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## CONTROL OVER NATURAL RESOURCES AND TRADE: THE VENEZUELAN EXPERIENCE

*Luis Xavier Grisanti\**

The nationalization of the oil industry in Venezuela cannot be regarded as an isolated event. For an industry that provides more than seventy percent of the government revenues, more than ninety percent of the foreign exchange earnings and accounts for thirty percent of the gross domestic product, nationalization could not have been an act of adventure but an act of great responsibility. The final take-over of the industry was the logical outcome of a set of policies that fitted an overall strategy of control initiated during the 1945-48 Administration of President Rómulo Betancourt and Development Minister Juan Pablo Pérez Alfonzo. However, the basic legal framework with which the mineral resources were to be exploited had been established earlier through Simón Bolívar's 1829 decree. The decree granted to the state the sole ownership of mines and "juices of the earth." This same concept was later recognized by the Hydrocarbons Law of 1920 which stated: "The right of exploitation does not confer any ownership of the mine . . . nor does it constitute any division of such ownership which is inalienable and inprescriptible."

STEPS LEADING TO THE LAW OF  
AUGUST 29, 1975

In essence, Venezuela has nationalized her mineral resources since 1829. As a consequence of this inalienability of ownership, a system of concession was devised to grant individuals or companies the right to

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exploit the hydrocarbon resources. Other laws and measures which set the stage for the final take-over of the industry were:

(1) The Hydrocarbons Law of 1943 which established reversion of concessions within forty years, set royalties and introduced the Income Tax Law applicable to the oil companies;

(2) The amendments to the Income Tax Law in 1948 establishing the 50-50 profit sharing principle based on market prices dictated by the oil concessionaires. The Income Tax Law was amended again in favor of Venezuela in 1958, 1966, 1970, 1971 and 1975. The income tax rate reached seventy-two percent of the reference price set by the government in 1975. This rate was about ninety percent and more of the market prices;

(3) The creation in 1960 of the Venezuelan Petroleum Corporation and the sponsoring of the formation of OPEC;

(4) The introduction of tax reference values or reference prices for oil in 1966, devised to calculate income tax revenues of the government through bilateral consultations between the latter and the oil companies. Until then, export prices were dictated unilaterally by the oil companies;

(5) The Law of 1970 authorizing the executive branch of government to set the reference values unilaterally, an initiative that emanated from the Venezuelan Congress and which had great historical significance to Venezuela and OPEC as all member countries adopted it later. Until then, no individual country or group of countries had experienced the right to set the prices of their raw materials. In Venezuela, some believe that this decision was "de facto" nationalization;

(6) The Reversion Law of 1971 designed to assure the continuity of the industry once concessions expired in 1983. Under this law, all plants and equipment as well as all material assets in general would revert to the nation in 1983 under proper operational conditions; and

(7) The Law Reserving to the State the Industry of Natural Gas of 1971, and the Law Reserving to the State the Domestic Products Market of 1973.

The ultimate decision, however, came a year later, in 1974. Only days after taking office, and a few months after OPEC's realignment of oil prices, President Carlos Andres Perez announced his government's decision to nationalize the industry, and proceeded to appoint a Presidential Reversion Commission of more than 100 high officials from industry, Congress, government, political parties and academia who were in charge of drafting the Nationalization Bill. Once the Commission submitted the draft, it was introduced by the President to Congress in March of 1975. And on August 29 of that same year, after an intensive legislative process and debate, Congress passed the Law Reserving to the State the Industry and Commerce of Hydrocarbons. The law called for the

creation of Petroleos de Venezuela, the state-owned holding company of the industry and set January 1, 1976 as the official date for the transfer of the industry to the state. On that date, Petroleos de Venezuela assumed full responsibility for the supervision, planning, control and coordination of fourteen subsidiaries that were the former Creole (Exxon), Shell, Texaco, Gulf and others.

#### THE ROLE OF PETROLEOS DE VENEZUELA, S. A.

Administratively, Petroleos de Venezuela has a board of directors comprised of a president, vice-president, nine directors and five deputies. In turn, relations with the affiliates are carried out by coordinators in charge of exploration, production, finance, refining, storage and transport, domestic marketing and human resources.

The administrative and operational structure of the affiliates has been kept fairly intact, although some changes are taking place as a result of a policy of consolidation and rationalization. The tax structure and paying mechanism was maintained with only a minor reduction designed to accommodate the ten percent net income fee that the subsidiaries have to pay by law to Petroleos de Venezuela.

#### COMMERCIALIZATION CONTRACTS AND THE NEED FOR MARKET DIVERSIFICATION

Before the nationalization, Venezuela signed two-year renewable commercialization contracts with the former concession holders. Nevertheless, Petroleos de Venezuela has followed an aggressive policy of market diversification aimed at finding new customers and reaching the final users of the oil, thus minimizing the use of intermediaries. In 1976, about twenty percent of the 2,150,000 barrels exported daily were sold to new clients. In 1977, this figure increased to twenty-five percent or 500,000 barrels per day which were sold to about fifty nontraditional customers, including about 100,000 barrels per day to state oil companies.

It is worth pointing out that this policy does not imply neglecting traditional customers. On the contrary, the policy stresses the importance of reaching the traditional final customers through more direct sales.

#### TECHNOLOGICAL ASSISTANCE CONTRACTS AND THE NEED TO BE MORE SELF-SUFFICIENT

Technical assistance contracts were also signed with the foreign oil companies. These two-year renewable contracts, approximately thirteen initially, provide the industry with special assistance in fields that range from exploration to human capital formation.

The majority of the contracts contemplated the payment of a fixed fee of twenty cents per barrel for the first two years. Some of the contracts which expired at the end of 1977 have not been renewed. As it stands today, contracts have been renewed with Exxon, Shell and Gulf, while negotiations have continued with Mobil and new contracts may be negotiated with Texaco and Chevron.

Petroleos de Venezuela and the Ministry of Energy and Mines have followed a policy of constant improvement of the terms, conditions and effectiveness of the contracts through thorough evaluations of the services rendered. As a result, the new contracts signed have included a five percent reduction in the per barrel fee vis-à-vis the 1976-77 contracts and the foreign companies' agreement to share the technological services with some or all of the nationalized operators. This pooling of know-how provided by the foreign companies will avoid duplication of services and permit a sort of "horizontal integration" of the services supplies to the industry.

In the long run, Petroleos de Venezuela through its Research and Development arm — the Venezuelan Institute of Petroleum Technology (INTEVEP) — expects to generate most of the technology and expertise needed. Currently, the Institute possesses 230 highly able professionals involved in various projects.

#### PRESENT AND FUTURE TASKS OF THE INDUSTRY

The nationalization process has proceeded rather smoothly. Nevertheless, the industry is currently launching a far-reaching revitalization scheme that includes all facets of the industry. A \$20 billion investment plan for the next ten to twelve years has been formulated and is presently being executed.<sup>1</sup> This figure is about twenty times higher than the total net book value of the assets of the industry at the end of 1975 which, incidentally, was used as the basis for compensation of the concessionaires. The investment is expected to address some of the industry's most urging needs which are as follows:

#### *Reserves and Exploration*

At the end of 1977, proved reserves were placed at 17.9 billion barrels with a reserve-to-production ratio of about twenty years at current production levels. However, some twelve billion barrels more are expected

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1. The figure is also 7.4 times larger than the new investments in fixed assets of the 1966-75 period prior to the nationalization. The amount of investments for that period was \$2.7 billion.

to be recoverable from known existing oil fields by applying techniques of secondary and tertiary recovery. Therefore, Venezuela has proved and semi-proved reserves of thirty billion barrels.

An area of possible reserves is the Venezuelan Continental Shelf — an almost unexplored territory of 500,000 square kilometers. Based on geological extrapolation of surrounding known land areas and discounted probability factors, generally light oil reserves of at least ten billion barrels, and possibly forty billion barrels, can be found there. Exploratory drilling in the Continental Shelf will be concentrated in Golfo Triste, Golfo de La Vela (off the western coast) and the Orinoco Delta. Drilling efforts are also being focused on Lake Maracaibo and the Barcelona and Maturin Basins.

All these exploration initiatives are taking place within the context of a policy aimed at finding new light oil reserves. The need to find new light oil reserves stems from the composition of proved reserves. Of the 17.9 billion barrels of proved reserves, only seventeen percent or three billion barrels are light oils, twenty-eight percent or five billion barrels are medium oils and fifty-six percent or ten billion are heavy oils. On the other hand, the composition of production is just the opposite. In 1976, production of light oils amounted to thirty-five percent, medium oils were thirty-eight percent and heavy oils, twenty-seven percent.

There is a high probability that there will be light oil reserves in the areas mentioned above. Exploratory drilling expenditures have increased sharply in order to accomplish this goal. In 1976, they were \$112 million; and for 1978, \$255 million have been assigned to that objective. These expenditures are in strong contrast with the \$10-15 million yearly average of the 1959-75 period.

Another effort is being made by Petroleos de Venezuela to correct the disparity between the composition of reserves and the composition of production. A policy of attracting heavy oil clients has translated into the execution of contracts in 1977 for the sale of 60,000 barrels of extra heavy oil. Furthermore, the change in the refining structure actually in progress will result in more heavy oil processing capabilities, as will be discussed later.

#### *The Orinoco Petroleum Belt*

In the area of possible heavy oil reserves, Venezuela has the Orinoco Petroleum Belt. Estimates of reserves have ranged from 700 billion to two trillion barrels of oil *in situ*. However, none of the estimates should be considered final. In fact, a thorough geological survey of this extensive territory (600 kilometers long and 40-80 kilometers wide) has not been made. Vast areas remain unexplored even though existence of the belt

has been known for forty years and production of the Morichal-type heavy oil has been flowing for years in southern Monagas State.

The giant reservoir contains extra heavy oils — highly sulfurous and highly viscous — which would have to be upgraded in order to make it a profitable medium or light oil suitable for conventional refineries. Heavy crude from the Orinoco Belt was sent to Japan to be tested by Exxon's "flexicoking" upgrading method and the results have been satisfactory. No major project is being executed at the moment. However, offers for the development of the Orinoco Belt have been received from Japan, France and other countries.

Today, extracting, producing, upgrading and refining the extra heavy oil is economically feasible and will become more so as prices rise and technology advances. Nonconventional oils will definitely play a more important role in supplying future energy needs. Currently, Canada's \$2.1 billion, 125,000 barrels per day first commercial-scale oil sands extraction plant in the Athabasca region is almost completed and synthetic crude oil from the Athabasca tar sands will start flowing in June 1979. The Athabasca oils are similar to those of the Orinoco Belt, and a cooperation agreement between Petroleos de Venezuela and Canada has already been established.

#### *The Change in the Refining Structure*

The 1.5 million barrels capacity of Venezuela's refineries was built by the foreign oil companies to process light and medium oils that would satisfy the residual fuel oil market of the Eastern Atlantic Coast of the United States. For many years, Venezuela supplied most of this market. Today, Venezuela sends directly, and indirectly, through Caribbean refineries 900,000 to one million barrels of crude oil and products per day. By the end of 1977, Venezuela was supplying about thirty-four percent of the residual market of the Eastern Coast. Nevertheless, the disparity between the compositions of reserves and production mentioned before has made it necessary to change the refining structure of Venezuela. Actually, Venezuelan refineries yield sixty percent of residual fuel oils and nineteen percent of gasolines as opposed to U.S. refinery yields of forty-five percent gasolines and only ten to eleven percent of residual fuel oils.

A \$1.63 billion project to increase the product yield is being carried out at the moment, and once completed, will result in greater heavy oil processing capabilities and higher gasoline yields will help to alleviate a booming domestic demand for oil products, particularly gasoline, which takes up one-half of the 250,000 barrels consumed daily in Venezuela. Furthermore, domestic demand for petroleum is rising at ten to fourteen

percent per year and is expected to reach some 500,000 barrels per day in 1985.

### *The Case of the Domestic Pricing Structure*

A domestic pricing structure which is far below international price levels aggravates the domestic consumption problem. As internal demand increases and less oil is exported, revenues from diverted exports decrease with negative consequences to the profitability of the industry. This subsidization of the domestic market will have to be corrected in the future.

### *Consolidation and Rationalization*

Ever since the nationalization, Petroleos de Venezuela has been conducting a policy of consolidation of the affiliates. The consolidation process decreased the number of affiliates from fourteen to seven. The smaller units report to the larger ones and the latter, in turn, report to Petroleos de Venezuela. Further consolidation is forthcoming.

I do not want to end this tight review of the industry without a word on human resources. At the end of 1977, there were 24,574 trained and well-experienced professionals. At the time of nationalization, more than ninety-five percent of the 23,500 personnel was Venezuelan, including a president of the second largest oil company, Shell (now Maraven), several vice-presidents and directors. The existence of such an efficient team of human resources was, perhaps, the major contributing factor in the success of nationalization.

### CONCLUSION

The policies outlined here constitute the basic factors in order for Venezuela to continue as a reliable and secure supplier of fossil energy resources to the United States, its main client, and the rest of the world.

I hope this presentation will demonstrate how a developing country can successfully manage and operate a complex, dynamic capital and highly skilled labor-intensive industry, the size of the Venezuelan petroleum industry.