstruction, if not properly contextualised. And so it proved, as the presiding judge proceeded to clarify that "state control" actually did NOT mean a majority shareholding stake, but only a supposed legal control. A Control Committee, just like the one PDVSA was going to propose for

Cristóbal Colón, would be enough to satisfy this particular requirement. In fact, state control would not even require any shareholding stake at all.

On the basis of this verdict, PDVSA promoted associations in which it henceforth would act as a minority partner. Indeed, in all association contracts it was explicitly stipulated that under no circumstances would PDVSA be allowed to become a majority partner. This clause, by the way, is incorporated in all the frameworks of terms and conditions published in the Gaceta Oficial, and which were approved by a National Congress in full decomposition. Invariably, these frameworks stipulated that "the percentage of equity to be held by [Lagoven, Maraven or Corpoven, as the case might be] would in all cases be lower than 49 per cent".

Moreover, the annulment of article 3 also bulldozed the path for the principle of international arbitration, which was likewise (and in a similar fashion) incorporated in all associations (an unprecedented development in all our history as a petroleum producing country). What was its importance of this? The fact that, at the same time, in all association agreements there were introduced the euphemistically called "stabilisation clauses", which obliged PDVSA to guarantee "fiscal stability" to its partners for the duration of the association agreement. PDVSA became legally bound to indemnify its partners if necessary, and it explicitly renounced, for this purpose, any legal privilege that it might have enjoyed in its capacity as a state enterprise:

"In the Association Agreement there will be included provisions that allow [Lagoven, Maraven or Corpoven, as the case may be] to compensate the other parties to the Agreement in equitable terms, on account of significant and adverse economic consequences directly derived from the enactment of decisions by national, state or local administrations, or by changes in legislation…"

PDVSA's Meritocracy guaranteed in this way, for its own sake, that it would neutralise any adverse decision by the sovereign National Congress pertaining to fiscal matters. But even more disturbing than this was the fact that Congress then proceeded to approve these clauses, as witnessed by the General Frameworks published in the Gaceta Oficial, where one can find the paragraph that we have just quoted. In this way, Congress abdicated its tax sovereignty in favour of that Meritocracy: after all, only the National Congress, not PDVSA, was in a position to give credible fiscal guarantees of this nature. Even if it only were for this absolutely unprecedented act, the National Congress of the time – and the parties that controlled it – were effectively condemning themselves to disappear. It therefore behoves the new National Assembly and the new political forces to claw back their sovereign power in this elementary matter.

By the by, the busy President of the Court also clarified what exactly had to be understood by "operating contracts". According to article 3 of the 1967 Hydrocarbons Law, the two Houses of Congress, in joint session, and duly informed by the National Executive about all germane circumstances, "had to approve the contractual terms within the overall conditions that they had determined". Well, the presiding judge determined that, as this type of contract quite clearly did not involve the sort of association contemplated in article 5 of the Nationalisation Law, that meant that they did

not really require any congressional approval and should be seen as being of PDVSA's sole competence.

Again, the National Congress ended up by accepting PDVSA's postulates and it gave up, in connection with the Operating Agreements, some of its most basic faculties in petroleum policy terms. In consequence, the discussions around petroleum policy thereby became something of a sideshow, in which a minority of revolutionary legislators strove in vain to resist the assault. In fact, as we have been able to prove, the key documents for these years were not even drafted by the Commission of Energy and Mines or Congress as a whole; rather, they were written by the Meritocracy and its advisors (all of whom hailed from developed oil consuming countries and the oil multinationals). All along the chain, from the Ministry of Energy and Mines down to the National Congress in joint sessions, the governing forces limited their actions to endorse these initiatives with their seals and their signatures. The country was defenceless.

3.3 The Apertura and the Ministry of Energy and Mines

By this time, not much was left of the Ministry of Energy and Mines of yore, weakened as it had been by the liquidation of CVP. At the time the Apertura began to gather pace, the Ministry was unable even to prevent PDVSA from taking its shareholding in Citgo to 100 per cent (supposedly on a "transitory" basis), or from continuing to supply its joint ventures abroad at discounted prices. In the end, ministry personnel went along with what they knew very well was yet another deception. As far as the Plea for Interpretation introduced by Lagoven and the verdict of the Supreme Court of Justice, everything seems to indicate that the implications of these events completely passed them by and, as a result, no alarm went off within the Ministry. In the same way, they first let pass and later wholeheartedly supported the Operating Contracts and the Association Agreements proposed by PDVSA. By the end of 1993, the Ministry was firmly under the control of PDVSA and its Meritocracy.

3.4 Conclusions

With this, the Meritocracy had fulfilled the role assigned to it by the international institutions controlled by the powerful oil consuming countries, on the one hand, and the oil multinationals, on the other. It had come out of the innards of the Trojan horse, and had occupied all the positions of power that, in oil terms, were worth occupying.

Let us now review their deeds: the Operating Contracts and the Association Agreements that are our legacy. And let us judge this legacy on the basis not of what they said but of what they did, just as the Bible admonishes us to do.

4 Operating Contracts

Throughout the decade of the 1990s, PDVSA organised three bidding rounds for Operating Contracts: in 1992, 1993 and 1997. In addition, there was also one direct adjudication (the operating contract for the Boscán field). Not all of the assigned contracts were successful, however, and at the moment the total number of operating contracts with private investors comes to 32.

As we have already seen, article 5 of the Law Reserving to the State the Industry and Marketing of Hydrocarbons, popularly known as the Nationalisation Law, contemplated the possibility of entering into operating agreements, establishing in a taxative fashion that:

"The State will carry out the aforementioned activities … directly through the National Executive or through entities of its sole property, but it will be allowed to sign all operating agreements necessary to better discharge these functions, although in no case are these arrangements to affect the essence itself of any reserved activity".

It was made very clear, then, that Operating Contracts were not meant to pervert in any way the restrictions on the activities that were being reserved for the state, and that their sole purpose was to aid in the improvement of the functions carried out by the entity granting the contract, in this case PDVSA. Contractors were clearly not meant to acquire any rights over volumes, reserves or prices, which were precisely the objects of the reservations and restrictions set out in the law. However, it has been demonstrated by the facts that, by means of these Contracts, PDVSA quite simply turned over to third parties the activities of exploration and production that had been expressly reserved by the Nationalisation law either for state enterprises or for Association Agreements carried out by a state enterprise.

In a statutory sense, the fact that the Operating Contracts were contrary to law from the very first Bidding Round is a conclusion that can be derived without the slightest doubt from a detailed legal study of all the Operating Contracts undertaken last year by the Ministry of Energy and Petroleum. They are definitely not what they were always purported to be: simple service companies. What they really are is oil producers, to the

With each successive bidding round (or direct adjudication), the Operating Contracts became even more illegal.

extent that many of them have placed the reserves that they exploit by means of their contracts in their books, with the approval of the American Securities and Exchange Commission, among others.

The aforementioned study also shows that, with each successive bidding round (or direct adjudication), the Operating Contracts became even more illegal. Whereas during the First Round, in 1992, PDVSA was still forced to keep up appearances, in 1997 what was granted were concessions pure and simple. There were only two remnants of the former decorum. Firstly, PDVSA was required to approve the annual investment plans of the contractors, but I am sure that nobody will at this point be surprised to hear that, in case of differences around these plans, the matter would be decided by arbitration. Secondly, all of the output was sold to PDVSA.

As we have already asserted, there exists a total of 32 Operating Contracts. I have been informed that each time that Congress or the National Assembly requested copies of the agreements, the old PDVSA replied that they contained privileged information and that, as a result, the company could not hand them over. We mean to put an end to this game and, therefore, I hereby put in your hands copies of the 32 contracts, so that they can be kept in the archives of the National Assembly.

The Operating Contracts were presented to public opinion as a solution to the problem of producing and managing marginal fields. With the First Round, it was stated at the time, only marginal or abandoned fields would be turned over to contractors, and this proved to be the case. By the time of the Second Round, both active and inactive marginal fields were involved. But when the Boscán field was turned over in 1995 by direct adjudication, its production came to no less than 80 MBD, which makes it exceedingly difficult to classify this as a marginal field. By the time of the Third Round, all the oil fields involved were active and in production.

In this way, the old PDVSA was privatizing its oil production activities, by means of a policy that would continue to unfold with the Association Agreements for the Orinoco Oil Belt. In these Associations, as we shall see, PDVSA also tied itself to volume commitments by contractual means, to the detriment of its own share of output in the total production of the country. This policy of privatisation of oil production activities was extended to other activities that were euphemistically denominated as "non–score" (jargon very characteristic of the Meritocracy), within the context of outsourcing policies. In this way our oil tankers were sold, our information systems were turned over to SAIC through the infamous INTESA, port facilities were turned over, and the same happened with gas injection systems and electrical systems. If they did not manage to turn over the whole of the oil industry, that was only because of the arrival of the Fifth Republic in the wake of President Chávez's accession to office.

In sum, throughout the first quarter of this year, the Operating Contracts produced a total of 499 MBD of oil, with a unit value of 34.67 dollars. The contractors on average invoiced 18.17 dollars per barrel for their services; that is, the equivalent of 52 per cent of the unit price (by way of contrast, the lifting costs of barrels that PDVSA produces through its sole effort are around 4 dollars per barrel). Let us recall that, according

to article 5 of the Nationalisation Law, the Operating Contracts should not affect the essence of the activity reserved to the state. It is quite a difficult to sustain that this condition is being met when the alleged services cost 52 per cent of the unit price! It is also worth recalling that, in the exposition of motives of this law it was set out quite clearly that operating agreements were not to involve a significant percentage of our production!

Thus far we have been talking in terms of global averages, but it is worthwhile to examine these contracts on a round by round basis. In the case of the three contracts adjudicated during the First Bidding Round, the contractors' invoices to PDVSA come to around 80 per cent of the unit value of the crude. In other words, they produced 34 thousand barrels a day, at an average value of 30.29 dollars per barrel, and the invoice for their "services" comes to 24.09 dollars per barrel. Taking into account that PDVSA – not the contractor – has to pay a 30 per cent royalty and that long–term administrative costs can be approximately estimated at 3.33 per cent of the unit value, we come to the conclusion that PDVSA would have lost around 3.14 dollars for every barrel produced, for a total loss of 9.7 million dollars. And we say that it "would have" because we have put an end to this absurd situation on April 12th, 2005, by means of a Ministry of Energy and Petroleum Directive that, with immediate effect and in all circumstances, caps the payments to these Operating Contracts at 66.67 of the unit value of crude, so that PDVSA will not experience any out of pocket losses through their operations. (Of course, I hereby turn over a copy of this directive to the National Assembly). We have both the right and the obligation to act in this manner, in the light of the fact that, in formal terms, the issue only involves simple service contracts. We shall not negotiate on this point. It is simply unacceptable that PDVSA should have losses on account of any Operating Contract.

Eleven Operating Contracts assigned during the Second Bidding Round are currently active, and their vital statistics are as follows: they produced 192 thousand barrels per day, at an average unit value of 37.68 dollars, and with a unit service invoice of 24.81 per barrel (that is, 66 per cent of the total value). At first sight these contracts appear more advantageous. However, once again these figures only reflect the average of all contracts. The fact is that within some of the Operating Contracts, the Meritocracy embedded veritable time bombs, in the form of incentives that are triggered once production reaches certain volumes. And these provisions have been triggered in the past two years. Hence, there are currently some Operating Contracts whose invoices for services amount to 93 per cent of the unit value! For certain contracts, the invoiced incentives amount to half a million dollars per day. In other words, every two days we have to pay a one million dollar incentive to these companies to produce oil in our country, and to cause immediate out–of–pocket losses to PDVSA! Such were the "good deals" that the Meritocracy used to do! However, once the cap of 67.67 per cent on unit value is applied to all these contracts, PDVSA – and by extension, the Nation – will achieve savings in the order of 78.3 million dollars. The average value invoiced by

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contracts from this Round will therefore go down from 66 per cent to 54 per cent.

Seventeen Operating Contracts assigned during the Third Bidding Round are currently active. The produce 162 thousand barrels per day, with a unit value of 35.75 dollars per barrel, and a unit invoice for services that comes to 53 per cent of this figure; that is, 19.06 dollars per barrel. This looks much better once again, but it is worthwhile to go into greater detail to explain why this is the case. The fact is that when these contracts were signed, the Meritocracy was embarked in a campaign to scrap royalties once and for all. (In this sense, we should recall the strong pressure that the old PDVSA brought to bear against the idea of a 30 per cent royalty within the confines of the Presidential Commission that drafted the Organic Law for Hydrocarbons currently on the statute books). The operating contracts incorporate a mechanism whereby payments are determined on the basis of the value of the barrel, less a deduction for the royalty, which PDVSA has to pay. Hence, if royalties were to have been eliminated completely, the payments would have gone up substantially. But it so happened that the reverse situation actually materialised: with the new Organic Law for Hydrocarbons enacted in 2002, we increased the royalty from one sixth to 30 per cent – in accordance with our policy to maximise the value of our natural resource – and the payments to contractors went down accordingly. Therefore, the promulgation of the new Organic Law for Hydrocarbons translated into a net saving for PDVSA to the tune of 69 million dollars.

As far as the savings associated with the Directive issued by the Ministry of Energy and Petroleum, suffice it to say that there it was foreseen that, during the first quarter of this year, losses for PDVSA associated to the more onerous Operating Contracts from the three rounds would have come to 89 million dollars.

Finally, let us turn to the Boscán operating contract. In figures, and at first glance, it appears to be the most favourable of the lot, as payments only amount to 34 per cent of the unit value, which came to 29.26 dollars per barrel. However, this contract appears in a less favourable light as soon as one remembers not only that the contractor is producing 111 thousand barrels a day, but also that the contractor received a field that was already producing 80 thousand barrels a day without having to make any down payment whatsoever. Indeed, by virtue of the fact that it was a direct assignment, the Boscán operating contract can be seen as one of the emblematic cases of the maladroitness and bad faith of the Meritocracy.

4.1 Income Tax

The factors mentioned above show that the Operating Contracts were structured in a way that the contractors would pay no royalties, which PDVSA was supposed to take care of. At the same time, they were structured in such a way that they would not have to pay the income tax rate applicable to oil activities – 67.7 per cent at the time they were assigned – but the non–oil tax rate of 34 per cent. The fact that the companies that have these contracts pretend to be mere service providers means that, at the moment, 499 thousand barrels per day of Venezuelan oil production is facing exactly the same income tax rate as a bakery or a drugstore. Here one can discern a massive and deliberate evasion of oil taxes. At the same time, the Meritocracy strove, successfully, to make sure that the State had no direct access to the accounts of petroleum activities. As part of this initiative, the old PDVSA managed to shut down the offices that the former Bureau for the General Administration of Income Tax used to keep within its headquarters, practically and symbolically diminishing in this manner the specificity and importance of oil levies. But since 2003, the Finance Ministry, through Seniat, has reestablished a special directorate for oil levies. And Seniat, upon studying the issue of operating contracts, has reached the conclusion that the applicable tax rate for these contracts is the oil rate, which today stands at 50 per cent. This decision is supported by the fact that, for the purposes of the Income Tax Law, and here in Venezuela as in the rest of the world, the tax authorities focus on the economic essence of the activity involved, and not on its outward legal appearance. Thus, whether the operating contracts are true operating contracts or not in the sense of article 5 of the Nationalisation law is something that has no relevance whatsoever for Seniat. The criterion that Seniat has to use to determine tax obligations is far simpler than this: the profits of these companies vary in harmony with production and prices; hence, for the purposes of the assessment of income tax obligations, contractors are actually oil producers. Therefore, the applicable tax rates for their profits are 67.7 per cent for 2001 – the last year for which Seniat can still table a fiscal claim – and 50 per cent from 2002 onwards (the lower rate reflecting the reform of the Income Tax law promulgated that same year).

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Quite apart from the issue of the appropriate applicable rate, it has to be pointed out that when Seniat examined the income tax returns of the contractors, it found to its great surprise that the majority of these companies, and among them the large multinationals, are simply not paying any income taxes whatsoever, because their accounts have shown fiscal losses year after year. It is not up to me to dwell upon too many details in this regard, because that clearly falls within Seniat's remit. However, I would like to

make an observation regarding these fiscal losses. The Meritocrats convened with the contractors that the latter would always be paid in dollars, a situation that we have just put an end to after receiving instructions from the President of the Republic himself and which will require a coordinated action with the Venezuelan Central Bank, as it constitutes a clear violation of the prevailing foreign exchange controls. Notwithstanding the aforementioned, the contractors accounts also show that some of them finance their operations with up to 100 per cent debt. In other words, their equity in the ventures is zero. They then pay high interest rates on these debts and, in that way, they transfer profits abroad while paying minimal amounts of income tax, when any income tax is paid at all. These debts, it goes without saying, are as a ruled owed to the parent companies of the contractors. It also happens that some of these debts are denominated, for instance, in euros, which has led to substantial losses being alleged on account of the devaluation of the dollar versus the euro.

This is an unacceptable situation; it is a mockery of our institutions and our laws. Our Income Tax law might be very flexible, possibly too flexible as regards oil, but this is a shameless abuse. This cannot be allowed to continue, and we are sure that Seniat will put an end to it, and for that purpose it can count on our technical backing as well as our full support for its measures. This being the situation, Seniat has in its hands fiscal claims amounting to billions of dollars, which are currently being quantified more precisely.

The instructions we have given PDVSA in the sense that it should extend its full cooperation, without restrictions, to Seniat, are in diametrical contrast to the attitude of the old PDVSA, which allowed its activities to become black box and impenetrable to any control on the part of the Venezuelan state. We are taking apart this black box bit by bit, so as to make the operations of the new PDVSA transparent, once and for all.

4.2 The Migration of Operating Contracts and the National Assembly

In all, as we have said, there are currently 32 Operating Contracts which produced around 499 thousand barrels per day in the first two months of the year. This is around 5 per cent less than the average posted for last year, and it is a consequence of a 25 per cent cut in the contractors' investment plans, which the Ministry of Energy and Petroleum enacted in its budgetary appropriation for 2005, as a first step in a process whereby all these contracts are to migrate in order to comply with the new Organic Hydrocarbons Law, in accordance with the aforementioned Ministerial Directive.

The process of migration can be summed up as follows. Firstly, migration is an obligatory step to leave behind a situation characterized by its illegality and by vices of all kinds. Secondly, from this moment on, recognition will no longer be granted to any costs that exceed 66.67 per cent of the value of oil produced, and it is on this basis that the net present value of the Operating Contracts over what remains of their formal lifetimes will be assessed. Thirdly, we will not allow anybody to migrate if they

have not previously reached an agreement regarding their tax situation with Seniat (we have given a period of six months for this requirement to be satisfied). Fourthly, we have instructed both PDVSA and CVP to put to rights some irregularities and shady situations whose existence had already been pointed out not only in the 1999 and 2000 reports of the statutory auditor but also by PDVSA's own Audit office. The Meritocrats, of course, deliberately ignored these various findings as well as successive instructions from the shareholder to deal with the issues. Finally, the migration should take place in accordance with the Organic Law for Hydrocarbons currently in force. The companies have to obey the law in Venezuela, as they can no longer count with the complicity of PDVSA to get around our legal framework. This is the new PDVSA.

Mixed enterprises will constituted with a 51 per cent majority State shareholding, in accordance with the law. They will be submitted for approval by the sovereign National Assembly, so we are therefore at the Assembly's beck and call to inform it about progress being made in the process, without prejudice to subsequently presenting a complete report on each and every case, for its revision and eventual approval.

I would like to conclude this point by announcing to the Assembly a goal that we set for ourselves, valid for this migration, as well as for any future oil deal. We have set out the principle that the State, and by extension the Venezuelan people, will obtain at least 50 per cent of the market value of every barrel of oil produced, taking royalties and income taxes together.

This is a new vision of the historic "fifty–fifty", which of course was predicated on profits. However, with every passing day oil is becoming more valuable and, hence, the new fifty–fifty has to make reference to the market value of the barrel. Moreover, this new "fifty–fifty" is merely a floor; it is the minimum retribution to which we aspire in exchange for the exploitation of a resource that belongs to the Venezuelan people. The fiscal floor that the Meritocracy, the old PDVSA, used to aspire to was zero: zero royalties, zero income taxes. The strategy deployed with foreign interests to reach the objective of expropriating our oil wealth led us to the profound economic and social crises that have systematically impoverished millions of Venezuelans, without distinction. We should also bear in mind that this floor we are talking about is purely fiscal in nature; on top of it will come the dividends from our majority shareholding in all the mixed enterprises that are to be constituted.

5 The Association Agreements

Throughout the decade of the 1990s, the antinational project of the Meritocracy advanced along three paths: internationalisation, operating contracts, and association agreements. As far as the latter are concerned, we also wish to focus on the cases that are most relevant, particularly in retrospective. Hence, we will concentrate on association agreements for the Orinoco Oil Belt.

The four association agreements for upgrading extra–heavy crude oil from the Orinoco Oil Belt currently produce around 660 thousand barrels of extra–heavy per day, which results in the production of around 600 thousand barrels per day of upgraded crude.

Two of these associations – the ones now known as Sincor and Petrozuata – were authorised by Congress in 1993: the other two – Ameriven and Cerro Negro – were authorised in 1997. All these authorisations were granted in accordance with the content of article 5 of the Nationalisation law, which was in force the time. In general terms, we observe the same trends that we have already referred to above. On the economic side, massive fiscal sacrifices: 1 per cent royalty, 34 per cent income tax rate (that is, the non–oil tax) on profits, which would have been applicable to any accounting profits, had any such profits been generated. Alas, this has not been the case and up to now, the associations have only paid laughable amounts in income taxes. Finally, in all associations, PDVSA has a minority shareholding stake, in keeping with the interpretation of article 5 of the Nationalisation law that the Supreme Court rendered in its 1990 verdict (and according to which "state control" amounts merely to legal control). In addition to this, the associations authorised in 1997 – but NOT those authorised in 1992 – were allowed to have "development production". In other words, they were given permission to produce extra–heavy oil while their upgrading plants were being built. This crude would not be destined for upgrading, obviously, but would instead be used for blending with lighter crudes, and the resulting blend would then be sold as crude oil, albeit oil attracting extremely low taxation levels.

The reduction of the royalty rate from 16 2/3% to 1% was effected by means of a self–serving interpretation of article 41 of the 1943 Hydrocarbons law, which established temporary reductions in royalty rates for active projects, whose degree of

maturity called for such a measure. In other words, this exception contemplated for mature active projects was applied to associations which had not even been fully fleshed out as paper projects. The reduction in royalties to a one per cent rate was to have lasted for 9 years.

In September 2004, these associations recorded extraordinary financial results (extraordinary enough to allow the associations to pay off nearly 9 billion dollars in debt in only 4 years, and to allow the parents of the foreign companies involved in the associations to declare extraordinary dividends). Hence, our office proposed that the royalty be reinstated at the 16 2/3% rate set out in the 1943 law, in accordance with the provisos of the same article 41 that had been invoked in order to reduce the royalty rate to 1 per cent, but which in its second paragraph stated that:

And you can be confident that the national government will not back down from its task of enforcing our laws and making our sovereignty count. We will only heave dealings with companies that respect these principles!

"The National Executive can once again increase the previously lowered tax up to the original rate when, in his judgement, the conditions that prompted the reduction no longer apply".

President Chávez therefore put an end to the 1 per cent royalty rate in September 2004, thereby reestablishing in these associations the violated principle of the property of the natural resource and increasing the fiscal take for the benefit of the Venezuelan people. It should be pointed out that this measure has been approximately worth – on average and at current price levels – around 2.5 million dollars per day.

This measure, fully justified from both a legal and an economic point of view, has been accepted by the majority of the foreign companies involved in the associations, with only one of their number threatening us with taking the matter to international arbitration. We have not yet been officially notified of any such step, however. And you can be confident that the national government will not back down from its task of enforcing our laws and making our sovereignty count. We will only heave dealings with companies that respect these principles!

All four associations, and this cannot come as a surprise to anybody, have legal problems which are quite apart from the aforementioned scandalous and unacceptable clauses in the General Terms and Conditions, and according to which PDVSA not only has to be a minority partner but it also has to give a guarantee of "fiscal stability" for the 40 to 50 years that these associations may last (their duration is set at 35 years counted from the first shipment of upgraded crude, but to this has to be added the years of project development and possible five year extensions in case they are ever made subject to an OPEC quota).

But there is one association that deserves special attention on the part of the National Assembly, as the abuses in this case are of such a nature and magnitude so as to place it in a special category. This is the case of Sincor.

5.1 Sincor

In 1993, Maraven presented to Congress two projects for association agreements for upgrading extra–heavy crude from the Orinoco Oil Belt: Sincor and Petrozuata. In Sincor, the main partner was always Total (whose current shareholding stake is 47 per cent); the second partner, today, is Statoil (with 15 per cent), and PDVSA holds the remaining 38 per cent. In Petrozuata, ConocoPhillips holds 50.1% of the shares, and PDVSA holds the remaining 49.9%.

Now, what is really curious about the Sincor case is that, when we went through all the extant documentation in connection with negotiations leading to an expansion in the association, we were unable to find anywhere, either for Sincor or for Petrozuata, a number of key documents: namely (i) the projects presented at the time to the National Congress and, more precisely, to the Bicameral Commission of Energy and Mines; (ii) the report by this commission to the National Congress and, lastly, (iii) Congress' own documents on the matter. The former minister of Energy and Mines, Doctor Álvaro Silva Calderón (who formed part of that commission in 1993), made great efforts – albeit in vain — to obtain these documents from the official archives. The same was true for the legal teams from the Ministry of Energy and Petroleum and PDVSA. This led us to an astonishing conclusion: somebody had taken care to comb all the relevant files and had retrieved the documents from them, in order to make them disappear. The two companies asserted that they had no idea what we were talking about, even though the report of the Commission is made reference to in the first paragraph of the authorisation published in the Gaceta Oficial (No. 285.650, September 9th, 1993):

"After studying and discussing in joint session of the Legislative Chambers the report presented by the Bicameral Commission for the Strategic Associations, it was agreed, with the favourable vote of the majority of its members, to authorise formally the association between the companies MARAVEN, TOTAL…"

In all cases, the Gaceta Oficial only published the General Framework for the associations, which dwelled on legal aspects of the associations. What were never published were the contents of this report itself. However, this type of report is normally published in the Senate gazette, and this was indeed done in the cases of Ameriven and Cerro Negro but not, inexplicably, in the two cases that we are now occupied with.

We finally found, through our own efforts, a copy of the original Maraven–Conoco project and also an unsigned copy of the aforementioned Report by the Commission for Strategic Associations. Finally, and also as a result of our dogged insistence, Total managed to come up with copies of the selfsame report and of some other papers that it found in its files in Paris, but not with a copy of the project itself, which it insists it has been unable to find. However, we do have a copy of the Maraven–Conoco project, and the report states (on page 28) that "both projects are almost identical, with the sole difference being that in the Maraven–Total project … there will be installed a hydrodesulphurisation complex in Jose, with the aim of producing an upgraded crude with a better quality". We consider that it is necessary to re-establish the memory of our

institutions and their comptrolling role in the case of the associations authorised by a former National Congress. In this sense, we hereby turn over to this Commission all the documents that we have been able to obtain so that they can be kept in the archives of the National Assembly, where they should always have been in the first place.

When one studies this documentation, the implications of what one finds are truly staggering. Maraven–Total presented before Congress a project which was to have produced, approximately 114 thousand barrels per day of extra–heavy crude oil with a gravity of 8 to 9º API, to be transformed into 100 thousand barrels per day of upgraded crude. As things turn out, Sincor is currently producing 210 thousand barrels per day of extra–heavy crude, and it intends to expand this output in the near term to 250 thousand barrels per day. The upgrading plant built by the association has a capacity 0f 200 thousand barrels per day, double the 100 thousand barrels per day originally foreseen. In the same way, according to the Project, Congress was asked to set aside for the project a surface of 250 km2 containing 1.5 billion barrels in proved reserves (enough, in other words, to produce 144 thousand barrels per day over 35 years). Well, it turns out that Sincor has in fact been assigned an area of 324 km2 (which contain 2.5 billion barrels of reserves), and it also has a reserved area totalling a further 170 km2 which it wants to incorporate on a permanent basis the next year. By the same token, it disposes of the natural gas produced in its wells at its sole whim, even though it does not have the legal faculties to do so.

The only thing that can possible be concluded from the above is that the partners in the association acted with the most profound disdain for the decisions of the National Congress, taken in joint session. Is there a higher authority in the land than this one? Never mind: as long as the National Congress had approved some Project, they felt free to do whatever they pleased. Among the partners, of course, was PDVSA, and all these abuses and slights were duly incorporated into the Association Agreement, with the assent and the necessary dispensations of the Ministry of Energy and Mines. These were indeed the darkest years of the Apertura.

Now, in the Ministry of Energy and Petroleum we will take the most obvious measures to remedy some of these situations. We will begin by levying a 30 per cent royalty on each and every barrel that the association produces in excess of the 114 thousand barrels per day that Congress sanctioned. We are already working on this measure. In addition, we will insist that the partners reduce their area of operations to the 250 km2 authorised by the National Congress. But this is nowhere near enough to clean up the situation. What is more, such is the magnitude of this case that it is our conviction that it is not only the Ministry who should act. We are studying various options but all of them appear to lead us to an identical conclusion: the National Assembly has to assume a position

in response to this scandalous case, because it is the Assembly as an institution that has been treated with maximal contempt. And being as the National Assembly is the depositary of national sovereignty, it is our sovereignty that has been vilely trodden underfoot. By the same token, it is our opinion that an investigation into the matter has to be opened, with the aim of identifying responsibilities and derelictions of duty among the authorities at the time.

As we have already said, we have found irregularities in all cases, but no other matches Sincor in the egregiousness of its abuse. The other three associations – which are still under study at the moment – have at least kept to the production volumes originally agreed upon. That is why we feel that, in those cases, the Ministry of Energy and Petroleum is in a position to rectify abuses on its own, and reach agreements that are advantageous for the Nation but also acceptable for the companies. We do not question the presence of these companies in our country or that they obtain profits as a result of their investments. What we do demand without any compromise is that their participation in our oil sector should be carried out in accordance with our laws and with respect for our sovereignty.

5.2 Conclusions: Conservation Policy

There is a further point of maximal interest, and that is that in two of the projects presented to the National Congress for its approval, Sincor and Petrozuata, the partners committed themselves to injecting steam into the production wells, thereby increasing the recovery factor in the reservoirs. The following text can be found in a document from the National Congress called "Aspectos Técnicos", where reference is made to the case of Maraven–Total in page two (an identical text can be found for the Maraven-Conoco project):

"The wells will be produced with the assistance of cyclical steam injection (5 thousand tons/well/cycle) and they will be capable of producing at initial rates of over 1,200 barrels per day. When production falls to approximately 300 barrels per day, the wells will be stimulated. It is hoped that every cycle will last around 16 months (including one month dedicated to steam injection)…"

Neither Sincor nor Petrozuata have ever injected any steam into their wells. They simply limited themselves to extracting oil in the cheapest way possible, that is, through cold production. In this manner, the recovery factor barely reaches 7 per cent. In other words, around 93 per cent of the oil in situ is lost, probably for ever. From a foreign perspective, it seems logical to go for the option of extracting the maximum oil at the lowest cost possible, even at the cost of damaging the reservoir. This, after all, has been the traditional behaviour by multinational companies in producing countries. But the fact that the old PDVSA was willing to play the same game demonstrates the ideological commitment of the Meritocracy with the surrender of our National Resources. It demonstrates the absolutely antinational character of their management. Not in vain did all their leadership come from the managerial cadres in the foreign multinationals and not in vain were they all educated in study centres in the large consuming countries.

That Meritocracy promised the associations more and more lands, more and more reserves. The Meritocracy, in fact, by this means discouraged any investments meant for the conservation of this non–renewable, depleting natural resource that is oil. Finally, in 1997, Ameriven and Cerro Negro were not even required to inject steam.

In this way, all four associations resort to cold production, with a recovery factor of barely seven per cent. However, the whole country has been informed for years that reserves in the Oil Belt come to around 267 billion barrels (indeed, according to the meritocrats, we had so much that it was not even justified to charge a royalty). This reserves estimates rests on two assumptions: firstly, that oil in situ comes to 1.2 trillion barrels and, secondly, that recovery factors in the fields are in the order of 22 per cent. The measly 7 per cent that we are observing at the moment implies that our reserves will shrink to 84 million barrels … unless we act immediately.

We have taken the decision to tolerate no longer the predatory exploitation to which the Orinoco Oil Belt is being subjected at this moment. We will demand from all companies operating in the area that they increase, in a significant way and effective immediately, the oil recovery factor. We are therefore demanding that our natural resource be accorded the consideration and care that its value demands, and also that a conservation policy based on best industry practice be adhered to, in the light of the fact that this is a cause for concern at a global level. We will not give any more authorizations in the Orinoco Oil Belt to any company that does not heed our orders to preserve and manage our natural resources!

6 The Fiscal Regime

The discourse that became the norm in PDVSA

from the very day of its foundation onwards was that of maximising "shareholder value", with this term being understood as it is in any private corporation: after taxes. PDVSA's executives therefore overlooked the fact that the shareholder in the company was the State, which was entitled to receive not only general taxes but, even more importantly, the rents and royalties generated not by entrepreneurial initiative, but by virtue of the State's ownership of a bountiful natural resource. These executives therefore deliberately ignored the quid of nationalisation, which involved the maximisation of the value of this natural resource: a non–renewable, depleting natural resource that is the property of the Venezuelan people.

The worse thing about this "maximisation of shareholder value" mantra was that, in the same way as the later discourse about the "global energy corporation", nobody took it seriously and it never amounted to anything more than hot air and empty words. What was taken very seriously was the minimisation of the national fiscal contribution and, by extension, the minimisation of the value of the natural resource itself. Ultimately, production policy all came down to Volumes versus Prices. To produce and produce, with no regard for prices and even less for fiscal contributions. To produce and to produce, no matter who produced. In this way, we found ourselves faced with the disastrous price collapse of 1998, most of the blame for which has to be laid at the door of that same meritocracy, not only because of the wanton overproduction that it sanctioned but also on account of its dogged refusal to participate in any coordinated actions within OPC aimed at stabilising the market. Prices began to recover in 1999, as soon as President Chávez reasserted our traditional posture of always considering prices to be an integral part of a conservationist policy.

The recovery of the fiscal regime, also in ruins, has been a more difficult and arduous task. Four were the traditional components of the fiscal regime: royalty, income tax, the so–called Fiscal Export Value (which amounted to an export tax) and finally dividends.

6.1 Oil Export Tax

Among all of the instruments mentioned above, the most powerful one was the Fiscal reference value, or export tax. Leaving aside technical considerations, we can sum up its functioning thus: the National Executive levied a set percentage on the value of exports, which in the end was paid by foreign oil consumers and not by national consumers.

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Alter 1971, the National Executive was authorised by Congress to set this percentage unilaterally. This was an extraordinarily efficient instrument to bring taxation levels in line with short–term developments in the oil market. Thus, for instance, in 1981, this tax reached a level amounting to 20 per cent of the export price. However, in that same year, Congress legislated to limit the export tax to a maximum of 18 per cent for 1982, 15 per cent from 1983 to 1985, and 12 per cent from 1986 onwards. And then, in 1993, Congress once again legislated to reduce the export tax to zero by 1996. Obviously, the National Congress was playing the game by the rules set by the Old PDVSA.

6.2 Royalty

The second most powerful fiscal instrument was the royalty, the emblematic mineral rent. This instrument was present in our legislation from the moment that the decree of the Liberator Simón Bolívar was promulgated in 1829, and it expresses the right that we have as owners of a national resource to receive a rent in exchange for its exploitation, all the more so since what is involved is the exploitation of a non–renewable natural resource.

Royalties have a very effective way of being liquidated, as it requires nothing beyond the measurement of prices and volumes. Before Nationalisation, the minimum royalty rate was one sixth. However, through a number of bidding rounds, the Nation was able to obtain royalty rates far in excess of this minimum, of up to one third. Indeed, Sinclair paid such a royalty in a concession that it obtained in 1944 up to 1976 inclusive, at which time the concession was nationalised. Upon nationalisation, and without the public being aware, all these preferential rates were levelled downwards, to one sixth. Then, PDVSA's endeavours centred on weakening the measurement of both volumes and prices. From 1986 onwards, the prices for the liquidation of royalties were based, without any control, on the discounted prices of the internationalisation programme, which meant that the then Ministry of Energy and Mines had effectively abdicated its regulatory and control responsibilities. Finally, there came the attack on royalty rates themselves. All of a sudden, all of PDVSA's lawyers, in unison, imposed as an indisputable truth that the rate of one sixth was not a floor, but a ceiling.

In this way, as far as the operating contracts of the First Bidding Round were concerned, the royalty rate agreed behind the scenes was one per cent. For the Cristóbal Colón project it was zero per cent. For the associations in the Orinoco Belt, 1 per cent for at least the first nine years of operations of the upgraders. In the associations for conventional crudes, denominated "Risk Sharing Contracts", the royalty would vary in accordance with profitability, but always downwards, it goes without saying. Finally, in 1998, PDVSA left all niceties aside and announced that royalties would be completely eliminated, and under this directive they went as far as to oppose – to the extent of participating in destabilisation efforts – the promulgation of the Organic Law for Hydrocarbons currently in force, among other things because it elevated the prevailing royalty rate to 30 per cent.

However, step by step, president Chávez's government has been trundling uphill, retaking lost ground. First, in September 1999, minister Alí Rodríguez terminated the extant Royalty Agreements with PDVSA and demanded the discounted transfer prices be excluded for the purposes of calculating royalty obligations. Then, in 2000, the Organic Law for Gaseous Hydrocarbons elevated the royalty rate to 20 per cent as a minimum and, in 2001, with Álvaro Silva Calderón as minister, the new Organic Law for Liquid Hydrocarbons enshrined 30 per cent as the customary royalty rate. As we have already pointed out, when this law came into force in 2002 it had an immediate economic impact as regards the Third Round operating contracts, to say nothing of PDVSA's operations themselves. Then, in September 2004, within the overall framework of the policy of full sovereignty over oil put forward by President Chávez, our office eliminated the royalty rate of 1 per cent for associations in the Orinoco Oil Belt, and reintroduced the usual rate from the old Hydrocarbons law, which was one sixth. This year, the Ministry of Energy and Petroleum also eliminated the sliding scales royalty in the "Risk sharing" associations. Finally, on April 12th, 2005, the Ministry issued the Directive for Operating Contracts aimed at preventing PDVSA from continuing to suffer economic losses, and it also ordered the migration of these contracts to the conditions of the law currently in force. In economic terms, it is a fact that all Operating Contracts now generate a royalty of 30 per cent.

6.3 Income Taxation

Income taxes are, without a doubt, far more difficult to levy than royalties. It is not enough to know prices and volumes: it is also necessary to know the costs of production. The above notwithstanding, income taxes by a long way, generated the largest share of the state's fiscal participation, until the Apertura came around. All the same, one should note that back in 1989, when PDVSA took its shareholding in Citgo to 100 per cent, the consolidation of the accounts of the two companies led to a plunge in the fiscal income provided by income taxes. This is because the damages generated by transfer prices are duplicated if one takes into account the damages caused by the importation of costs into Venezuela. For instance, all the financial costs associated to the internationalisation programme are deducted for income tax purposes in Venezuela, at Venezuelan rates. Successive reforms to the Income Tax Law gave ever more leeway

both to PDVSA and to private investors to minimise their income tax obligations, quite apart from the fact that the applicable rate to Orinoco Oil Belt associations was reduced to 34 per cent, the non–oil tax rate. And here are the results of all that: whereas in 1980, income taxes represented 46 per cent of all oil fiscal income, by 1993 this percentage had fallen to 20 per cent, and currently it is around 15 per cent. We intend to reverse this situation with the actions that we are undertaking, and that we have already described.

6.4 Dividends

If one adds up to three instruments for fiscal participation that we have mentioned up to now, the picture looks like this: between 1976 and 1993, on average, out of every dollar of oil exports, 66 cents ended up in the government's coffers; from 1993 to 2002, the average fell to exactly half, that is, 33 cents. It is this that explains why the second Caldera government, in desperation, had to resort to dividends to supplement its oil income. Up until then, the oil export tax had been the instrument used to mop up any surplus. Dividends were meant to compensate but, in contrast to the tax, dividends are only paid at the end of a fiscal exercise and they are also subject to accounting and financial manipulations. Thus, the Meritocracy had every opportunity to spend the money that would have gone to dividends before these were declared and, unsurprisingly, that is exactly what they proceeded to do.

In the end, all that the declaration of dividends achieved was to take those 33 cents out of very dollar and increase them to 45 cents. The net balance represents a tangible loss of 21 cents for every export dollar. In absolute terms, the reduction in oil fiscal income for the ten years going from 1993 to 2002, in comparison to the previous 17 years going from 1976 to 1992 inclusive, amounted to 34 billion dollars, or 3.4 billion dollars per year. Behold one of the main causes for the brutal impoverishment of the country throughout the decade of the 1990s.

7 The Sabotage of the Oil Industry

In the light of the facts presented here, and with no possibility of any doubt about the antinational role played by the old PDVSA and its meritocracy, it is hardly surprising then that the ideological affinity with foreign interests would take PDVSA to mount a violent challenge to the Venezuelan state, first by taking part in the coup d'etat of April 11th, 2002, and then through their active and militant participation in the criminal sabotage to our oil industry, carried out between December 2002 and February 2003.

At this point, it is worthwhile to recall one of the particularly repellent sayings that went around in the old PDVSA: "the problem for PDVSA is that we are a First World company stuck in a Third World country". The meritocrats, in consequence, decided to use all their power and their place at the till of the company in order to attack the Bolivarian Constitution and those millions of poor who make up, in truth, the majority of the Venezuelan people.

We should bring to mind the ferocity and irrationality of the oil sabotage, because this dramatically highlights the fact that the internationalisation, the Apertura, and the privatisation of PDVSA were all very clearly defined and implemented strategies whose objective was to take away from us, for good, the control and usufruct of our main natural resource, oil. Given the clarity of purpose of President Chávez and the institutions of the Venezuelan state to prevent this expropriation, foreign interests and

their political operators in control of the old PDVSA chose violent confrontation. Oil would either be for them, or it would be for nobody.

This is the only explanation that one can find for the actions that the Meritocracy undertook against its own country. Attacking our oil industry was not only threatening the stability of our government, it was fundamentally tantamount to an aggression against the whole of our people, against the Motherland. Only an antinational elite would act in a way that not even an occupying army would have done.

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The oil sabotage, according to estimations carried out with the final accounting figures for 2003, generated 14.43 billion dollars in losses to PDVSA and the nation. This is an unprecedented situation, whose material authors are clearly identified. The competent organs of the state should act in order to penalise in an exemplary manner those responsible, in a way that actions as grave as this do not go unpunished in our country.

By the way, the same mass media that clamoured on a daily and relentless basis for a deepening of the sabotage, those same mass media that opened up their spaces for publicity in order to echo the calls for sabotage and chaos, now attack us every day in a ruthless fashion, because they resent the fact that the new PDVSA is in the hands of the people, they resent the fact that we are applying ever more profoundly our full oil sovereignty. Lords of misinformation, nobody believes in you any more!

Likewise, there can be found a number of petroleum experts, as they like to call themselves, with profound links to the situation that we have described here as well as to the oil industry sabotage. Today, these experts profess to be worried about the production levels attained by the new PDVSA. What lack of ethics, and what lack of morals this is! After all, as the Apertura was unfolding, these experts helped to privatise our oil production, sacrificing our share in national output to the welfare of the operating contracts and the association agreements. Then, during the sabotage, they collaborated in collapsing our production to 25 thousand barrels per day, damaging our reservoirs and paralysing our industry.

What the new PDVSA has done is to restore in an extraordinary manner our production, the operations at our refineries, our operational and control systems, our fuel supplies, our international marketing and all the facilities that they sabotaged! The fact is that

What the new PDVSA has done is to restore in an extraordinary manner our production, the operations at our refineries, our operational and control systems, our fuel supplies, our international marketing and all the facilities that they sabotaged!

PDVSA is now the people's, and it is perfectly aligned with the overall orientation of the Venezuelan state, in the hands of its patriotic leadership, of its workers, of our Armed Forces and of our people, all of them aware and vigilant in the defence of our main industry, of our sovereignty and of the tangible possibility of distributing the oil rent for the benefit of our people. The new PDVSA now has the face of the people and it has multiplied itself in the missions: Robinson, Barrio Adentro, Ribas, Mercal, Misión Milagro and all the extraordinary social upheaval that is going from end to end of our country like a liberating sword at the service of our people!

The new PDVSA has had enough technical–operational capabilities to get over the sabotage and take our main industry back on the path of sound operations and growth. We have besides all the moral and ethical power to subject ourselves to permanent revision, to make the administration of our industry ever more transparent, as we are now doing. With the defeat of the sabotage the country rid itself of a veritable nightmare: the old PDVSA represented an insufferable burden for the Nation. All the problems that we still have to face within the new PDVSA are but a shadow, in terms of their magnitude, of the problems that we had to face before. PDVSA and its workers are now an integral part of the country, committed to the reconstruction of the enterprise and committed to building a better future for the whole Nation. The maximisation of the natural resource is its lodestar, because this PDVSA is at the service of the people.

The new PDVSA is a Venezuelan company, proudly Venezuelan, profoundly rooted in the soil of the Motherland.

8 The Popular Distribution of Petroleum Rent

This conception of the new PDVSA goes hand in hand with another one, over the ultimate destination of petroleum rent. The meritocracy and its followers were willing to “globalise” our natural resource and grant free access to it to the powerful consuming countries. Under the leadership of President Chávez, the people defended our main resource and rescued it, in order to make it serve our Nation.

Under this same orientation, it is also the people who will be the beneficiary of petroleum rent: the popular distribution of this rent constitutes the revolutionary dimension of our oil policy, beyond its eminently national character. It is, at the same time, a popular vision of the sowing of oil. The sowing of the oil in the past failed, certainly, because it rested on an elitist vision of an exclusionary Venezuela.

The meritocrats, the oligarchy and their political representatives greet this, of course, by screaming to the skies. But this is the extension of the struggle that has been ongoing from the coup d’etat of April 11th onwards; the popular and revolutionary orientation of our Government, which has made the firm commitment to rescue and redistribute petroleum rent for the benefit of the people.

With its popular distribution, with its investment in the welfare of the people, in its human capitalisation, in its social and economic advancement, with its investment in infrastructure and services and in projects to increase national production, petroleum rent therefore is vested with the potential to transform the terrible imbalances and social

inequalities which, paradoxically, are present in one of the countries with the largest oil endowments in the planet.

But for the forces of reaction, for the traditional seats of economic power, the popular distribution of oil rents is unacceptable. What is acceptable is if the oil rent is channelled towards foreign capital and the economic elites which traditionally have appropriated it in our country (as happened, with grave consequences, during the decade of the 1970s).

That is why the lodestar of our policy of distribution of the oil rent is to put it at the disposal of the people, of human beings, who are the focus and essence of our Revolution.

We feel proud of this mission that has been entrusted to us, because the new PDVSA is consciously committed to the objective of meeting all the technical–operational objectives that will allows us to become stronger and to turn our main energy resource, oil, into an instrument of transformation.

The new PDVSA has been assigned a role of beauty: to contribute effectively, with all of our capabilities, to liberate our people from the gloom of misery, of exclusion. The new PDVSA is an instrument of its people, of its revolution, an instrument that will be used to build the new socio–economic relationships that will support and lend impulse to the very high levels of consciousness and mobilisation that our people has achieved, through all the battles that it has fought in defence of its revolution: the defeat of the coup d'etat, the defeat of the sabotage of the oil industry, the defeat of violence and destabilisation, the victory in the battle of Santa Inés, and the many battles that we are still to fight in our pursuit of the construction of a motherland free men, where the principles of solidarity and fraternal love will lead us inexorably to happiness for our people, to socialism.

Full Sovereignty Over Oil

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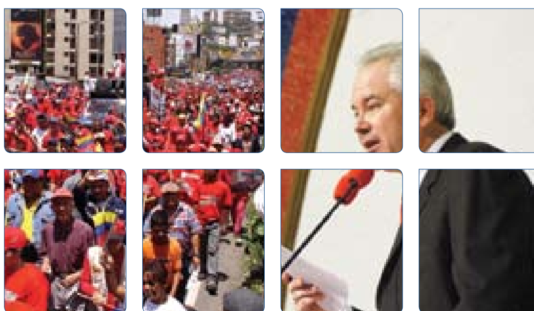

A National, Popular and Revolutionary Oil Policy

An address to the National Assembly of the Bolivarian Republic of Venezuela by

Rafael Ramírez Carreño, Minister of Energy and Petroleum and President of PDVSA

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