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## Venezuela Increases Royalty Fees for Oil Drilling Greatly

Venezuelan President Hugo Chavez announced that he would be increasing the royalties the government would charge for oil drilling along the Orinoco oil belt in the country's southeast. The move surprised corporate executives who had not received prior notice of the royalty increase. A former director of the state petroleum corporation warned that oil multinationals might sue over the hike while Chavez boasted that it would add large amounts of revenue to his social-benefits programs. Orinoco project royalties go from 1% to 16.6% "There will be no more petroleum given away," announced Chavez on his weekly radio and television broadcast. The increase would strip a tax holiday that had been established in the mid-1990s to encourage the development of heavy-crude projects along the Orinoco river corridor, dropping royalties companies would have to pay to between 0% and 1%. Chavez announced an increase to 16.6%, saying it was part of "the true nationalization of the petroleum industry."

The affected projects and future operations lie in four petroblocs in the southeastern Orinoco river area Hamaca, Cerro Negro, Sincor, and Petrozuata that produce more than 500,000 barrels per day. The area has proven reserves of 235 billion barrels. Foreign companies that operate in the region include US giants Chevron, ConocoPhillips, and ExxonMobil, along with France's Total, Norway's Statoil, and British Petroleum (BP). Venezuela's Energy and Mines Minister Rafael Ramirez said the government was willing to explain but not to negotiate the tax increase with foreign partners. The tax holiday for Orinoco extra-heavy-oil ventures had allowed international oil companies for years to pay very low initial rates on output to cover high startup costs. Chavez said the 1943 Ley de Hidrocarburos fixed the royalty rate at 16.6% but the companies had signed contracts in the 1990s that gave them extraction rights at a rate of "almost zero." "There is no reason for them to continue enjoying this exception clause, applicable in extraordinary cases and for causes that don't exist anymore, if they ever existed," the president said.

The move was intended to "correct the wrongdoings we have inherited from the old PDVSA, which favored the interests of others, had no respect for the country, and was under the control of international interests," said Chavez. Companies may sue, warns ex-PDVSA director Former director of the state-owned Petroleos de Venezuela SA (PDVSA) Jose Toro Hardy said the Venezuelan government could be sued by transnational companies for the rate hike, although no lawsuits had been mentioned at the time of this writing. He said the Chavez decree contradicted measures established during the opening of oil fields in 1997, when the royalty rates were reduced. "Until that opening began, nobody had dared invest" in the region, said Toro Hardy. "It's a heavy crude and is extra heavy with lots of metallic residue, which can't be marketed without being converted into synthetic crude....If the royalty had not been reduced, those businesses and investments would not exist." Now a professor, Toro Hardy says that the royalty-rate reduction might have been ready to expire, "but when one stops respecting those agreements, one loses judicial security and the confidence of other nations and investors stop coming....This decision has made it so that judicial security disappears and it disrespects established contracts." Toro Hardy claimed that the rate hike was evidence that the government was desperate to get resources to cover the fiscal deficit. The increase could represent an increase of US\$1.2 billion of annual revenue to the government, taken from US\$6 on each barrel extracted.

Luis Giusti, another former president of PDVSA, said Chavez's move would "have an effect on Venezuela's image, which is negative and aggressive. The government is making nationalist propaganda, but it lies and distorts." Analysts told Reuters news service that the tax hike could dampen enthusiasm for new natural-gas and oil bidding rounds set for later this year. In 2001, Chavez administration plans to increase royalties on foreign oil exploration and other economic reforms led to a business-organized shutdown of the oil industry (see NotiSur, 2001-12-07). With Chavez's opposition in disarray after it failed to unseat him during an August recall referendum (see NotiSur, 2004-08-20), such economic disruption is unlikely to be repeated this year. Multinational companies react Oil corporations and oil-producing countries are both benefiting from record-high petroleum prices, with prices exceeding US\$55 per barrel at least twice in October. ConocoPhillips showed profits up 53% this quarter with revenues shooting up to US\$34.7 billion from US\$26.5 billion a year earlier. The announcement of increased Venezuelan royalty charges, however, could not have been welcome news in corporate boardrooms. On Oct. 28, US oil firm ExxonMobil said it had not been officially notified that the tax holiday for foreign oil companies working in Venezuela had ended. "Our affiliates in Venezuela have received no official notification of an increase in royalty taxes on operations there," said an ExxonMobil spokeswoman at the oil giant's headquarters in Houston. ExxonMobil said that, while it had not been officially told of the hike, it was evaluating the effects that such a decision would have on its business. The head of ConocoPhillips said he would travel to Venezuela to discuss the effect of planned tax changes that could cut the US oil and gas group's production by 7.5 million barrels a year. ConocoPhillips' operations in Venezuela's heavy-oil region make it the most exposed of its peers to the surprise decision by President Chavez to raise the royalty rate.

Oil-industry watchers believe this could be part of a trend by oil-producing countries to secure a larger share of the benefits of sustained high oil prices. In addition to changes in Russia's tax regime, there is speculation about new agreements in Nigeria, Chad, and Kazakhstan. Jim Mulva, ConocoPhillips' chairman and chief executive officer, also said his company had yet to be officially notified of the changes in Venezuela but was studying the proposals "pretty thoroughly." Mulva told investors in the last week of October, "I expect to take a trip to discuss this more, prior to the holiday season." He said the impact could cut ConocoPhillips production by about 20,000 bpd, below some analysts' estimates, though there is also concern that a new royalty regime could reduce the economic viability of other planned developments in the country. The combination of tax changes and rising costs are forcing oil companies to re-evaluate their capital-expenditure plans, despite the boost in cash flow from high oil prices. His comments came as ConocoPhillips reported a rise in net profits from US\$1.31 billion to US\$2 billion in the quarter to Sept. 30. Multinationals have a strong interest in developing projects along the Orinoco tar belt and have signed agreements with Chavez in the past to maintain access to Venezuelan fossil-fuel resources. Toro Hardy says the Orinoco region offers the "greatest accumulation of heavy-crude petroleum in the entire world." Companies have also begun exploration projects in Venezuelan waters.

[Sources: El Universal (Venezuela), The Financial Times (London), 10/11/04; El Tiempo (Colombia), 10/14/04; The Economist (London), 09/11/04, 10/16/04; La Opinion (Los Angeles), 10/16/04; BBC News, 10/11/04, 10/18/04; El Mercurio (Chile), Stratfor, 10/18/04; Associated Press, 10/19/04; The Miami Herald, 10/07/04, 10/11/04, 10/13/04, 10/15/04, 10/22/04; El Nuevo Herald (Miami), 10/11/04, 10/15/04, 10/18-20/04, 10/22/04; Inter Press Service, Venezuelaanalysis.com, 10/22/04; Notimex, 10/10/04, 10/11/04, 10/13-17/04, 10/18/04, 10/22/04, 10/25/04; Vheadline.com, 10/12/04, 10/15/04, 10/21/04, 10/25/04; Reuters, 10/11/04, 10/13/04, 10/19/04, 10/26-28/04; Spanish news service EFE, 10/01/04, 10/09-11/04, 10/13/04, 10/14/04, 10/16-21/04, 10/29/04, 10/30/04, 11/01/04; Latin America Advisor, 11/01/04]

