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How Will New Tariffs Affect Venezuela's Oil Industry?

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Q and A: How Will New Tariffs Affect Venezuela's Oil Industry?

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On April 21, Venezuelan President Hugo Chávez announced drastic changes to windfall oil tax rates, hiking the tax from 60 percent to 95 percent when oil prices surpass $100 per barrel. The new legislation also raises the taxes to 80 percent when oil prices are between $70-90 per barrel and 90 percent when prices are between $90-100 per barrel. The government has since sought to reassure investors, saying that companies will only pay the higher rates after they recoup their original investment. How are the new taxes likely to affect investment in the country's oil sector in the short- and medium-term? How will the taxes affect the development of Venezuela's Orinoco belt? Are Chávez's social spending projects, funded with oil revenues, achieving lasting results?

A: Gustavo Coronel, former member of the board of directors of PDVSA:

"The new Venezuelan oil tax was to affect all companies producing oil in Venezuela but was rapidly modified to include only Petroleos de Venezuela and its partners in joint ventures, excluding those foreign companies initiating projects in the Orinoco region, any incremental production generated during 2010 and the oil exports to China that are in payment of the Chinese loans. The new tax, therefore, will be applied to about one million barrels per day of oil production. The big losers are, of course, the state-owned petroleum company and its foreign partners in the joint ventures. The major impact of this new tax will be political, designed to show the government as obtaining maximum benefits for the nation. Hugo Chávez is already campaigning for re-election in December 2012. A second effect will be the loss of autonomy of Petroleos de Venezuela. The new tax intensifies the direct transfer of oil income to the central government, leaving the company with little money for investments. This is tragic for a company that keeps getting into new debt. The third effect will be to increase the reluctance of foreign companies to invest in the country. All in all, the short-term financial benefit that can be obtained from this new taxation is clearly offset by its detrimental effects in the long term. Social projects that should have been generated by oil income are nowhere to be seen in a country where promises have replaced deeds."

A: Juan Pablo Fuentes, economist at Moody's Analytics:

"A recently announced increase in the windfall oil tax is another example of arbitrary policymaking by the Venezuelan government. Since the early 2000s, the government has used revisions of the legal framework for the oil industry to advance two clear goals: obtaining control over all oil-related operations and increasing the industry's tax burden. Unsurprisingly, the result has been disastrous for Venezuela's oil industry. Output has declined consistently in recent years despite record high oil prices. The government seems to be genuinely concerned about falling oil output and is aggressively pursuing new investments to develop the Orinoco Belt. Despite some concessions and high global oil prices, international oil companies (including state-owned companies) have remained cautious about investing in Venezuela. The latest increase in the windfall tax will only make investors more reluctant. Some of the new Orinoco projects were already in doubt due to PDVSA's inability to finance its share. The windfall tax increase might effectively kill some of those projects, even though the government offered them temporary exemptions from the increase. In any event, the windfall tax hike will further delay development of the Orinoco Belt. The main victim of the tax increase is PDVSA, which will suffer a measurable drop in revenues, further eroding its finances. This will make it harder for PDVSA to invest in new projects as well as to maintain existing oilfields. PDVSA's ability to fund social programs will also decline. In essence, the government is transferring that responsibility, at least partially, to the development fund, Fonden. The increase in the windfall tax will provide President Hugo Chávez with about $12 billion in additional revenues this year. These resources will fund higher levels of government spending on wages, imports and some infrastructure projects designed to boost Chávez's reelection chances in 2012."

A: Boris Segura, economist at Nomura Securities International Inc.:

"This changed oil taxation in Venezuela is likely to have a lasting impact on the private sector's willingness to invest. The new sudden profits tax represents yet another change in 'the rules of the game' in the oil sector, which is likely to have a chilling effect on private investment in the sector, especially at a time when the authorities are putting pressure on minority partners to increase investment and production. This new tax regime practically borders on confiscation once oil prices surpass $70 per barrel. These tax changes are particularly relevant to the development of new heavy oil projects in the Carabobo/Junin areas. As there are very costly investments (basic infrastructure, upgraders, etc.) that run in the billions of dollars, the unpredictability of the basic investment conditions are likely to make it more difficult for minority partners to justify allocating resources to new investments in Venezuela. The jury is still out on the effectiveness of President Chávez's social programs. However, this latest tax change is explicitly devised to allow the authorities to do away with oversight on the use of public resources, displaying a worrisome lack of transparency. As such, the Fondo de Desarrollo Nacional (Fonden) provides plenty of discretion to the authorities in deciding how to spend the revenues it holds that otherwise would have to go into the official budget. More importantly, Fonden captures revenues from PDVSA before they make it into the budget, so as to avoid sharing them with the states and municipalities."

A: Carlos Bellorin, petroleum analyst at IHS in London:

"The new 'special contribution' (SC) as it is known, also set in $70 per barrel as the ceiling for the calculation of royalty, extraction tax and import registry tax payments for companies liable to pay the SC and established a 20 percent rate on the difference between the price of the value of the Venezuelan hydrocarbon basket as established in the Annual Budget Law (currently $40) and $70 per barrel. The first tier ($40-70) is the regressive part of the SC which commences to be progressive after price breaks up the $70 per barrel barrier. Although progressive in nature, the biggest chunk of the SC is payable when prices are between $70-90 because the base is larger than the second tier ($90- 100) and mostly likely to be larger than the third one (greater than $100), even though the rates are higher when prices are higher. The effect on investments is still to be assessed when the Ministry of Energy and Petroleum issues a resolution in order to help in the implementation of the SC, defining the parameters for 'recovery of investments' and 'incremental production,' which are essential issues to determine if a certain project is exempted from the payment of the SC or not. What can be said now is that this new levy will have a negative effect in the cost of the financing the new projects in the Orinoco Belt. This would be the most immediate effect. Existing projects in Venezuela (including the ones in the Orinoco belt) are liable to pay the SC although their 'incremental production' is exempted and new projects are exempted from this tax until they have recouped their total investments. Again, we will have to wait for the ministry's resolution to measure the full impact of the SC. It is not a secret that despite the massive amount of money received by the Chávez administration, it hasn't been able to implement any sustainable, lasting and viable social projects. I really hope that this trend changes during this new high oil price wave."

The Energy Advisor *welcomes responses to the Q&A above. Readers can write editor Gene Kuleta at kuleta@thedialogue.org with comments.*