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Powering up: Latin America's energy challenges: oil and twenty-first century socialism in Latin America: Venezuela and Ecuador

Report

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Oil and Twenty-First Century Socialism in Latin America: Venezuela and Ecuador



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Hugo Chavez, since first becoming president of Venezuela in January 1999, has pursued an active and influence-seeking foreign policy, involving both oil and non-oil aspects. He has clearly aimed to enable Venezuela to ‘punch above its weight’ internationally and has succeeded, at least for now. Chavez’s name recognition internationally is probably higher than any Venezuelan since Bolivar. He has played a leading role in a significant process of political realignment in both OPEC and Latin America as a whole, significantly reducing the diplomatic isolation of Cuba, and has become a significant thorn in the side of the US government. Ecuador’s Rafael Correa, more recently in power and president of a smaller country, has been something of a lieutenant to Chavez though occasionally taking a different line on particular issues.

VENEZUELA AND ECUADOR: THREE DIMENSIONS OF OIL POLITICS

Both governments have adopted politically striking domestic resource-rent policies. They both have to satisfy domestic electorates which in both countries – and particularly Venezuela – are acutely aware that national oil wealth exists and whose expectations of redistribution are high. Yet it is not at all easy to turn oil revenue into sustained development or even to raise standards of living for the majority of the population. The failure of their predecessor governments in these respects played a major part in the rise of Chavez and Correa in the first place. Voters, unhappy with the performance of a series of governments, turned to more radical figures out of a deep sense of frustration. Since then Chavez, in particular, has been the unexpected beneficiary of much higher oil prices since 2004 and he has proved a determined redistributor of income and wealth. Correa has had less money and less time in office, but he has moved policy in a similar direction. Both figures have benefited from the perception, which is not without foundation, that they have sought to use these resource rents for the benefit of the majority of their populations and that they are less socially exclusionary than their predecessors.

At the same time, both countries face specific domestic and external challenges in their oil sectors. The Venezuelan and Ecuadorian economies depend heavily on oil and gas exports, which provide the material foundations for both their foreign and domestic radicalism. In terms of export income, Venezuela and Ecuador are the most oil dependent countries in the

region, with the corollary that they are the least dependent on the performance of their non-oil economies. Worryingly, though, Venezuelan oil and gas exports are currently in decline, partly as the result of long term trends and partly because of Chavez's style of government. Ecuadorian oil exports are not really in decline in the same way but they are likely to grow only slowly while domestic consumption may grow faster. Some 40 percent of Ecuadorian oil is now consumed domestically and the figure for Venezuela is nearly 30 percent. Domestic prices are very low in both cases and some oil listed under 'domestic consumption' may well have been smuggled to Colombia, whose oil consumption appears suspiciously low, and also to Guyana. International oil prices have risen significantly in the past decade, which has more than offset –for now at least – the consequences of stagnant or falling production. These issues point to a important and growing area of vulnerability in both countries.

A key question, for the future, therefore, is whether stagnant oil production represents Chavez's and – to some extent – Correa's feet of clay. Although the statistics are to a degree opaque, it does not appear that Venezuela has sufficient financial resources to cope with low oil prices without hardship. This potential vulnerability seems even greater in the case of Ecuador, which is a dollarised economy that has recently defaulted on part of its government debt. The Stalinist system relied on by the Cuban authorities to cope with the politics of economic decline in that country does not seem available to either Chavez or Correa, who risk electoral defeat if economic setback impacts on their domestic popularity – as to some extent it seems bound to do. At the very least, Chavez may have to scale down some of his international ambitions if the Venezuelan economy turns down, especially since there is no strong evidence that these international ambitions are popular within Venezuela itself.

OIL PRODUCTION IN VENEZUELA AND ECUADOR

This pattern of broadly stagnant oil production and declining exports is overwhelmingly not the result of any shortage of oil reserves. The main factor is an insufficiency in the quantity and quality of investment. Private investment has been held back, in part, by widespread distrust of the transnational oil companies that dominated the world oil industry up until the 1970s and who still tend to be viewed as 'imperialists'. This is so despite the fact that the big US companies such as Exxon-Mobil no longer play much of a role in either Ecuador or Venezuela. It is true that there is a major lawsuit between the Ecuadorian government and Chevron to do with ecological pollution in Amazonia but Chevron is no longer a current producer in Ecuador either. In fact, the international oil market has deconcentrated to the point that oil producing governments face a significant range of choice in the companies with which they wish to deal. The issue of 'oil imperialism' – real enough in much of the twentieth century – is therefore less salient than it was. Even so, foreign- and particularly US-owned oil companies remain unpopular.

More importantly, PDVSA – Venezuela's state owned oil company – has tended to under-invest and is increasingly subject to day-to-day political considerations. It seems to have failed to establish mutually-respectful relationships with the specialist oil technology companies that do much of the actual work of oil exploration and abstraction. In 2009 there were several high-profile conflicts involving the Venezuelan governments and some of these specialist contractors who claimed that they had not been paid for many months. Some of these were nationalised but it is not clear how this will solve the problem.

This is a relatively new issue. Prior to the arrival in power of Chavez, successive Venezuelan governments allowed a high degree of public investment managed by a largely autonomous PDVSA. Indeed there was a widespread feeling in Venezuela that the autonomy of the state company PDVSA had gone too far. It is noteworthy that in the Venezuelan elections of 1998 both Chavez and Miguel Rodriguez, a market-reforming independent presidential candidate, both pledged to restrain the state company.

Reining in PDVSA made good political sense but there was a management problem. State oil companies find it difficult to prevent clientelism, politicisation and performance problems. This is not a universal truth since some state oil companies have markedly better records than others, but PDVSA has certainly lost efficiency since Chavez took office. This is largely because it lost a great deal of its human capital following the anti-Chavez strikes of 2002 and 2003.

Overall, Venezuelan oil production has fallen considerably since peaking in 1970. Continuing population growth makes the tendency even more pronounced in per capita terms and rising domestic consumption has also cut into the remaining export surplus. While there is some dispute over what Venezuelan oil production currently is, the lower estimate (IEA 2010) is that production fell to around 2.2 million barrels per day in late 2009. If one takes this figure as accurate then per capita Venezuelan oil exports in volume terms amount to no more than 15 percent of what they were when production reached its all-time high in 1970. Furthermore there has been little if any real increase in Venezuelan non-oil exports in the intervening period. This is partly because of the 'Dutch disease' effect of higher international oil prices leading to an over-valued domestic currency, and partly because of worsened diplomatic relations with both Colombia and the United States. If, as is possible, problems with electricity supply impact significantly on the aluminium-processing industry during 2010 then these, too, will further reduce Venezuela's non-oil exports.

A further factor holding back production in Venezuela has been OPEC-mandated restrictions. These impact to some extent on Ecuador but matter much more in the case of Venezuela. They can of course be seen as part of a potentially worthwhile trade off between lower production and higher prices. There has indeed been a considerable increase in international oil price levels since the beginning of the 1970s when Venezuelan oil production peaked. Several Venezuelan

governments, including Chavez, have played an active part in achieving this by helping to engineer international production cuts at critical times. However if currently high international prices are not sustained, Venezuela seems acutely vulnerable.

The Venezuelan government has recently responded to its chronic lack of investment by seeking to attract capital from newcomer companies. It is too early to say whether this policy will prove successful. The amount of investment now required to turn around the oil industry is very large and lead times in the sector are quite long. Even so, fresh sources of foreign capital are probably Venezuela's last chance to avoid really serious economic problems in the medium-term.

Ecuador faces a different set of policy dilemmas. Its oil production has increased unevenly since it first became a significant oil exporter in 1972. Pipeline construction and maintenance have been key to this process since most of the country's oil reserves lie to the east of the Andes. Today, Ecuador has two pipeline systems – one built in the early 1970s and the other started operations in 2003 – plus a spur line that connects Ecuador with Colombia. It is unlikely that an extra pipeline complex will be built anytime soon, as a result of which potential oil production growth is limited. Meanwhile domestic oil consumption is continuing to increase.

Much of Ecuador's oil production is in the hands of the state oil company but the technical capacity of this company is limited. The most significant oil politics in Ecuador comes from the 'traditional' situation in which the host government seeks to improve its share of the gross revenues earned by private companies. This is, in principle, quite an old story and a usual one among the vast majority of oil exporting countries. It does however seem that Correa has played the role of revenue-maximising host government quite skilfully in the short term. He was able in most cases to change the legal terms on which the companies worked from concessionaires (who might have a legal claim to the oil resources themselves) to subcontractors, simply rewarded for work put in. He did this by using the diversity of private operating companies to pressure them sequentially and prevent a united front from forming. Moreover, by threatening a windfall tax of 99 percent on concessionaire profits, he was able to make the idea of service contracts relatively attractive in comparison. What he has not been able to do, though, has been to attract any significant fresh foreign investment into the oil industry. Production has started to tend downwards as a result.

Ecuador has however floated the idea that the international community should compensate the government for agreeing not to allow oil or mining investment into areas of natural beauty inhabited by indigenous peoples. It is estimated that there are some 850 million barrels of oil located under the Yasuni National Park. The Ecuadorian government has asked for a kind of rental from aid donors in return for not drilling in the area. While not completely rejecting the idea, the main donors (mostly European governments) have been prepared to offer much less money than the Ecuadorian government was expecting. Disappointment with the progress of these negotiations led to the resignation of the Ecuadorian foreign minister in January 2010.

Meanwhile indigenous groups have taken legal action against Chevron for compensation as a result of environmental damage in the course of oil extraction. There has certainly been such damage, and large sums of money are in contention, but the company denies liability and the case is currently continuing.

VENEZUELAN NATURAL GAS

One possible way of increasing resource income would be for Venezuela to develop its gas reserves. These, like its oil reserves, are abundant and there is no problem with OPEC quota restrictions. However, what has held Venezuelan production back has been the unwillingness of its potential partners to enter into long term commitments with Venezuela in view of the heavy financing costs that these imply and the resulting political risk. During the Chavez's presidency, there were negotiations involving Shell and Mitsubishi over the so-called Mariscal Sucre LNG project but the private companies eventually pulled out over disagreements about financing. Subsequent negotiations between PDVSA and Petrobras over the same project also failed. The official reason given in the latter case was that Petrobras was unwilling to agree to devote as much of the project to providing gas cheaply to the domestic Venezuelan market as Chavez had wanted. However, the dramatic nationalisation of Brazilian gas interests in Bolivia in 2006 – for which the Brazilian authorities mostly blamed Chavez – may have been a factor in discouraging the Brazilians from committing large financial resources to Venezuela.

In 2006 Chavez also proposed an enormous trans-hemispheric gas pipeline to take gas from Venezuela to Brazil and Argentina but this too was abandoned due to a lack of support from Brazil, which blamed financing difficulties. In fact, despite Venezuela's abundant supplies of natural gas reserves and genuine willingness to develop them, the only significant gas project completed under Chavez has been a pipeline through which Venezuela has been importing gas from Colombia. Venezuela remains interested in developing LNG capacity and there remain some possibilities in that regard.

VENEZUELAN OIL DIPLOMACY: OPEC AND ALBA

There is a marked and dramatic disjunction between this rather downbeat picture of Venezuela's oil and gas production and the remarkably effective international diplomacy pursued by Chavez. There are some different facets of this diplomacy. Some of it is markedly driven by ideology, such as the close relationship with Cuba, Bolivia and the FARC in Colombia. The latter is essentially secret but was important enough to underlie a serious war scare with Colombia at the end of 2009. At the other extreme is Petrocaribe, which is 'ideology lite' and whose seventeen members include the vast majority of countries in Central America and the Caribbean. There are only a few notable non-members including Trinidad and Tobago which has oil production of its own.

Petrocaribe is an elaboration of the San Jose Pact, originally agreed between Mexico and Venezuela in 1980, according to which these oil exporters provided oil at subsidised prices to the oil importing countries of Central America and the Caribbean. Petrocaribe was set up by Venezuela in 2005 and in its present form it is an arrangement by which Venezuela provides oil at concessionary rates to Petrocaribe members, with the concessionary element mainly comprised of extended terms of credit at very low interest rates. Although there are some variances, most arrangements require importers to pay 65 percent of the cost of oil imports reasonably promptly and the rest within 25 years at 1 percent interest rates. Cuba is the most important single beneficiary of the arrangement but total exports to the region have been estimated at some 300,000 barrels per day. This is a significant but not enormous resource cost and gives Venezuela some 'soft power' with which to compete with the US in influencing small countries whose diplomatic role is based on the fact that they can vote in international organisations.

Venezuela's role in ALBA in 2004 is more overtly political and clearly represents an attempt to use the oil weapon to enhance Venezuela's diplomatic profile. Chavez originally proposed ALBA as an alternative to the 'free trade of the Americas' initiative led by the US government. Initially the only members were Venezuela and Cuba. It was not initially formally organised, instead taking the form of a kind of club made up of left-of-centre governments. In 2008, though, ALBA set up a bank (mainly financed by Venezuela) that afforded soft loans to member organisations. ALBA membership then extended to a number of small countries in the Caribbean as well as to Bolivia and Ecuador. At the end of 2009 ALBA members acted as a group to make their views heard at the Copenhagen conference on global warming.

CONCLUSIONS

Chavez's occasionally wild flights of rhetoric should not obscure his commitment to organisation and his talent for using broad issues to win and reinforce diplomatic support. There is little doubt that he finds participation in international politics rewarding for its own sake, but it may also be that he looks for international support as a means of influencing the political process within Venezuela itself. Chavez narrowly survived a coup attempt in 2002 and he is not the only political leader to hope that international backing may protect him from internal enemies –however questionable this may appear in practice. Whatever his motives, he does see himself as the leader of some kind of anti-US coalition and has been able occasionally to embarrass the US government even without causing much lasting damage. He has done this at a financial cost that up to now has seemed affordable.

Nevertheless, although 'twenty-first century socialism' may be bold it is precariously based. There is a case that Venezuelan oil and gas production faces a prospect of declining export revenue, which Chavez's international showmanship is obscuring rather than resolving. ■