10 Petróleos de Venezuela, S.A. (PDVSA): from independence to subservience
DAVID R. HULTS

1 Introduction

Venezuela’s national oil company (NOC), Petróleos de Venezuela, S.A. (PDVSA), has undergone the most significant recent transformation of the NOCs in this volume. Between its 1976 creation via nationalization and the early 2000s, PDVSA was one of the most capable, forward-thinking, and autonomous NOCs. During 2002 and 2003, however, it launched a series of politically disastrous strikes against President Hugo Chávez. After surviving the strikes, Chávez purged the company in 2003 of (real and perceived) dissidents, converting PDVSA from a commercially oriented firm to one that is less proficient but much more attentive to state objectives. The current version of PDVSA functions simultaneously as an operating company, development agency, political tool, and government cash cow.

Yet in some respects the PDVSA of today remains similar to its pre-Chávez incarnation. PDVSA has maintained its status as one of the world’s fifty largest companies and two or three largest NOCs (Petroleum Intelligence Weekly 1986–2009). Since the 1980s, the company has held extensive international interests, including major US gasoline chain CITGO. And since the 1990s it has been one of a handful of NOCs to partner with international oil companies (IOCs) in domestic upstream operations (though not without acrimony).

This chapter explains PDVSA’s continuity and change. I focus on how the key variables considered in this book - the nature of oil resources, state institutional capacity, and state goals - apply to Venezuela and have affected the relationship between company and state. I then explore how that relationship has shaped PDVSA’s performance and strategy.¹

I advance six main arguments in this chapter.

First, changes in the relationship between the Venezuelan state and PDVSA largely explain why PDVSA’s performance has deteriorated and its strategy has shifted since Chávez’s 2003 takeover of the company. Unlike many nationalization experiences, Venezuela minimized oil sector disruption by preserving the private sector orientation of the newly formed NOC. Venezuelan politicians maintained a mostly hands-off approach to PDVSA through the late 1990s. Because of its autonomy and private sector heritage, PDVSA became a highly efficient enterprise that insulated itself from the state. When the Petroleum Economist conducted three expert polls in the 1990s, each one rated PDVSA as both the best-managed and best financially managed NOC (Petroleum Economist 1993, 1995, 1999). Following the 2003 company overhaul, the Venezuelan government became more deeply interventionist. The Chávez administration fired a net 30–40 percent of PDVSA’s workforce in the immediate aftermath of its anti-government strikes (derived from Mares and Altamirano 2007). The government has also levied irregular and heavy financial obligations that annually consume up to 40–50 percent of PDVSA’s revenues (roughly $35–45 billion/year). And it has imposed an ever-changing slate of non-core domestic and foreign policy goals on the company. Partly as a consequence, PDVSA’s performance has weakened; current production is likely more than 25 percent off pre-strike levels, despite the Chávez administration’s claims otherwise. And PDVSA’s strategy has switched from autonomy seeking to accommodation of the many government demands.

Second, while the Chávez administration has been the immediate cause of the changes between PDVSA and state, Chávez’s rise to power occurred in the context of broader structural factors. By the late 1990s, PDVSA had become controversial because it grew in influence at a time when the Venezuelan economy declined (partly as a result of an extended period of low oil prices). Many Venezuelans perceived that PDVSA had become, by virtue of its autonomy and sway over government policy, a state within a state. Chávez capitalized on those perceptions in a successful populist campaign to win the 1998 presidential election. Once in power, the Chávez administration slowly but deliberately took steps to assert greater authority over the oil sector, particularly as oil prices rose in the early 2000s. These steps, which included the dismissal of three PDVSA presidents in three years, inspired PDVSA’s management to initiate
its 2002–2003 antigovernment strikes – a profound misjudgment rooted in management’s history of independence and its assumption that the government would back down. The failure of those strikes then set the stage for Chávez’s decisive reordering of the company in 2003.

Third, Venezuela’s endowment of abundant, heavy and extra-heavy oil has had a formative impact on PDVSA. Heavy and extra-heavy oil are relatively costly, require specialized technologies to produce and upgrade, and pose some environmental threats. PDVSA became one of the world’s most vertically integrated NOCs in the 1980s in part to ensure that its heavy and extra-heavy oil could reach downstream markets. Venezuelan oil has become even heavier over time: Today, nearly 60 percent of Venezuelan proven reserves are extra-heavy and another 15–20 percent are heavy (PDVSA 2008). This geological reality is a reason Chávez has maintained PDVSA’s operational structure despite making wide-ranging changes to the company in other respects.

Fourth, personal ties substantially color the relationship between PDVSA and the Venezuelan state; institutional arrangements play by contrast a minor role. Before Chávez, PDVSA preserved its autonomy by cultivating links with the political leadership and by capturing the country’s weak regulatory institutions and government ministries. (Venezuela has remained among the bottom 50 percent of countries for all six World Bank governance indicators since compilation began in 1995 (Kaufmann et al. 1999–2009).) Since Chávez took command of PDVSA in 2003, bureaucrats remain on the sidelines; Chávez relies mostly on trusted allies to manage the company. Institutions have, in fact, become even more ineffective than before.

Fifth, in accord with the arguments above, PDVSA largely conforms to this volume’s research design. The three independent variables in the research design – state goals, state capacity, and nature of resources – explain much of the relationship between PDVSA and the Venezuelan state. Shifts in Chávez administration goals for the oil sector caused dramatic changes in the state–PDVSA relationship, but the continuity in Venezuela’s heavy oil resources and weak state institutions have ensured that some aspects of that relationship remain intact. This relationship, in turn, accounts for much of PDVSA’s performance and strategy. As I discuss below, other factors not explicitly considered in our research design – particularly oil prices – also played critical background roles. Nevertheless, I argue that the research design provides a useful framework for understanding PDVSA.

Sixth and lastly, both doomsayers and stalwart defenders of PDVSA in the Chávez era make a mistake in taking Chávez’s pronouncements at face value. Chávez has announced far-reaching plans for PDVSA to bankroll new initiatives, but those imagined plans are often not carried out. Rather, PDVSA and the government usually negotiate practical implementation of the Chávez administration’s grand announcements to better reflect commercial realities. There is thus often a gap between pronouncement and policy. PDVSA’s new autonomy lies, to some degree, in how it creates and exploits that gap – though the distinctions between government and company strategy are sometimes difficult to parse.

This chapter is structured as follows. Section 2 chronicles the development of the Venezuelan oil sector, from its beginnings in the 1910s through today. Over the course of several decades, foreign oil companies established an entrenched organizational structure and spirit de corps that carried over to PDVSA. Section 3 analyzes several factors affecting the state–PDVSA relationship over time: nature of resources, state capacity, and state goals. In Section 4, I discuss how PDVSA’s links to the state have affected the company’s strategy and performance. Pre-Chávez governments took a mostly hands-off approach toward PDVSA, and that approach led to high company performance and an autonomy-seeking strategy. Since the 2002–2003 strikes, PDVSA’s performance has waned and its strategy has shifted toward managing state demands. Section 5 concludes.

A methodological note before proceeding: After Chávez remade the company in 2003, PDVSA and the Venezuelan government released oil sector data selectively and somewhat haphazardly. More recently, PDVSA has made more information available. Nevertheless, questions abound about the accuracy of PDVSA data and scholarship seeking to debunk that data (Boué 2009). Keeping these questions in mind, I refer to established third-party sources, like BP or Petroleum Intelligence Weekly, where available. I also rely in part on PDVSA’s own financial reports, though I draw findings based on those reports cautiously.
2 Historical background on the Venezuelan oil sector

2.1 The foundations of the Venezuelan oil sector (1910–1958)

IOCs turned Venezuela into an early and important oil producer. Commercial development began in 1914, when foreign-owned Caribbean Petroleum (later acquired by Shell) started producing from the Mene Grande fields. Major discoveries followed in fields at Las Cruces (1916) and especially at La Rosa (1922). The Venezuelan government, controlled by powerful military general Juan Vicente Gómez, allocated long-term oil concessions to cronies who then resold them to IOCs. Because of the pro-development taxation framework in place at the time of concession allocation, the IOCs paid extremely low royalty (often 3 percent) and subsurface tax rates (Manzano and Monaldi 2010). The IOCs enjoyed tremendous success under these conditions and by the late 1920s a sophisticated Venezuelan oil industry was under way. Venezuela became the world’s leading oil exporter and second-largest oil producer (behind the United States). (Around this time, Venezuelan intellectual Arturo Uslar Pietri urged the country to sembrar el petróleo – “sow the oil” – by investing oil rents in productive economic sectors. This saying still resonates in Venezuela today.)

These initial IOC concessions proved politically unsustainable. Particularly after Vicente Gómez’s death in 1935, Venezuela’s government began pressing for changes in taxes and concession terms. After protracted negotiations between the government and IOCs, Venezuela set landmark laws in 1943 and 1948 creating a roughly “fifty-fifty” profit split. (Saudi Arabia and Iran later followed Venezuela’s lead.) The Venezuelan government and IOCs reached forty-year concession agreements under this taxation framework, and Venezuelan-IOC relations would remain steady for the next fifteen years.

The combination of legal stability, long-term investment horizons, and the country’s copious oil resources substantially benefited Venezuela. From 1944 through 1958, Venezuelan oil production increased at an annual rate of 19.5 percent and its capital stock grew by 14.3 percent annually (Monaldi 2001, 2004). Oil sector wealth spilled over to the broader Venezuelan economy. By some estimates, Venezuela had by 1960 become the wealthiest country in Latin America.

2.2 Creeping nationalization (1958–1976)

Although Venezuela prospered under the 1940s hydrocarbon framework, fissures later emerged. Venezuelan politicians challenged military government laws, including the 1940s hydrocarbons legislation, as the country transitioned to (elite-based) democratic rule. Because Venezuela had set low income tax rates for IOCs, it received a decreasing share of revenues as oil prices rose or as costs declined; the government share fell from around 50 percent in 1943 to 40.4 percent by the late 1950s (Manzano and Monaldi 2010). Ironically, just as Venezuela’s “fifty-fifty” split arrangement became a model in the Middle East, it no longer accurately described actual revenue sharing in Venezuela.

Starting in the late 1950s, successive Venezuelan governments used a hodgepodge of tools to increase state involvement and capitalize on
sink IOC investments.⁹ One front was fiscal: Venezuela's military-civilian regime raised taxes in 1958, shattering the long-established "fifty-fifty" profit split.¹⁰ The democratically elected administrations of Rómulo Betancourt (1959–1964), Raúl Leoni (1964–1969), and Rafael Caldera (1969–1974) later followed suit. (See Table 10.1 for a list of presidential administrations.) Another tack was contractual: in 1963, the government chose not to renew the forty-year concessions awarded twenty years previously, shortening IOC investment plans. Organizational changes also occurred. Through a 1958 law and fee system for foreign workers, Venezuelan governments established local employment preferences for private oil companies (Randall 1987).¹¹ By the time of nationalization, nearly all Venezuela's oil sector employees, including most top managers and engineers, were Venezuelan. And the Venezuelan government became a pioneer in the world oil cartel: Betancourt's oil minister, Juan Pablo Pérez Alfonzo, and his Saudi counterpart spearheaded OPEC's formation in 1960. (Interestingly, Pérez Alfonzo also referred to oil as el excremento del diablo – "the devil's excrement" – and predicted that it eventually would ruin the country.)¹² Venezuela even experimented with the idea of building an NOC from the ground up fifteen years before establishing PDVSA. In 1960, the Betancourt administration founded the Corporación Venezolana del Petróleo (CVP) to learn about the oil industry and catalyze Venezuelan-run oil operations. CVP foudered, however, and PDVSA later absorbed CVP upon nationalization (Mares and Altamirano 2007).

By the 1970s, Venezuelan oil sector interventions had reached a crescendo. A decade-long period of tax and contract changes, combined with the emergence of low-cost alternatives from the Middle East, had hollowed out private sector investment in the sector (Monaldi 2001). To compensate for the private sector retreat, Venezuela – emboldened by rising oil prices and a global tide of resource nationalism – looked to the state. The congress passed a 1970 law mandating reversion of oil sector concessions upon expiration, government approval of IOC changes to operations, prohibitions on movement of assets, and an IOC requirement to post a bond or guarantee. The Caldera administration initially viewed this legislation as overreaching but later, sensing public sentiment, supported it (Matsuda 1997). In this environment, nationalization of the oil sector became the obvious next step.

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**Table 10.1. Venezuelan presidents, 1959–present**

<table>
<thead>
<tr>
<th>Term</th>
<th>President</th>
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<tbody>
<tr>
<td>1959–1964</td>
<td>Rómulo Betancourt</td>
</tr>
<tr>
<td>1964–1969</td>
<td>Raúl Leoni</td>
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<tr>
<td>1969–1974</td>
<td>Rafael Caldera</td>
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<tr>
<td>1974–1979</td>
<td>Carlos Andrés Pérez</td>
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<tr>
<td>1979–1984</td>
<td>Luis Herrera Camps</td>
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<tr>
<td>1984–1989</td>
<td>Jaime Lusinchi</td>
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<tr>
<td>1989–1993</td>
<td>Carlos Andrés Pérez (second term)</td>
</tr>
<tr>
<td>1993–1993</td>
<td>Octavio Lepage⁶</td>
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<tr>
<td>1993–1994</td>
<td>Ramón José Velásquez⁷</td>
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<tr>
<td>1994–1999</td>
<td>Rafael Caldera (second term)</td>
</tr>
<tr>
<td>1999–present</td>
<td>Hugo Chávez</td>
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</tbody>
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⁶ Lepage became Venezuela's interim president after the congress removed Carlos Andrés Pérez from office because of corruption charges.

⁷ Velásquez replaced Lepage as interim president until Caldera won elections and entered office in 1994.

Yet PDVSA formed mostly from a peaceful transfer of power rather than from the fires of resource nationalism. Cognizant of Mexico's tumultuous nationalization of Pemex and Venezuela's own experiences creating CVP and nationalizing the iron ore industry,¹³ the first Carlos Andrés Pérez administration (1974–1979) structured nationalization to dampen oil sector politicization and smooth large-scale change. (Venezuela's strategy parallels that of Saudi Arabia. See Chapter 5.) To retake policymaking control from the congress, the government formed a presidential commission on nationalization in 1974. Removed from congressional politicization, the commission carried out technical discussions and brokered compromises among different interest groups, easing the path to agreement (Matsuda 1997). Venezuelan oil industry employees – long opposed to nationalization until that outcome was unavoidable – voiced additional concerns through their lobby group, AGROPET (the "Agrupación de Orientación Petrolera," or oil association). The Venezuelan government incorporated many of AGROPET's concerns in its final legislation (Coronel 1983). Lastly, the Venezuelan government agreed to substantially compensate private companies for the value of their
expropriated assets, paying the equivalent of $1.02 billion over time (Manzano and Monaldi 2010). (PDVSA later would enter into lucrative oil distribution and technical assistance contracts with private companies that offered owners of the nationalized assets still more compensation (Manzano and Monaldi 2010)). With these steps in place, the government introduced, and the congress later passed, a 1975 bill nationalizing the Venezuelan oil sector and providing the nationalized company with fresh state capital. PDVSA subsequently formed as a 100 percent state-owned company on January 1, 1976.

2.3 A private business under government control (1976–1982)

Because of Venezuela’s nationalization strategy, the newly minted PDVSA built heavily upon its private sector heritage. Most former Venezuelan IOC employees immediately joined PDVSA, holding virtually the same roles and responsibilities as before – a process aided by the previous “Venezuelization” of the oil sector workforce. Through at least the mid 1980s, some PDVSA managers followed the private sector tradition of holding meetings and writing reports in English (Randall 1987). Moreover, PDVSA adopted a “federal model” in which its formerly private-owned affiliates retained control over operational decisions (the PDVSA holding company, by contrast, at first had authority only over strategic and financial planning). Two of the most important affiliates, Maraven and Lagoven, behaved much like their private sector predecessors, Shell de Venezuela (Shell) and Creole (Exxon), respectively. Befitting their corporate pedigree, Maraven excelled in marketing activities, like Shell; and Lagoven’s specialty was exploration and development, the same as Exxon (PESD Interviews). The similarities between PDVSA operating companies and their predecessors even extended to corporate color schemes. Maraven used Shell’s yellow and red ensemble, whereas Lagoven chose Exxon’s red and blue combination. Nationalization critics would later call PDVSA a “Trojan horse” because of its heavy private sector legacy (D’Leon 2006).

Nationalization also led to few immediate changes in corporate structure. PDVSA initially converted twenty-two private sector concessionaries into thirteen state-run operator subsidiaries; CVP, Venezuela’s first failed experiment in state-run oil, became operator subsidiary number 14 (Boué 1993). Because the operator subsidiaries had their own departments of marketing, accounting, etc., they suffered from substantial overlap and duplication. Yet they were also well positioned to compete with one another because they had done so prior to nationalization.

As time passed, PDVSA implemented broader-scale reforms that balanced the benefits of increased economies of scale and intra-firm competition. Between 1976 and 1978, PDVSA cut the number of major operator subsidiaries from fourteen to Maraven, Lagoven, Corpoiven, and Meneven. (Meneven became part of Corpoiven in 1986.) Even as consolidation occurred, PDVSA took care to promote competition among its operating subsidiaries. Upon merging Corpoiven and Meneven, PDVSA transferred part of the refining and production activities to Maraven and the exploratory acrege to Lagoven (Boué 1993). The operator subsidiaries also had the power to negotiate with individual clients over services, delivery, and time (price competition was discouraged, however) (Baena 1999b).

Due in part to these measures, both PDVSA and the Venezuelan state thrived during the late 1970s. Nominal PDVSA investment in exploration and production grew by more than 500 percent and 600 percent, respectively, between 1976 and 1981 (derived from PDVSA various years). Buoyed by PDVSA’s growth and an oil price boom, Venezuela became known as “Saudi Venezuela.” Wealth conferred many privileges. The country was at that time a leading importer of whisky (and remained among the world’s top ten in 2007) (Enright et al. 1996; Scotch Whisky Association 2007).

2.4 PDVSA goes abroad (1982–1989)

Beginning in the 1980s, PDVSA launched an internationalization strategy to secure downstream markets for its production and place assets outside direct reach of the state. Brought on by its heavy oil endowment, oil price declines, OPEC domestic production quotas, and periodic government interference, PDVSA’s internationalization was the most aggressive of any NOC in the world. KPC carried out a less ambitious version of this same strategy. (See Chapter 8.) Initially, PDVSA entered into joint venture interests for refineries in overseas markets. PDVSA and German counterpart Veba Oel inked the first such contract in 1982. After a three-year pause, PDVSA
acquired further refinery interests in Belgium (1), Curaçao (1), Sweden (4), the United Kingdom (2), and the United States (7), including St. Croix. (Later deals reduced this number.) PDVSA also targeted downstream consumers. In 1986, PDVSA purchased and probably overpaid for a 50 percent stake in CITGO, which provided a major distribution channel for gasoline products to consumers in the United States. PDVSA acquired CITGO's remaining 50 percent share in 1990. After taking full ownership of CITGO, PDVSA became one of the first developing-country companies to run a major US oil business and among the first foreign companies anywhere to obtain an important piece of the US energy industry (Baena 1999b).

However, the rapid pace of internationalization sowed seeds of conflict between PDVSA and the Venezuelan state. Congress blasted PDVSA for not seeking its approval for overseas acquisitions, especially the 1982 Veba Oel contract and 1990 CITGO purchase. Although these criticisms did not stop—and in fact likely propelled—PDVSA's internationalization, they tapped into an undercurrent of discontent. Academics would later condemn internationalization for its high costs and for depriving Venezuela of tax revenues (Bové 2002; Mommer 2002). This argument would become gospel during the Chávez administration, in which several of those academics have served. (As detailed below, Chávez would nevertheless leave much of the internationalization legacy intact.)

While internationalization was under way, another major development occurred: PDVSA became one of the world's most technologically advanced NOCs. The company created a top-flight research center known as INTEVIP. Much of its early work focused on devising marketable products from Venezuela's extra-heavy oil in the Orinoco Belt. By the mid to late 1980s, INTEVIP research led to "Orimulsion," a patented underboiler fuel substitute made from the Orinoco's extra-heavy oil (Economides et al. 2007). Orimulsion subsequently became one of the company's first revenue sources from that region.

While PDVSA continued growing during the 1980s, the Venezuelan economy faltered. Because of low oil prices and the Latin American debt crisis, Venezuelan oil revenues plunged, its access to capital markets dried up, and public spending declined (Baena 1999b; Paris 2006). As a result, Venezuela and its regional counterparts became mired in a deep economic recession known region-wide as the "lost decade." Venezuela's economy shrank 2.6 percent annually per capita during the 1980s, the worst performance in at least sixty years (Haussmann 2003). The disconnect between strong company performance and fading national welfare would generate further conflicts for the company down the road.

2.5 Foreign investors move in (1990–1999)

By the 1990s, PDVSA's strategy shifted emphasis toward Venezuelan upstream operations. Because oil prices remained low, PDVSA had limited monies available for reinvestment. To fill the investment shortfall, increase access to new technologies, and cultivate marketing relationships, PDVSA solicited outside investor participation in a strategy known as la apertura petrolera (oil sector opening). Rolled out in three rounds during 1991, 1992, and 1997, the apertura gave private companies majority equity interests in development projects with attractive fiscal terms and strict procedural protections. The apertura centered on three elements: 1) expanding investment in extra-heavy oil from the Orinoco Belt; 2) developing the country's older, low-producing fields; and, least importantly, 3) increasing production in other high-risk areas through risk exploration and profit-sharing agreements.

The first element—aimed at encouraging investment in the Orinoco Belt, which was Venezuela's largest oil resource yet barely tapped—involved heavy-crude upgrading association agreements (AAs) between PDVSA and outside oil companies. The thirty- to thirty-five-year AAs, four in all (often with multiple companies holding interests), set low royalty (1 percent) and tax (34 percent of income) rates. The combined marginal rates were substantially more advantageous than the rates for traditional projects. AA participants included BP, ConocoPhillips, Chevron, ExxonMobil, Statoil, and Total.

For the second element, PDVSA and outside oil companies entered into operational service agreements (OSAs) to exploit marginal fields. Under these contracts, outside oil companies operated the oil fields; PDVSA paid the companies a fee for their services, with payment structures varying by apertura round. Because the OSAs designated outside companies as "operational service providers" rather than as
oil producers, those companies paid a lower-than-normal 34 percent income tax (PDVSA 2005b; Manzano and Monaldi 2010). PDVSA ultimately entered into thirty-two OSAs with twenty-two separate companies, including many large IOCs (Manzano and Monaldi 2010).

For the third and final element, PDVSA and outside companies researched risk- and profit-sharing agreements (RPSAs) for investment in high-risk blocks (only a few of which received offers). The thirty-nine-year RPSAs set a baseline 16.67 percent royalty rate and conventional income tax rate of 66.67 percent; contract provisions allowed for a reduction in the royalty depending on the rate of return. PDVSA had the option to purchase up to a 35 percent stake in the project if a company discovered commercial quantities of oil in the exploration phase, but the outside company would retain majority control (EIA 2009a). The RPSAs also included an additional contractual government-take fee.

The apertura-era contracts were in many respects successful. Foreign investment in Venezuelan oil skyrocketed from $619 million in 1995 to $4.4 billion in 1999 (Monaldi 2001). Most of this investment was for AAs and OSAs rather than for RPSAs. As Nolan and Thurber (Chapter 4) show, the skills of the IOCs in managing challenging projects created a special interest in high-risk (and high-reward) frontier operations such as in the Orinoco.

Despite their pro-investment effects, the apertura-era contracts stoked political controversy much like the internationalization strategy the decade before. Some scholars lambasted the contracts for reducing the share of revenues given to the Venezuelan state (Mommer 2004); these criticisms became particularly biting once oil prices rose in the early 2000s and as technology lowered production costs. Other critiques centered on the legality of the contracts and their effects on Venezuela’s (politically framed) oil sovereignty. Chávez would later enshrine these criticisms into his electoral campaign and, eventually, his oil sector policy.

Amid political controversy over PDVSA’s links to IOCs, PDVSA became more like an IOC itself. In 1997, PDVSA president Luis Giusti dismantled the company’s decades-old multiple operating company framework and began to establish a vertically integrated structure to replace it (Giusti 1999). That same year, Giusti pushed through public sale of shares in PDVSA’s petrochemicals affiliate, PEQUIVEN. In 1998, the Venezuelan government—acting with PDVSA’s support—opened up domestic distribution and retail of gasoline and other oil products to competition with private companies. These moves were opening salvos in a long-term PDVSA plan to increase private sector participation in the sector. In 1999 (the same year Chávez took office), PDVSA paid for an advertisement in the Latin American edition of Time suggesting that the company’s privatization was inevitable (Tinker-Salas 2005). Chávez would later seize upon PDVSA’s moves and claim that the company was not acting in the interests of the Venezuelan state.

PDVSA’s IOC-friendly stance put it on the losing side of a larger Venezuelan debate over the country’s direction. By nearly every estimate, Venezuelan economic growth remained deeply disappointing; its late 1990s per-capita GDP was roughly the same as it had been in 1960. Poverty levels had risen significantly; economic inequalities had compounded. Though many causes were to blame (especially low oil prices, high debt, and an uncompetitive non-oil sector), critics cited Venezuela’s “neoliberal” pro-foreign investment economic model, including oil policy, as a principal reason for the country’s poor performance.

This economic critique became a leading issue in Venezuela’s 1998 presidential campaign. Chávez, a lieutenant colonel in the Venezuelan army and ringleader of a failed 1992 coup (he served two years in jail before being pardoned), ran for president on a platform of ending Venezuela’s economic malaise and poverty. Chávez denounced the country’s economic model in general and targeted PDVSA as the model’s most visible symbol; another target was the country’s entrenched, corrupt two-party political system. Thanks to his campaign message and powerful charisma, Chávez won the election with 56 percent of the vote. At his February 1999 inauguration, Chávez called on his citizens to join in a “Bolivarian Revolution” to reshape Venezuelan society (so named in honor of Simón Bolívar, the nineteenth-century South American independence leader and native of what would later become Venezuela).

2.6 Transition to firmer state control (1999–2003)

Despite his aggressive campaign platform, once in power Chávez made few immediate changes to the Venezuelan energy sector. In 1999,
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Chavez appointed oil industry expert Robert Mendini as PDVSA president and signed an investment-friendly gas hydrocarbons law. That same year, Chavez lobbied for and won ratification of a new constitution by popular referendum; it also strengthened presidential executive power over the legislature, which had been drawing down the government's political capital. Chavez approved a new constitution by popular referendum, which strengthened presidential power over the legislature.

A second wave of unrest followed in late 2002. A three-day strike at PDVSA headquarters turned into a nine-week work stoppage. Chavez's role in the strike was heavily criticized. Critics accused Chavez of using the strike to divert attention from his government's economic policies. Despite the criticism, Chavez remained popular, and his government's economic policies continued to be supported by the majority of the population.

The conflict between PDVSA and the Chavez administration took place within a context of escalating political polarization throughout Venezuelan society. The 2001 Hydrocarbons Law, which included the Ley de Fracking (Law of the Land), gave the government power to tax and seize the ownership of non-government-owned oil fields. The law was opposed by the opposition parties, who alleged it would lead to the expropriation of private lands for use in oil production. The opposition parties' claim was that the law would lead to the expropriation of private lands for use in oil production.

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2.7 PDVSA partially transformed (2003–today)

Having outlasted the coup and multiple strikes, Chávez took near-complete command over PDVSA. During early 2003, the government shed more than 18,000 of the company’s 33,000 employees. After subsequent retrenching, PDVSA lost a net 30–40 percent of its staff (derived from Mares and Altamirano 2007). The Chávez administration later shuffled PDVSA’s senior management to put close confidants at the helm. In November 2004, Chávez appointed personal friend and energy minister Rafael Ramírez to become PDVSA president (subsequently changing the company charter to make the appointments legal); Ramírez continues to hold both positions through the present day. (Iran is another country in which the NOC president has simultaneously served as oil minister. See Chapter 6.) Ramírez would later declare in a 2006 speech that the new PDVSA was “roja, rojita” (red, red – the color of socialism). 44

The newly revamped PDVSA has vastly expanded responsibilities to the Venezuelan state. Starting in the run-up to his recall referendum, Chávez mandated that PDVSA fund and manage social programs known as Misiones Bolivarianas (Bolivarian Missions). Progressive, varyingy effective, and clientelistic, the misiones promote initiatives ranging from literacy training to inner-city health care; some thirty are under way as of early 2010.43 PDVSA’s management responsibilities for its social initiatives have been, in some cases, extensive. Since 2008, for example, PDVSA’s subsidiary, Producción y Distribución Venezolana de Alimentos (PDVAL) has run a price-controlled food distribution network. The government also siphoned off other PDVSA revenues for a Chávez-controlled fund (known as FONDEN) and politically driven international assistance programs. In total, PDVSA’s spending for these non-core obligations rose from $14 million in 2002 to nearly $14 billion by 2007 (PDVSA 2009).

Moreover, the Chávez administration increased PDVSA’s stake in oil operations by rolling back the apertura-era contracts. In 2004, the energy ministry demanded higher royalty payments from the Orinoco AsEs. Companies eventually complied with the demand, though ExxonMobil initially threatened international arbitration. In 2005, the government announced that OSAs should have paid the 50 percent income tax rate for oil production (set in 2001 for new projects), instead of the lower 34 percent rate that they were paying (because of the apertura framework).

The energy ministry then declared OSAs illegal in 2006 and mandated renegotiation of contract terms with higher taxes and majority PDVSA control. In 2007, Chávez decreed the migration of existing AsEs and RPSAs to empresas mixtas (mixed companies), also with majority PDVSA control. PDVSA offered compensation to the AA contracting parties but based it on book value, rather than the typical market value (which was estimated at $10 billion higher) (Millard 2007). Most companies eventually accepted the government’s terms; ExxonMobil and Conocophillips opted for arbitration, however. PDVSA took majority control of all projects, including those for which it did not reach agreement, on Venezuelan Labor Day, May 1, 2007. (De facto, however, IOCs continued to play significant roles.)

Yet in the midst of wide-scale change, key parts of PDVSA have remained intact. PDVSA has retained its legacies from the 1980s internationalization era and existing domestic operations infrastructure. 45 In addition, most PDVSA service-related subsidiaries continue to operate largely as before. 46 And because of PDVSA’s expansive new role in carrying out state social programs, the Chávez administration has in some ways maintained PDVSA’s status as a state within a state. 47

Chávez’s partial transformation of PDVSA reflects his broader consolidation of power across Venezuelan society. Since the 2002–2003 strikes, Chávez has nationalized larger segments of the economy and taken control of the country’s supreme court, lower courts, nearly its entire legislature, and armed forces. Though his agenda suffered a setback when Chávez lost a proposed constitutional reform in 2007, he won a pared-down referendum giving him the unlimited right to run for re-election in 2009 and remains popular among a sizable (though variable) segment of society. A key reason for his popularity is the government’s extensive social spending, pro-Chávez television stations (TeleSur, VTV), Chavista community organizations (círculos bolivarianos, or Bolivarian circles), and frequent political advertising. Chávez’s source of funding for these activities has primarily come from PDVSA.

3 Explaining the state–PDVSA relationship

3.1 Natural resources: oil-dependent government, investment-dependent company

Venezuela’s hydrocarbon resources have shaped the state–PDVSA relationship in four key ways. First, Venezuela has considerable supplies
3.1.2 Costly, dirty oil

Venezuela's oil is costly to develop. The country's first commercial oil strike yielded Venezuela's first oil, and heavy, extra-heavy crude oil have dominated Venezuela's production profile ever since. Between 1950s and 1970s, Venezuela's production has grown from 500,000 barrels per day to over 4 million barrels per day, with most of its output coming from the Orinoco Belt. The high cost of developing heavy crude oil and the need for large-scale infrastructure investments have made Venezuela's oil production expensive. Moreover, the heavy crude is subject to extensive processing to make it suitable for refining.

3.1.3 Limited oil reserves

Venezuela's oil reserves were estimated at 400 billion barrels in 2018, making it the world's sixth-largest oil producer. However, the low oil prices since 2014 have reduced PDVSA's production and revenue. Despite this, Venezuela has continued to rely heavily on oil exports for its economic stability.

3.1.4 Environmental impact

The heavy crude oil in Venezuela's Orinoco Belt has a high sulfur content, which is detrimental to the environment. The processing of this oil results in high levels of greenhouse gas emissions and other pollutants. Additionally, the high cost of developing heavy crude oil has led to a lack of investment in renewable energy sources in Venezuela.
Orinoco Belt. The Chávez administration has followed a largely different path, though it, too, has been cognizant of the technological hurdles of Venezuelan oil development. The Chávez administration continued to work with IOC partners in the Orinoco Belt even at the height of its nationalistic rhetoric (and has shown greater cooperation of late).

### 3.1.3 Long investment cycles

As in many other, large oil-exporting countries, oil investment in Venezuela has followed a recurring pattern. First, the government solicits outside investment at highly favorable terms, then steadily modifies those terms to the government's advantage, and finally returns to offering better terms in the hopes of fresh investment. This pattern emerged during the 1920s and 1930s (when the Venezuelan government sought out IOCs under Vicente Gómez and became more assertive towards them once he died) and repeated itself from the late 1940s to early 1970s (when Venezuela welcomed IOC investment under the late 1940s and 1950s “fifty-fifty” profit split only to increase intervention in the sector, ultimately culminating in the formation of PDVSA). The reason for this recurring pattern is that oil development projects are mostly front-loaded, especially if the projects concern costly, difficult heavy and extra-heavy oil. Because of this cost structure, government has an incentive to make attractive offers that draw in the large initial investments and then renege on those offers once the investments are “sunk” so as to capture a greater proportion of the rents. The cycle commences again once the initial investments become obsolete. Over time, the cycle of courtship and confrontation becomes a repeated game, and both government and IOCs know how to play it; the role of NOCs, like PDVSA, in this game is dependent on their relationship to the state. (See Chapter 4 for a discussion of this dynamic in greater detail.)

The wild swing in IOC investments between the 1990s aperatura and the Chávez-era nationalizations conforms to this longer-run pattern. In the 1990s, PDVSA—which was then the de facto Venezuelan oil policymaker—lured IOCs to invest in Venezuela through the aperatura. By 2004 and 2005, most of those investments were in place. Completion of these investments, along with high oil prices, gave the Chávez administration breathing space to then undo the aperatura and give the spoils of his nationalizations back to PDVSA (which shifted, over the course of the decade, from top government policymaker to trusted government agent). Thus, the fact that Chávez reversed course of many of the aperatura policies was less surprising than the speed and rhetoric with which he did it.

Less than three years after the nationalizations of IOC investments, the cycle of Venezuelan oil investment began anew. By 2009, the Chávez administration began a rapprochement toward IOCs by holding a public auction for development projects in the Orinoco Belt. I return to the subject of this rapprochement in section 4.

### 3.1.4 Off-the-radar natural gas

In contrast to oil, Venezuela's natural gas sector is mostly unexploited, though it offers some opportunity. Venezuela's natural gas reserves, consistently among the world's top ten, grew from 1.26 trillion cubic feet (Tcf) in 1980 to 4.84 Tcf in 2007 (BP 2009a). Roughly 90 percent sits in associated fields with higher-value oil (EIA 2009a). For
that reason, the oil industry absorbs 70 percent of Venezuelan natural gas production and uses a large share of that production for reинфекtion into oil fields (EIA 2009a). Venezuela's smaller supply of non-associated gas suffers from high carbon dioxide levels, decreasing its energy value and increasing pipeline corrosiveness (Boué 1993). The high proportion of associated gas and the lower quality of non-associated gas have limited the commercial attractiveness of this sector, though it remains important for oil production, domestic consumption, and implementation of any future Venezuelan climate change mitigation strategies.

Because of these geological conditions, Venezuelan governments have embraced a planning-based approach to PDVSA's natural gas development. This approach differs by necessity from the one for oil: instead of inheriting a mature infrastructure upon nationalization (as for oil), Venezuela has, to a much greater extent, built that infrastructure from the ground up.\textsuperscript{42} PDVSA discovered major natural gas fields in 1978 (Mejillones 1) and 1980 (Patao 1) (Mallett-Guy Guerra \textit{et al.} 1993). During the mid 1980s, PDVSA constructed a gas distribution network to free up higher-value oil for export (Boué 1993). And in the late 1980s, PDVSA drew up the "Cristóbal Colón" project to develop and export liquefied natural gas (LNG) from its offshore reserves. Cristóbal Colón marked PDVSA's first effort to give IOCs equity stakes in Venezuelan hydrocarbon operations. (High costs and low natural gas prices ultimately shelved the project, however.)

The relative underdevelopment of Venezuelan natural gas has prompted even the Chávez administration to exempt that sector from heavy political influence.\textsuperscript{43} The centerpiece of this policy is its 1999 law giving private operators the right to own a 100 percent stake in non-associated natural gas projects, far greater than for oil. PDVSA may take a 35 percent share of projects that reach a commercial stage, however (EIA 2009a). Results from the law have been mixed thus far—in part because oil is the bigger prize and domestic gas prices are uncertain.\textsuperscript{44} One promising development was Spanish IOC Repsol's discovery of a large natural gas field off the coast of Venezuela in late 2009 (Repsol 2009). Less successfully, the government sought to create an ambitious (and unworkable) trans-South American gas pipeline and revive the moribund Cristóbal Colón project by gearing it toward domestic demand.

3.2 State capacity: an oil company fills the state's gaps

As Venezuela's geology has shaped its dealings with PDVSA, so has the state's administrative capacity. I make two points below. First, Venezuelan institutions have been generally ineffective in formulating oil policy. PDVSA stepped into—or, arguably, elbowed its way into—the policymaking gap, dominating oil policy between the 1980s and 1990s. In the process, PDVSA became vulnerable to claims that it was a state within a state, creating an opening for Chávez to assert control over the company. Second, Venezuelan institutions have been unable to implement tax regimes that adjust revenue intake in response to price and cost changes. Partly because of this tax framework, the Venezuelan government has had periodic quarrels with IOCs and PDVSA.

3.2.1 The missing Venezuelan state

Venezuela has historically suffered from weak institutions.\textsuperscript{45} Though Venezuela established a two-party democratic system between 1958 and the 1990s that was remarkably stable by Latin American standards, competition within that system was limited\textsuperscript{46} and the two political parties relied on oil-funded patronage to maintain power. (The country was then known as a \textit{partidocracia} (partycracy) (Buxton 1999).\textsuperscript{47}) Partly because of their low accountability, Venezuelan public institutions have been largely ineffective in providing public goods, particularly as real wages fell during the 1980s and 1990s. Evidence of government mismanagement is legion. One academic compiled a three-volume dictionary on Venezuelan corruption in the late 1980s (Diccionario de la corrupción en Venezuela 1989; Philip 1999). Since 1995, Venezuela has remained among the bottom 50 percent of countries for all six World Bank governance indicators (Kaufmann \textit{et al.} 1999–2009).\textsuperscript{48}

Like the rest of the Venezuelan administrative apparatus, oil sector institutions perform poorly. The energy ministry, which at one time was populated with capable staff (Matsuda 1997), shriveled in competence after PDVSA's 1976 formation. The Venezuelan government reduced support for the energy ministry on the belief that ownership of PDVSA diminished the need for distinct oil policy (Baena 1999b). As a result, PDVSA sapped the ministry of technical talent (in part by offering higher salaries) and weakened its administrative responsibilities.
The Chávez administration, which took power partially on a pledge to stamp out mismanagement, has made Venezuela's governance worse by entangling political goals with public administration. Since Chávez came into power, four of the six World Bank governance indicators have declined by an amount that is statistically significant (Kaufmann et al. 1999–2009). In fact, Venezuela was in the bottom-fifth percentile for most World Bank governance indicators by 2008 (Kaufmann et al. 1999–2009). Interviewees report that the Chávez administration has concentrated talent and government resources in a few institutions—including, until recently, Venezuela's tax agency (known as SENIAT) and central bank—at the cost of reduced performance elsewhere and widespread politicization (PESD Interviews). Interestingly, control of corruption has not declined significantly under Chávez according to World Bank governance indicators (Kaufmann et al. 1999–2009). Nevertheless, corruption remains rife. To cite one instance in which it has likely played a role: So many government officials and favored businesspersons, known as “bolívar barons,” purchased Hummer brand sports utility vehicles during the oil price boom of 2007–2008 that Chávez publicly asked, “What kind of a revolution is this? One of Hummers?” (Treewater 2008). Chávez later imposed a luxury tax on the vehicles.

Throughout Venezuela's storied history of government ineffectiveness, PDVSA has remained comparatively efficient. Even during the Chávez administration—a time in which PDVSA's performance has waned—the company has remained probably the most effective institution under control of the Venezuelan government.

The combination of PDVSA's strengths and Venezuela's administrative weaknesses help explain why PDVSA has dictated Venezuela's oil policy. Although Venezuelan law gives the energy ministry wide-ranging formal powers, PDVSA frequently set oil policy as a practical matter before Chávez. Oil sector development priorities, overseas investments, and IOC contract terms were all mainly PDVSA decisions. PDVSA also generally enjoyed the freedom to set its own budget (though ministries had formal oversight powers), make operational decisions, and hire and fire staff. The energy ministry periodically sought to assert greater authority over PDVSA, but those efforts largely failed. Thanks to PDVSA's organizational efficiency and enormous information advantages, the company was, until Chávez, usually able to convince politicians its oil plan was in the best interests of the country. The energy ministry, plagued by institutional failures, typically did not stand a chance.

By the 1990s, PDVSA exerted pervasive influence over the Venezuelan state. The government reduced PDVSA's tax burden even though the country was in a fiscal and banking crisis (PESD Interviews). PDVSA loaned economists to other government agencies (Matsuda 1997) and gave frequent economic advice to the government (Philip 1999). At its late 1990s zenith, PDVSA had effectively replaced the finance ministry as principal negotiator with the International Monetary Fund (PESD Interviews). The company's wide-ranging influence helped feed the political blowback during the Chávez era.

Even after Chávez transformed the company in 2003, PDVSA has remained the pillar on which government stands. PDVSA administers most of Chávez's social programs and public works projects because of its competence and large, positive cash flow (which offers an attractive and readily tapped discretionary tool for government finance that is easier to insulate from patronage-seeking legislators and sometimes-corrupt bureaucrats). In fact, PDVSA has actually taken over more administrative functions than its pre-Chávez incarnation. This time, however, Chávez, rather than PDVSA, remains firmly in control of most decision making.

3.2.2 Tax policy in a rudderless policymaking environment

The strength of the oil sector and the weakness in Venezuelan institutions has also limited the country's capacity to appropriate rents from the oil sector. The Venezuelan government, primarily through the energy ministry and secondarily through SENIAT, has long levied a combination of income taxes, royalties, and surcharges on oil companies. (PDVSA and IOCs are generally subject to the same taxes.) In practice, however, Venezuela has relied on easily administered tax schemes that favor royalties rather than information-intensive income taxes (Manzano and Monaldi 2010). These regimes are regressive in nature because they appropriate a decreasing share of rents as prices rise or as costs decline; they may also reduce the financial viability of projects as prices fall or as costs rise (Manzano and Monaldi 2010).

Venezuela's regressive oil tax framework is one reason that Venezuelan governments periodically have come into friction with the oil sector (another reason is the long investment cycles, discussed above). The most explosive of these tensions occurred during the
Chávez administration – when the government introduced the tax framework of the 2001 Hydrocarbons Law\(^\text{76}\) and forcibly renegotiated apertura-era contracts with IOCs. But these disputes are part of a long-term pattern. Tensions also flared during negotiations over the 1943 Hydrocarbons Law\(^\text{78}\) and again during the 1960s and 1970s\(^\text{79}\) (Manzano and Monaldi 2010).

3.3 State goals: major shifts over time

Probably no factor led to more sweeping changes in the state-PDVSA relationship than Venezuela's state goals. I analyze three phases of time below. First, Venezuelan politicians mostly prized long-term oil sector stability between the late 1970s and 1990s. Only occasionally did short-term political aims preempt this political consensus. Second, state goals shifted during the early years of the Chávez administration, partly because of Chávez's growing appetite for control. By the early 2000s, this shift helped provoke PDVSA's 2002–2003 strikes against the government and Chávez's wide-scale firings. Third, Chávez administration goals for the oil sector have swelled in recent years. This expansion in state goals occurred because of Chávez's increased authority over PDVSA, perceived threats to his rule, and the temptations created by higher oil prices.

3.3.1 Pre-Chávez era: stability reigns (mostly) supreme

Venezuelan politicians initially refrained from interfering in PDVSA because of the justifications behind that company's formation and its early successes. Key among the justifications for nationalization – in Venezuela and elsewhere – was that IOCs had exploited Venezuela's regulatory weaknesses to short-change the state. Nationalization, according to this view, would help reduce asymmetries because a state-owned enterprise would act more faithfully on the state's behalf than would the private sector (Mommer 2002). As a result, Venezuelan politicians initially gave PDVSA wide latitude in which to operate. Moreover, Venezuela's nationalization was regarded as successful because the newly formed PDVSA sustained oil revenues flowing to the government (helped in large part by high oil prices) while it revitalized investment in the sector. As a result, PDVSA enjoyed a “honeymoon” of sorts (Coronel 1983).\(^\text{80}\)

Even after the honeymoon faded during the 1980s, Venezuelan governments continued favoring oil sector stability because the political dynamic remained tranquil. Venezuelan presidents set policy at that time in cooperation with a small number of repeat players: leaders of two national political parties (Acción Democrática (AD) and Partido Social Cristiano de Venezuela (COPEI)) and labor and business interest groups (the legislature, by contrast, was relatively weak). In this setting, policy volatility was low, until low oil prices and new electoral rules fragmented Venezuelan politics in the late 1980s (Monaldi et al. 2008).\(^\text{81}\)

Further supporting Venezuela's oil policy was its macroeconomic environment and policies. In line with conventional Latin American thinking, Venezuelan governments embraced a policy of “import substitution industrialization” (ISI) to build up domestic manufacturing capacity. To implement ISI, Venezuelan governments relied on a steady stream of oil revenues to prop up state-run petrochemicals, steel, and aluminum industries (Randall 1987). (In accord with rentista “rent-based” thinking, policymakers viewed the oil sector mostly as a source of rents rather than as an engine of growth (Espinasa 1996).) Oil sector stability, including limited political interference, became the means to secure reliable oil revenues, even as oil prices declined during the mid to late 1980s. Although Venezuela's ISI policy eventually sputtered\(^\text{82}\) as the policy did in other countries,\(^\text{83}\) oil dollars gave Venezuelan governments the means to maintain ISI policy for longer than its Latin American counterparts. (Other Latin American countries mostly abandoned the policy during the 1970s oil crises or early 1980s debt crisis.) Not until the second Carlos Andrés Pérez administration (1989–1992) did financial strains force Venezuela to pursue a different strategy.\(^\text{84}\)

This story of limited government interference comes with significant caveats, however. First, Venezuelan politicians have for political reasons long sought to channel oil sector wealth directly to the Venezuelan populace. As in other oil-exporting states, this goal has mostly taken the form of domestic gasoline subsidies.\(^\text{87}\) Venezuela began subsidizing gasoline in the 1940s and continues to do so heavily through the present day. In fact, Venezuela's 12 cent/gallon price made it the world's least expensive by 2008 – one-fifteenth the price of a liter of bottled water (Wilson 2008).\(^\text{86}\) During the 2002–2008 price...
3.3.3 Later Chávez era (2003–present): state goals expand

In the aftermath of the 2002–2003 strikes, the Chávez administration's own state-owned oil company, PDVSA, took a more active role in the oil sector. The government increased its ownership of PDVSA and began to implement policies aimed at increasing state control over the oil industry. This included steps to increase PDVSA's capacity and efficiency, as well as efforts to diversify its operations. The government also sought to improve PDVSA's international image and reputation, with a focus on promoting its role as a global player in the oil market.

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Table 10.2. PDVSA payments to government budget, 2003–2008

<table>
<thead>
<tr>
<th>($m)</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalties</td>
<td>5,945</td>
<td>8,881</td>
<td>11,327</td>
<td>17,505</td>
<td>19,872</td>
<td>20,294</td>
</tr>
<tr>
<td>Income tax and related taxes(^a)</td>
<td>1,216</td>
<td>1,978</td>
<td>5,069</td>
<td>7,594</td>
<td>5,392</td>
<td>4,872</td>
</tr>
<tr>
<td>Dividends</td>
<td>2,326</td>
<td>1,302</td>
<td>1,317</td>
<td>1,317</td>
<td>2,658</td>
<td>2,000</td>
</tr>
<tr>
<td>Extraction tax</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>797</td>
<td>1,720</td>
<td>2,487</td>
</tr>
<tr>
<td>Export registration tax</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>76</td>
<td>54</td>
<td></td>
</tr>
<tr>
<td>Total budgetary obligations</td>
<td>9,487</td>
<td>12,161</td>
<td>17,713</td>
<td>27,213</td>
<td>29,718</td>
<td>29,707</td>
</tr>
</tbody>
</table>

\(^a\) Precise figures should be interpreted with caution because they come from two different PDVSA sources.

\(^b\) The definition of "other taxes" (treated here as "related taxes") in PDVSA (2008) (used for the 2003–2006 figures) is unclear. Based on the taxation description in that document, it appears this grouping includes the surface tax, the value-added tax, and general consumption tax. PDVSA (2009) includes no such separate category but lists surface taxes, special advantage taxes on empresas mixtas, and the "LOPTISCFF" tax. I group these under related taxes for comparability purposes.


In addition to budgetary payments, the Chávez administration has appropriated substantial revenues for off-budget, or extra-budgetary, programs.\(^7\) Among these are the Fondo de Desarrollo Nacional (National Development Fund, or FONDEN), the misiones, and other social programs. Although the process by which the Chávez administration collects extra-budgetary taxes is murky, PDVSA has published some figures on taxation amounts. The single-largest category of extra-budgetary taxes is FONDEN, totaling nearly $28 billion between 2005 and 2008.\(^8\) (The Chávez administration has dedicated FONDEN monies primarily toward infrastructure, defense, and public debt restructuring.) The next largest extra-budgetary tax is for the misiones, especially Mision Barrio Adentro (low-income health clinics) and Mision Mercal (subsidized food). The remaining two types of spending obligations are classified as other social programs (mostly community building and public works projects) and social investment trusts (which hold monies for later social spending).\(^9\) These extra-budgetary taxes began rising in 2003—immediately after the strikes and company restructuring—and swelled through 2008. In 2008, the Chávez administration passed a windfall tax (known as a special contribution) in response to high oil prices, sending $5.73 billion directly to FONDEN that year (out of $12.407 billion total).\(^9\) Table 10.3 summarizes these many extra payments.

The Chávez administration has imposed new obligations on PDVSA in part because the apertura taxes were low and oil prices had risen strongly. As a result of the apertura, Venezuela's fiscal take declined from 51 percent in the mid 1990s to around 47 percent at the time Chávez came into power (Manzano and Monaldi 2008).\(^9\) (The apertura-era contracts also had a major pro-investment effect, but the Chávez administration devalued that effect because the investments were already in place.) The Chávez administration's new budgetary and off-budget obligations reversed this slide in fiscal take. But as I suggest in the next section, the Chávez administration has consumed so many PDVSA resources that it has undercut the company's performance.

Beyond using PDVSA to help finance the government, the Chávez administration has imposed a multiplicity of national missions on PDVSA to further policy goals. Some advance the government's development and related patronage agenda—such as managing (in addition to funding) the government's misiones, procuring goods from

Table 10.3. PDVSA extra-budgetary obligations, 2003–2008

<table>
<thead>
<tr>
<th>($m)</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>FONDEN</td>
<td>0</td>
<td>0</td>
<td>1,525</td>
<td>6,855</td>
<td>6,761</td>
<td>12,407</td>
</tr>
<tr>
<td>Misiones</td>
<td>141</td>
<td>1,070</td>
<td>2,008</td>
<td>3,101</td>
<td>4,248</td>
<td>340</td>
</tr>
<tr>
<td>Social investment trusts</td>
<td>300</td>
<td>3,100</td>
<td>3,200</td>
<td>1,066</td>
<td>2,131</td>
<td>1,315</td>
</tr>
<tr>
<td>Other social programs</td>
<td>108</td>
<td>146</td>
<td>554</td>
<td>971</td>
<td>962</td>
<td>671</td>
</tr>
<tr>
<td>Total off-budget obligations</td>
<td>549</td>
<td>4,316</td>
<td>7,287</td>
<td>11,993</td>
<td>14,102</td>
<td>14,733</td>
</tr>
</tbody>
</table>

Source: Derived from PDVSA (2008, 2009). By comparison, total extra-budgetary taxes for 2001 and 2002 were $34 million and $14 million, respectively.
social cooperatives, and expanding projects in Venezuela’s undeveloped interior (PDVSA 2008). Beyond these programmatic projects, the government has obligated PDVSA to construct one-off highways, hospitals, and other public works. Moreover, the government has used PDVSA monies to capture strategic segments of the Venezuelan economy (or potential sources of political opposition); at the government’s behest, PDVSA has acquired formerly private-owned cable, electric, and agriculture entities. PDVSA has also become an instrument of Chávez’s macroeconomic policy. In late 2009, PDVSA issued bonds in part to shore up the value of the local bolívar currency. And the Chávez administration has commandeered PDVSA to serve its expansive foreign policy priorities. Oil has become both a geopolitical carrot – through discounted oil sales programs and PDVSA partnerships with NOCs from Chávez-friendly countries – and a stick – through empty threats of oil sales embargoes to the United States. Because PDVSA is Chávez’s most powerful (and now trusted) instrument, the company has become embroiled in the government’s foreign policy adventures, such as the 2007 maletínazo or valijagate (the “suitcase scandal” in which Argentine officials discovered that a businessman flying in from Venezuela, accompanied by PDVSA officials, was carrying a suitcase with nearly $800,000 in undeclared cash). I analyze the effect of these obligations on company performance in section 4.

3.4 Effect of other factors on the state–PDVSA relationship

In discussing Venezuela’s state goals, state capacity, and nature of resources, I have referenced other factors affecting the state–PDVSA relationship. Most important among these factors is the price of oil. Low oil prices and the need for new investments have incentivized the Venezuelan government to grant PDVSA autonomy. Conversely, high oil prices and established investments have given Venezuelan governments opportunities to exert greater influence over the company. Here, the Chávez administration has been no exception; his government ratcheted up fiscal pressure on PDVSA as oil prices rose and forcibly renegotiated apertura-era contracts after the IOCs had completed many of their initial investments. And since the collapse in world oil prices in late 2008, his government has given PDVSA slightly greater freedom to work with IOC partners.

4 Explaining PDVSA’s strategy and performance

4.1 PDVSA strategy: from autonomy to partial accommodation

Because of the changing relationship between PDVSA and the Venezuelan state, PDVSA’s strategy has swung from political insulation to subservience. I make two points below. First, PDVSA’s strategy from the 1970s to 1990s was to advance commercial interests and secure freedom from intermittent government demands. Second, the Chávez administration has chosen a vastly more invasive approach to PDVSA. After Chávez reshaped the company in 2003, PDVSA developed a strategy to accommodate those interventions and, at times, mitigate them.

4.1.1 Seeking autonomy (1976–2002)

Between the 1970s and early 2000s, Venezuela’s approach to PDVSA alternated between (mostly) arm’s length and (infrequently) intrusive. Venezuela generally gave PDVSA broad discretion to run its business, though politics occasionally reared its head. As a matter of law and practice, PDVSA’s corporate governance system embodied this mostly hands-off approach.

As a matter of law, PDVSA’s corporate governance system gave the company considerable managerial independence. PDVSA was subject to the commercial (rather than administrative) code and its formal relationship with the state was through shareholder meetings. Article 3 of the Nationalization Law empowered PDVSA to use the most efficient means to commercialize hydrocarbons. Article 5 of the law gave Venezuela’s congress power to review PDVSA actions affecting the national interest, but the article – at least initially – carried little force. Article 6 of the law designated PDVSA’s operator subsidiaries under the commercial (rather than administrative) legal code and designated 10 percent of PDVSA’s operator net earnings for company reinvestment. And Article 8 of the law exempted PDVSA workers from public employee restrictions. Although these articles at times provoked differing interpretations (particularly Article 5), they nevertheless set rules of the game for state–PDVSA interactions.

PDVSA further insulated itself from government interference as a matter of practice. The energy ministry had de jure authority to
approve PDVSA budgets, strategies, and goals (including production levels and capital expenditures) at annual or semi-annual shareholder meetings. De facto, however, PDVSA had considerable influence over approval decisions because of Venezuela's weak state capacity. The law gave Venezuelan presidents the power to name PDVSA's board of directors but before Chávez presidents typically named industry experts rather than politicians to those positions (Matsuda 1997). The net effect of this corporate governance system was to grant PDVSA broad autonomy over the oil sector.

Because of the government's grant of autonomy, PDVSA's strategy initially focused on commercial considerations. (PDVSA's strategy for engaging the Venezuelan government was by comparison undeveloped.) The company's late-1970s highly successful plan to increase exploration and production spending was a business response to decades of decreased investment by IOCs. In the early 1980s, oil price declines motivated PDVSA's first tentative steps overseas. PDVSA's high-cost heavy oil had become less commercially attractive relative to low-cost light crude; in a difficult price environment, PDVSA sought out overseas refining and distribution systems to secure downstream markets for its oil production.

As PDVSA began internationalizing, however, politics intruded on PDVSA's independence. The Herrera administration's 1982 taking of PDVSA reinvestment monies to relieve Central Bank strains. Later that year, PDVSA's incipient internationalization strategy came under attack. PDVSA's first deal, its 1982 joint venture refinery agreement with Veba Oel, provoked a political firestorm in part because PDVSA did not submit it to congress for Article 5 approval. The opposition-led congress then sought to derail the agreement (Matsuda 1997; Baena 1999b). Caught in the congress-government political crossfire, the agreement remained in question for roughly a year. The controversy finally dissipated once the Lusinchi administration came into power in 1984 and Lusinchi himself intervened to quell the opposition (Baena 1999b).

The combination of political threats and commercial desire for downstream markets spurred PDVSA to deepen its internationalization strategy once the political fallout from the Veba Oel deal died down. PDVSA's 1986–1990 acquisition of overseas refinery interests and its purchase of CITGO helped politically insulate company assets. By selling oil to overseas refineries, PDVSA engaged in transfer pricing that minimized the risk of Venezuelan tax fluctuations, reduced net tax burden, and financed refinery upgrades (Baena 1999b). PDVSA further reduced its payments to the Venezuelan state by investing most dividends from its overseas operations in expansion overseas (Mares and Altamirano 2007)

A similar desire for commercial success and political insulation drove PDVSA's 1990s apertura strategy for foreign domestic upstream investment. On the commercial side, domestic upstream investment became critical because of declining conventional oil fields and continued low oil prices. And politically, company management believed that it could protect the oil sector from continued state predations by signing contracts with outside companies that included extensive procedural protections (Manzano and Monaldi 2010). Although the political component of the apertura ultimately proved unsuccessful – the Chávez administration eventually rolled back the contracts – it paid off commercially.

4.1.2 Switch to compliance (2003–today)

By the early 2000s, PDVSA's autonomy-seeking strategy backfired. After PDVSA launched strikes against the Chávez administration during 2002–2003, the company created an open conflict between the NOC and the state. Chávez's victory in this conflict opened the door for a fundamental break in state–NOC relations. The Venezuelan state's approach to PDVSA flipped from mostly arm's length to deeply interventionist, and the state implemented a new corporate governance system to reflect this approach. The once-clear separation between state and NOC became blurred.

Since transforming the company, the Chávez administration has governed PDVSA through informal ties at the senior leadership level. Though much of the pre-Chávez legal formalism exists – PDVSA continues holding shareholder meetings with the state – it has become more ceremonial than before. Ramirez (as PDVSA president) submits decisions to himself (as energy minister) for shareholder approval. Because managerial and oversight roles overlap, Chávez relies heavily on Ramirez and his coterie of advisers to both formulate and carry out the government's many goals. Personality has thus, in some sense, become the basis for policy.

Because of the interventionist state–PDVSA relationship, company strategy has swung from autonomy seeking to (real and superficial)
accommodation of government demands. Though specifics are opaque, it appears that Chávez funnels his directives through Ramirez, and Ramirez, in turn, uses his own influence with Chávez to negotiate their scope (PESD Interviews). The negotiated outcome may be different from stated plans—which are part political theater——that neither PDVSA nor Chávez fully believes.

Publicly, PDVSA’s plan is named—in a nod to Uslar Pietri’s famous saying—Siembra Petrolera. Particularly before the late-2009 economic downturn, this plan was deeply infused with politics; its objectives once included socioeconomic development, regional energy integration, and creation of a multipolar international relations system (PDVSA 2008, 2009). In some ways, these objectives materially affect PDVSA’s real strategy; in others, however, they function as political window dressing.\textsuperscript{112}

Consider PDVSA’s policies in the Orinoco Belt.\textsuperscript{111} Starting in 2005, PDVSA and foreign companies from Chávez-friendly governments (mostly NOCs) conducted reserves certification in sixteen development regions, or “blocks,” within the Orinoco Belt.\textsuperscript{114} This partly cosmetic project, known as Magna Reserva (Great Reserves), supported Chávez’s geopolitical goals for the oil sector.\textsuperscript{115} (In a gross overstatement, Chávez called the project the largest “ever envisioned in Latin America and one of the most important projects worldwide” (Otis 2007).) Since 2006, Venezuela has assigned several Orinoco development blocks to Chávez-friendly NOCs, also for political reasons. Despite the grandiosity of the initial announcements, several of these assignations—at such as those to NOCs from Belarus and Vietnam—are largely superficial. Others may become significant, though questions remain. PDVSA had agreed to work with Chinese NOCs in the Orinoco’s Junín 4 block (though the Chinese lack extra-heavy oil expertise) and with Russian NOCs in the Junín 6 block (though the Russians, for their part, may not have reliable funding for the projects) (Kebede 2009; Parraga 2009).

In the most promising parts of the Orinoco Belt, PDVSA and the Chávez administration have reversed course on years of confrontation by courting IOC interest. In late 2008, PDVSA launched a public auction process for minority interests in several blocks within the Orinoco Belt’s highly attractive Carabobo area. After several false starts, two consortia, led by IOCs Repsol YPF and Chevron, were awarded blocks in early 2010.

As the Orinoco Belt case illustrates, PDVSA’s underlying strategy is to marry political and commercial goals where possible (as with the Russian and Chinese NOCs) while quietly working with IOCs as necessary (as occurred in Carabobo). PDVSA’s dance of political and commercial objectives in the Orinoco Belt is the most significant element of its strategy, because of that region’s production potential. Other goals include developing the natural gas sector (in which political factors remain mostly at bay)\textsuperscript{116} and securing new refinery interests to diversify downstream markets (in which political and commercial priorities overlap).\textsuperscript{117}

Note that improvisation heavily colors PDVSA’s strategy. Because of Chávez’s impulsive governing style, PDVSA frequently reshuffles its priorities in response to new demands. And this constant retooling has taken a toll on company performance—the issue to which I turn next.

4.2 PDVSA performance: success, then decay

The changes in the state–PDVSA relationship have profoundly affected PDVSA’s performance. I argue two points below. First, limited state interference in the oil sector and the legacy assets and talents from IOC operations largely account for PDVSA’s tremendous performance between the 1970s and early 2000s. Second, the Chávez administration post-2002 interventions in PDVSA’s affairs have stymied the company. The unpredictability and weight of Chávez-imposed obligations have reduced PDVSA’s capacity to maintain and invest in operations. Moreover, Chávez’s wide-scale firings of PDVSA’s workforce have depleted its technical and managerial skill base.

4.2.1 World-class performer (1976–2002)

The hands-off relationship between Venezuelan politicians and PDVSA had a decisive effect on company performance between the 1970s and early 2000s. State interventions were infrequent, and those that did occur rarely affected how PDVSA deployed its capital or labor resources.\textsuperscript{118} Because of this autonomy, PDVSA paid its workers attractive salaries and advanced them on a non-discretionary basis (Randall 1987; Philip 1999). (PDVSA’s human resource policy was, in fact, called a “meritocracy.”) Combined with its extensive intrafirm competition and legacy assets (both physical and human capital), PDVSA fostered professionalism and commercial ambition.
In this environment, PDVSA flourished. \cite{petroleum_economist} Petroleum Economist conducted three expert polls in 1993, 1995, and 1999, and each one rated PDVSA as both the best-managed and best financially managed NOC (Petroleum Economist 1993, 1995, 1999). The combination of political insulation and a performance-oriented corporate culture transformed PDVSA into a technology leader. The company's research arm, INTEVEP, secured hundreds of patents for its innovations in instruments, substances, and equipment—the most notable of which was Orimulsion (Economides et al. 2007). PDVSA's operational data is also indicative (though not dispositive) of its performance: the company's oil production, natural gas production, and refining skyrocketed by more than 100 percent between the late 1980s and late 1990s. (Refining activities were not very profitable, however.) See Figure 10.3. \cite{4}

4.2.2 Transformation brings inefficiency (2003–present)

PDVSA's performance has waned since the Chávez administration overhauled the company in 2003. Most immediately, the firing of 30–40 percent of the company workforce depleted PDVSA's employee skill set. Those fired had an average of fifteen years of experience and included two-thirds of the company's managers and engineers (APS Review Oil Market Trends 2005; The Economist 2006). In the wake of the purge, PDVSA hired new employees—the payroll now exceeds 100,000 workers, more than twice as many as before the strike (The Economist 2010)—but many of them are inexperienced and their sheer numbers have strained company finances. Though PDVSA remains capable of carrying out most operations (and in this sense the company remains superior to the most dysfunctional NOCs), its talent stock has diminished considerably.

Moreover, Chávez's ever-changing and escalating demands on PDVSA have created uncertainty for the company. Unlike the pre-Chávez era, when Venezuelan politicians advocated a few, mostly complementary objectives, the Chávez-era goals are frequently divergent. Oil sector stability, for example, remains a Chávez administration objective, but that aim is in constant competition with—and has usually lost out to—foreign policy missions, political patronage, and other national goals. And because of Chávez's rash governing style, PDVSA's responsibilities change frequently. As a result, the company has struggled to define what its most important obligations are at any given moment.

The most debilitating of these obligations has been financial. Combining PDVSA's budgetary and extra-budgetary payments (see Tables 10.2 and 10.3), the share of PDVSA's revenues controlled by the government increased, according to its own figures, from 21.5 percent in 2003 to 45.4 percent in 2007. (This share dipped to 35.2 percent in 2008 as company revenues and costs escalated during the early mid-year oil price spike.) The jump in government take occurred even though PDVSA's own revenues rose on the strength of rising oil prices. Furthermore, the government has appropriated between 85 percent and 100 percent of PDVSA's revenues net of costs and expenses since 2006. \cite{4} See Table 10.4 for more information. PDVSA has to some extent compensated for the weight of these obligations through bond issues, but its efforts have been insufficient: Partly as a result of revenue shortfalls, PDVSA has by its own figures failed to invest sufficient resources to maintain production (EIA 2009a). Only in 2007 and early to mid 2008, when high oil prices fueled revenues, did PDVSA's core investment perhaps surpass recommended levels of $3 billion/year. \cite{4} See Table 10.5 above.

Tax uncertainty has further complicated PDVSA's ability to plan production and produce hydrocarbons. As suggested in Table 10.4 above, off-
Table 10.5. Total PDVSA investment, and investment in exploration and production, 2003–2008

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total PDVSA investment (^a)</td>
<td>1,969</td>
<td>2,960</td>
<td>3,938</td>
<td>1,748</td>
<td>9,254 (^c)</td>
<td>11,656 (^d)</td>
</tr>
<tr>
<td>Investment in exploration and production</td>
<td>1,276</td>
<td>1,912</td>
<td>2,077</td>
<td>N/A (^e)</td>
<td>4,809</td>
<td>6,986</td>
</tr>
</tbody>
</table>

\(^a\) Note 1: Actual investment refers to “cash used in investment activities” (worldwide) from the most recent PDVSA financial reports in which that data is available. Note 2: Where possible, I rely on PDVSA’s most recent report filed with the SEC.

\(^b\) Total investment excludes investment from third parties, such as *empresas mixtas*.

\(^c\) PDVSA reports actual 2007 investment as $13,187 million, but that figure apparently includes $3,933 million in “Support and Management.” I subtracted 3,933 from 13,187 because Support and Management is not found in previous financial reports and includes PDVSA’s purchase of electric companies and investments in non-core electric operations.

\(^d\) This figure excludes: 1) $1,175 million in non-PDVSA investment by *empresas mixtas*; 2) $1,258 million in non-PDVSA investment from partners in the Orinoco Belt; and 3) $1,738 million in “other” investment, much of which goes toward non-core activities like PDVSA América, PDV Naval. Because some of PDVSA’s “other” investment may go toward core activities, this figure may be a slight underestimate.

\(^e\) Based on the 2007 report, which does not break out our 2006 investment in exploration and production. PDVSA’s 2006 report lists $4,166 million for investment in exploration and production, but that figure is based on $7,205 million in 2006 total investment. Because this figure is inconsistent with the $1,748 million in 2006 total investment reported in 2007 (and on which I rely, following my decision rule above), I have left this figure blank.


Note: Amounts differ slightly depending on source. I rely on the most comprehensive source available, where possible, on PDVSA’s annual report filed with the SEC. Figures are not based on SEC fillings. Details on budgetary and extra-budgetary taxes are included in Tables 10.2 and 10.3, respectively.
obligations and state goals, PDVSA’s investment fluctuated wildly from less than $2 billion in 2003 and 2006 to more than $11 billion in 2008. See Table 10.6. Because of heavy government obligations, PDVSA’s workforce turnover, and other factors, PDVSA’s oil production has failed to recover to pre-strike levels. Keeping in mind that statistics on production are more contentious than others, PDVSA’s production conservatively fell off by 10–15 percent between 2002 and 2007, including its joint ventures with IOCs. See Figure 10.4. Increased IOC production in joint ventures partly masks the decline in PDVSA’s production. Excluding those joint ventures – and considering the company’s effort only – PDVSA’s production conservatively dropped from 2.2 million bbl/d before the strikes to 1.5 million bbl/d in 2007, a more than 30 percent decline (EIA 2009a). The reasons for PDVSA’s production fall are complex, but some part of the decline probably indicates weakening performance.

5 Conclusion

In this chapter, I argue that the relationship between the Venezuelan state and PDVSA accounts for much of PDVSA’s strategy and performance. From the 1970s to the late 1990s, Venezuela awarded PDVSA broad control over the oil sector, although periodic interventions occurred. In this environment, PDVSA walled itself off from the state and became a highly competent NOC.

After shaking up the company in 2003, the state–PDVSA relationship flipped almost completely. The Chávez administration has taken a much more obstructive role in oil sector management. As a result, PDVSA’s strategy has moved away from autonomy and toward accommodation. In particular, it has taken on many of the goals of the state, including providing a wide array of social services. As an oil company, its efficiency has declined due to the inability of senior managers to focus on oil operations and due to the scarcity of capital for investment – even with high oil prices. The purging of the company’s top ranks after disastrous strikes in 2002–2003 has further undercut performance.

Looking ahead, the global economic collapse has pulled PDVSA in competing directions. On the one hand, the late-2008 price drop

<p>| Table 10.6. Estimated actual and planned PDVSA investment, 2003–2008 |</p>
<table>
<thead>
<tr>
<th>($m)</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total PDVSA investment</td>
<td>1,969</td>
<td>2,960</td>
<td>3,939</td>
<td>1,748</td>
<td>9,254</td>
<td>11,656</td>
</tr>
<tr>
<td>Planned investment for that year</td>
<td>2,978</td>
<td>6,706</td>
<td>6,607</td>
<td>8,244</td>
<td>11,048</td>
<td>13,422</td>
</tr>
<tr>
<td>Difference between actual and planned investment</td>
<td>-1,009</td>
<td>-3,746</td>
<td>-2,668</td>
<td>-6,946</td>
<td>-1,794</td>
<td>-1,766</td>
</tr>
</tbody>
</table>

* Total investment excludes investment from third parties, such as empresas mixtas.
* As above, PDVSA reports actual 2007 investment as $13,187 million, but that figure apparently includes $3,933 million in “Support and Management.” I subtracted 3,933 from 13,187 because Support and Management is not found in previous financial reports and includes PDVSA’s purchase of electric companies and investments in non-core electric operations.
* As above, this figure excludes: 1) $1.175 million in non-PDVSA investment by empresas mixtas; 2) $1,258 in non-PDVSA investment from partners in the Orinoco Belt; and 3) $1,738 million in “other” investment, much of which goes toward non-core activities like PDVSA América, PDV Naval, because some of PDVSA’s “other” investment may go toward core activities, this figure may be a slight underestimate.
* This figure is based on PDVSA’s 2004 SEC report (published in 2006) rather than its 2005 financial report because only the 2004 report shows planned 2007 worldwide investment. The 2005 financial report shows domestic investment ($10.070 billion) only.
* PDVSA reports planned investment as $15.671 million, but that figure apparently includes $2,249 million in “Support and Management.” I subtracted $2,249 million from $15.671 million because Support and Management is not found in previous financial reports and includes PDVSA’s purchase of electric companies and investments in PDVSA América, PDV Naval, and other items.

dried up PDVSA’s (already unstable) investment budget. Partly to fill the investment gap, the Chávez administration has sought outside companies, including many IOCs, to develop the Orinoco Belt. (It has also made its books somewhat more transparent — perhaps to reassure bond creditors and potential IOC partners.) The success of this approach depends on outside company judgments of Venezuela’s reserves and its dreadful track record in contract enforcement. At the same time as PDVSA rebuilds IOC relationships, it is straining relationships with oil field service companies. Because of stressed finances (caused by both falling oil prices and government taxation), PDVSA fell nearly $8 billion in arrears to those companies by 2009 (Parraga 2010). The Venezuelan government subsequently nationalized some of their operations later that year and pledged to repay some debts.

I make no argument on whether PDVSA’s transformation has benefited Venezuelan society. The Chávez administration has captured a much higher share of PDVSA’s revenues relative to previous governments and has redirected some of those revenues toward social spending. Scholars have reached little consensus on the developmental effects of these policies.11 What is clear, however, is that Chávez’s reshaping of PDVSA has come at some cost to company performance and, in all likelihood, future revenues for the Venezuelan people.

Notes

In preparing this chapter, I interviewed eighteen individuals from PDVSA, the Venezuelan government, IOCs, academia, energy consulting groups, and non-governmental organizations (NGOs). Most interviews took place in Caracas, Venezuela during August 2006 and March 2007. A few additional interviews occurred in Palo Alto, California at later dates. To encourage openness during interviews, I have kept the names of interviewees private.

I thank David Victor, Mark Thurber, Peter Nolan, and my wife Rachel for their feedback and Ramón Espinasa and Francisco Monaldi for their incisive, detailed reviews. Thomas Heller, Noah Long, and Rose Kontak participated in and helped arrange visits to Venezuela; their perspectives were very helpful in writing early drafts of this chapter. Any errors are my own.

1 This chapter contributes to a rich literature on PDVSA. Various 1970s and 1980s works examine the Venezuelan oil sector, particularly its nationalization. Among these are Tapp (1975); Petras et al. (1977); Corro (1983); and Randall (1987). By the 1990s, scholars devoted increasing attention to PDVSA specifically. Key works include Boué (1993); Sosa Pietri (1993, 2000); Espinasa (1996); Baena (1999b); and Mommer (2002). After Chávez took control of PDVSA in 2003, a new wave of scholarship looked at the company’s transition period. These works are highly polarized — reflecting the charged political environment of the time. Major research in this vein includes Mommer (2004) and Espinasa (2006). Most recently, Mares and Altamirano (2007) and Bermúdez Romero (2004) provide historical accounts of PDVSA and examined its behavior during the Chávez era. My chapter builds upon this literature by evaluating PDVSA from its inception through the Chávez administration.

2 Answering the polls were senior-level energy specialists from financial institutions, advisers, and accounting and law firms. PDVSA won the poll convincingly in 1993 (KPC and Saudi Aramco were its nearest competitors); beat out Saudi Aramco in 1995; and edged Statoil in 1999.

3 Including the opportunity cost of Venezuela’s enormous domestic gasoline subsidy, the proportion of potential revenues controlled by the government rose from roughly 30–40 percent in 2003 to 50–65 percent in 2007.

4 The heaviness of oil is gauged by its API gravity, which measures petroleum’s weight relative to water. PDVSA classifies extra-heavy oil as having an API of less than 11 degrees; and heavy oil as having an API gravity of less than 21 degrees but greater than or equal to 11 degrees (PDVSA 2008).
5 Taxation rates slowly rose over time but higher rates applied only to new concessions.
6 Úsinar Pietri (1936).
7 Actual profit shares between the government and IOCs varied somewhat, however. For more, see Randall (1987) and Mommer (2002).
9 Note that Venezuelan governments took care not to alienate the private sector. The Betancourt administration was nationalistic, but it did not pursue nationalization and maintained a pragmatic approach toward IOCs (Matsuda 1997). The Leoni administration was more confrontational but backed off its most aggressive proposals after receiving IOC resistance (Matsuda 1997).
10 The civil-military government in power at the time issued the Decreto Sanabria raising oil sector income taxes from 28.5 percent to 46.5 percent (Manzano and Monaldi 2010).
11 Shell, however, adopted a policy of employing Venezuelan talent voluntarily (Randall 1987).
12 The term “devil’s excrement” has had impressive staying power, being used in popular books on oil dependence (e.g., Karl 1997) and a political blog (Wordpress.com blog www.devilesexcrement.com/).
13 For more on Mexico’s nationalization, see Chapter 7. For more on Venezuela’s nationalization of the iron ore industry, see Baena (1999b).
14 By providing substantial compensation, the Venezuelan government ousted IOCs “in a gentleman-like way – i.e., asking them to leave and still keep in touch” (Baena 1999b).
15 In some ways, PDVSA’s immediate post-nationalization experience mirrors that of Saudi Aramco. See Chapter 5.
16 Again like Saudi Aramco, PDVSA inherited the talent pool and capital stock of its IOC forerunners. See Chapter 5.
17 Post-1986 Corpoven was the merged entity of Corpoven and Meneven. Only the Meneven part of Corpoven came from Mene Grande, but that part dominated the corporate culture.
18 2004–present oil minister and PDVSA president Rafael Ramírez (2006b) would later use the same term to describe PDVSA’s 1990s opening to IOCs, known as la apertura petrolera.
19 PDVSA also maintained the legal status of other operating subsidiaries, like Bariven and Palmaven (even though those companies were no longer active) because it wanted to preserve flexibility for future corporate changes. PDVSA also established other types of subsidiaries, such as petrochemical subsidiary Pequiven.
20 Unlike some other NOCs, PDVSA never internationalized its upstream exploration and production activities.
21 The strategies of KPC and PDVSA contrast with the more recent upstream acquisitions of many NOCs. See Chapter 12; Chapter 18 and Chapter 14.
22 Through the Ruhr Oel joint venture, PDVSA has held 50 percent interests in four German refineries.
23 PDVSA held a 50 percent interest in a Belgian refinery through joint venture company Nynäsv.
24 PDVSA entered into a lease agreement with the Netherlands Antilles for a refinery in Curaçao.
25 Four refineries in Sweden are part of the Nynäsv deal.
26 Two refineries in the United Kingdom are part of the Nynäsv deal.
27 Venezuela’s CITGO subsidiary (discussed immediately below) owns five of the US refineries (after acquiring the Lemont refinery from another PDVSA subsidiary, Midwest Refining, in 2002). Another was owned by LYONDELL-CITGO, in which PDVSA held a 41.23% ownership interest. (PDVSA sold its stake to this refinery in 2006.) Hovensa, a joint venture in which PDVSA holds a 50% interest, owns the St. Croix (US Virgin Islands) refinery. Lastly, Chalmette Refining, a joint venture in which PDVSA holds a 50% interest, owns the Chalmette refinery. Note that ExxonMobil owns the other 50% interest in Chalmette. Although PDVSA and ExxonMobil would enter into a protracted legal battle over interests in Venezuela’s Orinoco Belt, their joint interest here – as of mid 2009 – remained intact.
28 PDVSA paid out $120 million in cash and $170 million in crude supplies for the 50 percent stake (Baena 1999b).
29 By 1999, the company had 13,000 CITGO gas stations and controlled more than 10 percent of the US market (Economides et al. 2007).
30 The opposition party Acción Democrática (AD) led the political fight against this contract.
31 Venezuelan energy minister and PDVSA president Rafael Ramírez claimed in 2006 – in a probable exaggeration – that PDVSA’s internationalization strategy transferred $14 billion in taxable assets outside the country (Ramírez 2006a).
32 This strategy was part of a broader Latin American trend toward welcoming foreign investment during the 1990s.
33 These interests took the form of profit-sharing agreements (PSAs) and operational agreements.
34 Most of the contracts gave companies the right to subject disputes under those contracts to international arbitration; the provisions called for arbitration in New York under International Chamber of Commerce
(ICC) rules. These contracts further contained *force majeure* clauses providing for compensatory damages if the state were to act in a discriminatory way (rather than of general applicability) that impeded production. And the contracts exempted the companies from regional and local taxes (Monaldi 2001).

35 However, PDVSA paid the full royalty and oil tax on the oil produced. The OSAs designated companies as "operational service contractors" rather than as oil producers even though the companies were, in fact, producing oil. Because of this classification, the OSAs exempted companies from the 1943 Hydrocarbons Law, which set forth special taxes on oil production (including a higher royalty, special rate of the income tax, and surface tax). The OSA contractual definition of operational service contractors implicated Article 5 of Venezuela’s 1975 Nationalization Law, which allowed joint venture foreign participation subject to three conditions: that 1) PDVSA “controls” the joint ventures; 2) the joint ventures are in effect for a limited timeframe; and 3) the Venezuelan congress approves their basic framework. The “control” provision of Article 5 further affected RPSAs and AAs, because those contracts permitted oil companies (which were, in fact, mostly IOCs) to take majority control of the projects.

PDVSA and the Venezuelan government took creative measures to minimize the impact from, or circumvent, these laws. To work around hydrocarbons law and the nationalization law provisions on “oil production” affecting OSAs, the Venezuelan government convinced the supreme court to interpret the laws so as to uphold the legality of those contracts. And to reduce the effect from Article 5 Nationalization Law “control” provision on RPSAs and AAs, the Venezuelan congress approved, and the supreme court later upheld, a loose definition of control. PDVSA “controlled” the joint venture according to this interpretation so long as it approved “important” decisions (even though the joint venture could make “regular” decisions by approval of a majority of shareholders) (Monmer 2002). Appendix A, Table 5.2, which shows that Venezuela’s Gross Domestic Product per capita grew poorly relative to most Latin American states between 1960 and 2000. The issue of whether Venezuela suffered a “resource curse” is hotly debated. For a skeptical view, see Rodríguez (2006).

The neoliberal prescription for economic reform called for, inter alia, reduced government spending, privatization of state enterprise, and trade liberalization. Many Latin American governments adopted neoliberalism in the early 1990s as part of the “Washington Consensus” (Williamson 2002). By the late 1990s, however, neoliberalism became a bogeyman among the Latin American left, including in Venezuela.

39 PDVSA’s defenders argued that Venezuela had to shed its *rentista* model of development (using the oil sector to fund the rest of the Venezuelan economy) and instead view the oil sector as the principal engine of growth (Espinaza 1996).

40 One major change was to prohibit, at the constitutional level, PDVSA’s privatization. However, the 1999 constitution does not prohibit privatization of PDVSA’s operating companies.

41 The Chávez administration decreed this law in part because of long-standing concerns about income taxes in weakly administered states like Venezuela (Monmer 2002). (The concern was that states need company cost data to collect income taxes, which companies could more easily manipulate in weakly administered states.) But in the rising oil price environment of the early 2000s, the 2001 Hydrocarbons Law actually gave the state a smaller proportion of the total take than previously.

42 For a detailed comparison of the changes resulting from the 2001 law, see Espinaza (2001).

43 Ship captains in the state-owned oil fleet and dockworkers later joined in the strike.

44 See www.youtube.com/watch?v=dXpbT7Fhwa. Ramirez is also vice president of Chávez’s political party, the Partido Socialista Unido de Venezuela (PSUV). This combination of roles is unprecedented in Venezuela’s history.

45 For discussions of the misiones, see Penfold-Becerra (2007); Ortega and Rodríguez (2008).

46 PDVSA management contemplated selling off CITGO in 2003 but decided against it. In 2006, PDVSA sold off its Texas-based Lyndell-CITGO refinery; most outside observers believe this sale occurred for business rather than ideological reasons (PESD Interviews).

47 Although some social development-oriented PDVSA subsidiaries have sprouted up, their long-term significance is unclear. These new subsidiaries include PDVSA Industrial (“PDVSA Industrial,” designed to manufacture consumer products such as shoes and clothing); PDVSA Agrícola (“PDVSA Agriculture,” aimed at harvesting food); and PDVSA Desarrollos Urbanos (“PDVSA Urban Development,” designed to assist in home construction).

48 Indeed, PDVSA has become known as an *estado paralelo* (parallel state).

49 Note that the growth in Venezuelan oil reserves is partially illusory. Venezuela discovered some new reserves, mostly in the eastern part of the country during the 1980s, but some of the growth resulted from Venezuelan political decisions to reclassify (and third-party decisions to accept reclassification of) already known supplies. PDVSA and the
Venezuelan government carry a long tradition of reserves overstatement, having done so in the late 1980s and early 1990s (Boué 1993) and again during the Chávez administration. The reasons behind reserves overstatement have been to increase Venezuela's influence within OPEC, financial creditworthiness, and (especially during the late 1980s and 1990s) OPEC production quotas. Many other oil-exporting governments have engaged in similarly creative reserves accounting.

This figure is based on purchasing power parity (PPP) estimates. Although long-term trends are quite stable, the yearly figures are subject to considerable variation, especially in the case of contribution government revenues and GDP.

This strategy contrasts with the approach taken by Venezuelan governments between the 1950s and early 1970s, which imposed escalating tax and local content obligations on private companies in the oil sector. By the mid 1970s, these companies mostly expected nationalization to occur.

Venezuela's dependence on oil exports has also led the government periodically to seek control over oil prices and, as a consequence, oil sector production plans. This desire for control is a principal reason that Venezuela first promoted cartelization among oil exporters in the 1940s and co-founded OPEC in 1960. After that time, however, middle Eastern countries with larger oil reserves and closer affairs largely overshadowed Venezuela within OPEC, and Venezuela's enthusiasm for OPEC has waned. (Further eroding Venezuelan support was the formation of PDVSA—which often disagreed with OPEC policies.) By the early 1990s, PDVSA advocated Venezuelan withdrawal from the organization (Boué 1993; Philip 1999). Venezuela became the second-worst cheating OPEC member between 1992 and 2001 (behind only Qatar, whose oil output was only one-fifth of Venezuela's) (Molchanov 2003).

This situation changed markedly under the Chávez administration. Venezuela – along with Mexico and Saudi Arabia – led efforts to cut OPEC production since 1998 and has remained an OPEC enthusiast and an oil price hawk ever since. Not coincidentally, the Chávez government's price hawkishness dovetails with PDVSA's diminished capacity to produce oil, which is explored in more detail below.

As of 2007, the average API gravity of Venezuelan oil fields was less than 20 degrees, heavy by international standards (EIA 2007).

Even during these early years, however, Venezuela was the world's leading heavy oil supplier (Boué 1993).

Venezuela has four traditional sedimentary basins for oil production: Zulia; Oriental; Barinas–Apure; and Falcón (these basins do not include the more recently exploited Orinoco Belt). The Barinas Basin is located in the south-central part of the country, in an area historically known for cattle production. Although the basin showed some promise in the 1990s, its production remained minor – 2.6 percent of total – during the 1990s (PDVSA 2008). The Falcón Basin, near the northwest coast of Venezuela, has minimal production and has very little potential (Boué 1993).

57 The most common production process in Venezuela is “cold” heavy oil production which uses horizontal well and multilateral wells. Estimates of Venezuelan production costs differ because of changing input prices and technological developments. A recent estimate of production costs in Venezuela's extra-heavy Orinoco Belt is $15–20/barrel (Centre for Economics and Management 2007). Production costs for conventional oil projects are, by comparison, somewhat lower but difficult to obtain because a common proxy for production cost – oil company threshold decisions – includes taxes and other considerations.

58 Extra-heavy oil contains several environmental harmful contaminants, including sulfur, nickel, and vanadium, that require treatment and disposal (Neff and Hagemann 2007). Another by-product of upgrading is petroleum coke. Thermal power plants can use petroleum coke for power generation but it is very carbon-intensive. In April 2010, Venezuela entered agreement with China to develop extra-heavy oil in the Orinoco Belt and to build three thermal power plants that would run on petroleum coke (Carlisle 2010).

59 The motives behind PDVSA's 1980s internationalization strategy remain hotly debated. For more on the argument that PDVSA internationalized to secure downstream markets for its heavy oil, see, e.g., Espinosa (2006). Boué (2002), among others, counters that PDVSA could have ensured revenue stability through hedging on capital markets rather than through internationalization and argues that a primary motive behind internationalization was instead to avoid tax liability and Venezuelan government interference.

60 At the time, extra-heavy oil was not easily convertible into conventional oil.

61 This strategy had the side-benefit of circumventing (already partially ignored) OPEC production quotas because Orimulsion was not classified as conventional oil (see EIA 2007).

62 Some pre-nationalization development had occurred, however. Between 1945 and nationalization, IOC's shifted natural gas production from flaring toward reinjection and feedstock use for petrochemicals (Boué 1993). And in the 1960s and 1970s, Venezuela established gas pipelines in the Andean, Central-Western and Eastern regions (Mallet-Guy Guerra et al. 1993).

63 Taking over existing oil operations is much less expensive than developing new natural gas operations.
64 Several IOCs bid for exploration blocks auctioned in 2003 but later blocks received less interest. Part of the reason for uncertainty is that the law requires operators to sell some natural gas domestically, but the domestic sales price is uncertain. Note that even in investor-friendly Brazil, it has proved difficult to encourage private exploration and production of gas due to high exposure to local price regulation and long payback times for gas infrastructures (Chapter 12). In addition, the Chávez administration also supported PDVSA's construction of pipelines internally and between Venezuela and Colombia; these pipelines are mostly for natural gas re-injection. The Venezuelan government plans to reverse the course of the Venezuela-Colombia pipeline in the future after it has further developed its natural gas reserves (EIA 2009a).

65 The reasons behind Venezuela's institutional failures are mostly beyond the scope of this chapter. See Karl (1997) for more discussion.

66 See Monaldi et al. (2008) for discussion.

67 As Venezuela transitioned from military rule to democracy in 1958, the major Venezuelan political parties agreed on a power-sharing agreement known as the Pact of Punto Fijo (named after a Venezuelan home in Caracas where party leaders met). This pact served as the basis for Venezuelan democracy through the 1990s. Although puntufismo provided stability to the Venezuelan political system, it enshrined a system of clientelism and marginalized third-party competition. See, e.g., Myers (2000); Hellinger (2003) for general discussion. Note that public participation in the Venezuelan political system broadened somewhat in the 1980s because of decentralization reforms (Naim 2001).

68 The six indicators are: 1) voice and accountability; 2) political stability and absence of violence/terrorism; 3) government effectiveness; 4) regulatory quality; 5) rule of law; and 6) control of corruption.

69 These four indicators are: 1) voice and accountability; 2) political stability and absence of violence/terrorism; 3) regulatory quality; and 4) rule of law. The word “significantly” refers here to statistically significant change.

70 In the case of voice and accountability, Venezuela has fallen from the bottom 50 percent to bottom 30 percent of countries.


72 They are known as “boli-bourgeois” because of their wealth and at least public commitment to Chávez’s Bolivarian revolution.

73 The energy ministry had two types of formal powers to control pre-Chávez PDVSA: 1) to formulate energy policy under the Oil Nationalization Law and 2) to control PDVSA through its authority as state representative in shareholder holdings (in which the state was, of course, the only shareholder). Here, PDVSA lost out in the drafting of the Oil Nationalization Law. AGROPET had advocated giving ministerial rank to the PDVSA president (so that the PDVSA president would answer only to the Venezuelan president) but the law did not incorporate its position (Matudos 1997). Note that the nationalization process stripped the oil ministry of its pre-nationalization power to serve as sole oil sector supervisor (Baena 1999a).

74 The only real exception to this pattern was in the Herrera administration (1979–1984), when budget pressures and ideology prompted the government to temporarily wrest budget control and administration for itself. That moment did not last.

75 Other factors facilitated PDVSA's pre-Chávez control over oil policymaking. From the time of PDVSA's first president, Rafael Alfonzo Ravard, PDVSA leadership enjoyed close relationships with the Venezuelan executive. These personal relationships – themselves a product of appointment decisions reflecting the importance of PDVSA to the Venezuelan economy – allowed the company to largely circumvent energy ministry interference (Coronel 1983). Partly because of its successful nationalization experience, Venezuela also had a strong political norm of oil industry non-interference, especially between the late 1970s and early 1980s. And legal questions over the limits of government authority also gave PDVSA greater policymaking space.

76 Note that other countries with even fewer institutional resources have had greater success in implementing a progressive oil tax system. Perhaps part of the reason of Venezuela’s lack of success is a self-ingrained belief in its institutional inabilities.

77 Staffed with critics of the pre-Chávez Venezuelan oil tax structure like Bernard Mommer, the Chávez administration shifted a greater proportion of the tax burden from income taxes to royalties. This shift made the oil tax scheme easier to administer but also less progressive (Manzano and Monaldi 2010).

78 At that time, the Venezuelan government transformed existing oil concessions into new concessions based on a “fifty-fifty” revenue-sharing model.

79 During this time, the government steadily increased its fiscal take.
Carlos Andrés Pérez sided with PDVSA, rather than with the energy ministry, in awarding PDVSA jurisdiction to manage the Orinoco Belt. He also gave PDVSA the power to reorganize its newly absorbed petrochemicals industry (Matsuda 1997). Congress was similarly restrained, holding few hearings on the oil sector (Matsuda 1997).

These changes include: 1) direct elections for governors and mayors starting in 1989; and 2) a 1993 shift in the legislative electoral system, from pure proportional representation to a mixed-member system of personalized proportional representation (Monaldi et al. 2008).

State-run enterprises became inefficient and often corrupt; for a brief time, the government operated a dog track (Philip 1999).

Possible exceptions include Brazil and Mexico, where large internal markets created more favorable conditions for ISI. See generally Silva (2007).

The Lusinchi administration (1984–1989) also faced strains because of falling oil prices but largely maintained spending because it believed low oil prices would recover. By the time Carlos Andrés Pérez (or CAP) came into power, the problems became great enough (as did the need for IMF conditionality requirements for financing) that the government instituted significant economic reforms. Interestingly, CAP had presided over the expansion of the state during his first term and then reduced its size during his second term.

This goal differs from the tax-and-redistribute features of ISI policy because the oil sector distributes oil resources directly – mostly to car owners – rather than through the government.

In January 2007, Chávez announced that domestic fuel prices would rise, but in April 2007 the legislature decided that the government would not raise prices in the short term.

The government then compelled PDVSA to use some of those monies to purchase public bonds from a bankrupt bank.

When the Persian Gulf War (1990–1991) created demand for Venezuelan oil, the government and IMF entered into an agreement whereby the government agreed to divert windfall oil revenues in return to IMF financing. However, the government spent much of the oil revenues and ultimately compelled PDVSA to transfer monies to make up the shortfall (Baena 1999b). Further economic troubles during the second Carlos Andrés Pérez administration (1989–1992) prompted the Venezuelan government to significantly cut PDVSA’s budget and halt investment plans (Mares and Altamirano 2007).

In 1979, the government issued a decree rewriting PDVSA’s corporate governance rules to exercise greater control over the company. Then, the government and left-wing politicians put political pressure on PDVSA to postpone a 1979–1980 Orinoco Belt development plan in which US construction company Bechtel served as technical adviser (the project later ended for unrelated reasons) (Matsuda 1997).

Ideology played some role, however. Critiques of PDVSA by Bernard Monmer and other left-wing academics, by this time members of the Chávez administration, also informed Chávez’s views.

For a detailed account of Chávez’s personality and biography, see Marcano and Tyszka (2006). Note that some of Chávez’s more public outbursts may in fact be carefully staged.

Foreign companies operating in the Orinoco Belt paid a lower rate through 2004.

As oil prices rise income taxes have become an increasingly important source of revenue.

Extra-heavy oil projects once paid a lower 34 percent rate.

These programs are extra-budgetary because the congress does not approve them as part of its formal budget.

In March 2009, PDVSA president Ramirez raised eyebrows by claiming that FONDEN had accumulated $57 billion, a number that is almost certainly an exaggeration (Minuto 59 2009).

Included in these trusts are monies for the Fondo para el Desarrollo Económico y Social del País (National Economic and Social Development Fund, or FONDESPA).

The rate of 50 percent applies to the difference between the actual average of the Venezuelan basket and the reference price of $70. If the price goes above $100 the rate applicable to the difference is 60 percent.

Monmer (2002) points out that the Venezuelan government suffered a long-term decline in its share of PDVSA oil income between 1981 (when the share was 71 percent) and 2000 (when the share was 39 percent). Although non-regressive tax frameworks are one part of the explanation for the declining share, rising costs (as Venezuelan oil became increasingly heavier) were another important cause. See Dunning (2008) for further discussion of changing fiscal takes in Venezuela over time.

Note that this effect is not universal. To some degree when prices were low, e.g., in 1998, the government has put pressure on PDVSA to compensate for lower government revenues. Whereas when revenues were large, e.g., in the early 1980s, PDVSA was able to invest even beyond original plans.

The government granted PDVSA permission to keep these export earnings in dollar-denominated accounts overseas. The purpose behind this provision was to give PDVSA greater flexibility to make international payments (Matsuda 1997).
In fact, PDVSA managers initially lacked an effective government strategy. Accustomed to working with foreign corporate management, PDVSA at first struggled to communicate effectively with politicians. Matsuda (1997) cites one instance in which politicians asked PDVSA managers not to use graphic presentations in a briefing session because the politicians had difficulty understanding them.

PDVSA sometimes carried out internationalization on behalf of (rather than to avoid) the Venezuelan government. One reason that PDVSA entered into its joint venture arrangement on the Caribbean island of Curacao is because the Venezuelan government was concerned about the political stability of the nearby island (Baena 1999b).

The 1983 Veba Oel deal took place the year after oil prices fell, creating an incentive for PDVSA to secure markets for its high-cost oil. (The same logic drove PDVSA’s later internationalization decisions, too.) However, some scholars reject the argument that PDVSA began its internationalization process for commercial purposes. Mommer (2002) points out that the company’s first foreign refinery, in Germany, has never refined extra-heavy crude; it refines instead PDVSA’s smaller supplies of light oil, which are more easily marketable.

PDVSA’s internationalization strategy differs strongly from the strategies of other NOCs seeking to hedge downstream oil market risks. Some, like Pemex, bought oil futures on the open market (Boé 1993). Others, like Saudi Aramco, entered into netback contracts with separately owned refineries (Baena 1999b).

Another reason for transfer pricing to the refinery network overseas was to finance the investments required to upgrade and make adequate these refineries to intake larger quantities of the extra-heavy and sour Venezuelan crude. These refineries at the time of purchase were not fit for taking full amounts of Venezuelan crudes.

An alternative explanation for why PDVSA did not remit significant dividends to Venezuela for its US subsidiaries is because Venezuela and the United States did not have a double tax treaty (Mares and Altamirano 2007). Note also that oil sales to overseas refineries helped PDVSA evade OPEC-set production quotas (Baena 1999b). OPEC quota evasion was possible because those quota restrictions arguably bound exports rather than production. Under this interpretation, PDVSA refineries could produce from non-Venezuelan sources without regard for quota restrictions. The Oil Ministry, by contrast, argued that OPEC quota restrictions affected all of PDVSA’s production (Baena 1999b).

Pre-Chávez shareholder meetings were often also for show, but Chávez has erased the fiction of energy ministry supervision.

These links have remained strong thus far. Ramírez’s power has not threatened Chávez partly because Ramírez presents himself as a technocrat with little political ambition. Long-standing ties between Ramírez and Ali Rodriguez, another Chávez confidant, have helped cement the Ramírez-Chávez friendship (Bodzin 2009).

For more on Chávez’s use of public pronouncements to enhance his image, see Marciano and Tyszka (2006).

For example, the company also has specific growth targets, but like other elements of PDVSA’s formal strategy, those targets appear probably not credible. In 2008, PDVSA envisioned increasing production from an EIA-estimated 2.7 million barrels in 2007 (1.5 million under direct management) to 5.8 million barrels per day by 2012 (4 million barrels per day under direct management) (PDVSA 2008; EIA 2009a). PDVSA’s real strategy is likely more modest.

PDVSA’s approach to procurement embodies the same differences between government goals and reality. Formally, the company has initiated a program to incentivize procurement from social cooperatives known as Empresas de Producción Social (EPS, or social production companies). In accord with Chávez’s development and/or patronage goals, the EPS program is designed to democratize oil wealth. Evidence of EPS cooperatives actually carrying out work for PDVSA, however, is minimal. PDVSA continues to rely on traditional suppliers for the vast majority of its contractor services and in early 2009 suffered major disputes with them.

The Oriente Belt consists of twenty-eight total blocks, divided into four areas: Ayacucho, Carabobo, Boyacá, and Junin.

These goals include: 1) building ties with NOCs from Chávez-friendly governments; 2) increasing Venezuela’s OPEC production quotas (which are based on reserves) and therefore its influence within OPEC; and 3) increasing Venezuela and PDVSA’s standing within the financial community by using booked reserves as a measure of creditworthiness. A PDVSA newsletter states that Magna Reserva would contribute to the “creation of a multipolar world” (PDVSA 2006b).

In keeping with this strategy, PDVSA signed contracts for development of two liquefied natural gas (LNG) plants in March 2009 (Watkins 2009).
117 Government foreign policy objectives have strongly influenced PDVSA's choice of new refinery locations (including Brazil, Cuba, China, Jamaica, and Nicaragua). Announcement of these refineries serve short-term, political needs, but actual project implementation – which depends on hard-nosed commercial calculations by PDVSA – is up in the air.

118 Key exceptions, noted above, were PDVSA's 1982 joint refinery agreement with Veba Oel and its 1990 acquisition of CITGO's remaining shares.

119 Chávez heavily criticized PDVSA's compensation levels during his 1998 presidential campaign. Before the strikes, young executives made $30,000–45,000 per year and top executives took in more than $250,000 per year (Miller 2002). Even after the strikes, however, PDVSA salaries have nevertheless remained attractive by Venezuelan standards.

120 The company remained highly efficient virtually from the time of nationalization until Chávez reshaped it in 2002–2003. External assessments of PDVSA's performance before the 1990s are less available, however.

121 PDVSA also boasted of having lower operating costs than IOCs in the later 1990s (PESD Interviews). Operating costs, however, are only a partial measure of performance, as geologic, geographic, and other factors substantially influence them.

122 An ideal analysis would compare government obligations to PDVSA rents, but the latter figures are not available. Export figures might approximate rents, but exports include some oil production that is refined and other production that is not; therefore I take the rougher approach above.

123 If the estimated opportunity cost of Venezuela's domestic gasoline subsidy is included, this figure rises even higher: the proportion of PDVSA's potential revenues (including the subsidy) controlled by the government rose from roughly 30–40 percent in 2003 to 50–55 percent in 2007.

    Exact figures are omitted because the confidence in this estimate is low. Venezuela's domestic gasoline subsidy costs PDVSA roughly $10–20 billion/year, but accurate time-series data is not available.

124 One estimate is that PDVSA needs to spend $3 billion/year to maintain production at existing fields (EIA 2009a). This figure is a crude estimate only because it does not reflect changes in costs.

125 Exact 2006 figures are unavailable but must be below $3 billion because total investment was only $1.748 billion.


127 The government directs most of its extra-budgetary funds to specific beneficiaries, who may lobby for continued spending on extra-budgetary programs like the misiones. The lobbying power of these beneficiaries is questionable, however, because they are widely dispersed, generally poor, and support the current government.

128 PDVSA's 2007 reported investment is even higher but includes monies used for the purchase of Venezuelan electric companies. PDVSA reports actual 2007 investment as $13,187 million, but that includes $3,933 in “Support and Management” I subtracted 3,933 from 13,187 because Support and Management is not found in previous financial reports and includes PDVSA's purchase of electric companies and investments in non-core electric operations.

129 Part of the reason for this persistent shortfall is that planned investment figures were probably unrealistic even at the time PDVSA made them.

130 Many of Venezuela's fields outside the Orinoco Belt are very mature and therefore declining as part of the ordinary hydrocarbon production process. Moreover, several of Venezuela's fields were damaged because the 2003 PDVSA strikes – because of sabotage by disaffected workers on strike (an argument made by Chávez supporters) and improper reactivation by unskilled PDVSA workers in the wake of the strike (an argument of Chávez detractors).

131 For discussions of the misiones, see Penfold-Beccera (2007); Ortega and Rodriguez (2008). Note also that these extra-budgetary social programs have reduced the accountability of traditional Venezuelan political institutions.