



**EMBASSY OF THE BOLIVARIAN
REPUBLIC OF VENEZUELA**

Nº UP 1443

Washington D.C, July 06th 2006.

The Honorable
Richard G. Lugar
United States Senate
Chairman Committee on Foreign Relations
306 Hart Senate Office Building
Washington, DC 20510-1401

Dear Senator Lugar:

With the recent issuance of the Government Accountability Office (GAO) report on the Venezuelan/U.S. energy relationship that you had requested, I thought it appropriate to write you personally to present our initial comments regarding the findings, analysis, and conclusions reached by the GAO.

Regardless of one's viewpoint, everyone can agree that the overriding theme throughout the report is the incredible importance of Venezuela, and its national oil company Petróleos de Venezuela, S.A. (PDVSA), in supplying crude oil and refined petroleum products to the United States. We are justifiably proud of the role we have in this regard.

Significantly, the report recognizes in a number of ways our commitment to maintain and strengthen this energy relationship and, indeed, to keep it separate from whatever political differences our two countries may have with one another. The question that is raised by the report, although not explicitly stated, is whether the U.S. Administration, for its part, is equally committed to the same goal. In this respect, we ourselves have questioned whether the United States treats Venezuela, and its approaches to solving problems facing it, with the respect all sovereign countries merit – particularly a country which serves such a vital role in helping to meet U.S. energy needs and a country for which the United States is so vital as its natural market for crude oil and refined products.

The report correctly noted, however, that it was not Venezuela but the U.S. government, solely for political reasons, that has discontinued the bilateral technology and information energy exchange agreement between our two countries that had been successfully ongoing for over 20 years. There have been other examples of the U.S. government's refusal to talk with us about energy matters, discussions that would only have benefited both countries. Even the one action documented by the report is a strong indication of the imposed prohibition on U.S. agencies, like the Department of Energy, to engage effectively with Venezuela. This decision by the United States has harmed the energy relationship between both countries. Ironically, it has also been a factor in helping to create "a sense" in the United States of a lack of security of Venezuelan energy supplies, when the facts are otherwise.

Significantly, the report explained that at the meeting of the hemispheric energy ministers in Trinidad and Tobago in 2004 (at which, by the way, the United States pointedly did not include Venezuela in an organizational role when Venezuela had previously played a central role in these meetings) the Secretary of Energy agreed that, as the report stated, "it was very important not to politicize the oil trade between the United States and Venezuela." Whereas we continue to want to remove politics from the energy equation, the United States, unfortunately, has acted in ways more apparent than real in this regard.

Indeed, the GAO described how U.S. unwillingness to engage in dialogue has directly hurt U.S. companies. DOE may be right in its comments that these technical exchanges and forums do not, in and of themselves, result in energy security for the United States, but they clearly are a component of overall security considerations. As set forth in the report's analysis, officials from U.S. oil companies have explained that the poor bilateral relationship between Venezuela and the United States makes it more difficult for them to compete for new investment contracts in Venezuela. In addition, the report states that U.S. companies do not even seek U.S. government assistance in negotiations and the like because it would be more harmful than beneficial given current U.S. Administration attitudes. The report demonstrates how the lack of dialogue and cooperation, which we seek and I understand you too believe needs to be restarted and, in fact, enhanced throughout the hemisphere, is impeding a more productive energy relationship between our two countries, including increased investments by U.S. companies in the Venezuelan energy sector.

Insofar, as current and future Venezuelan oil production capabilities are concerned, GAO acknowledged the unassailable fact that, regardless of the different production numbers often attributed to Venezuela, the level of Venezuelan oil exports to the United States continue at precisely the same levels as they have always been. Even if Venezuelan production were to have declined (a claim that we categorically deny), what better indication of the commitment of Venezuela to the United States as its most important customer is there than our continuing to meet U.S. energy needs while supplying less to others?.

Regarding Venezuela's current production, GAO essentially relied on the U.S. Energy Information Agency and failed to expressly note analyses of the International Energy Agency and the BP Statistical Review, both independent sources, that place Venezuela's production in 2005 at over 3 million barrels per day. As for increasing production, GAO's "concerns" really come down to little more than "investment risks" which, of course, can – and do – describe basically every production plan associated with the oil industry everywhere in the world, including the United States.

What GAO failed to explain adequately is that Venezuela has made a decision – fully in accordance with sound commercial considerations – to devote financial resources, both domestic and foreign, primarily to the development of the extra-heavy oil fields of the Orinoco Belt – and not our older, more depleted fields that, while still important and not to be ignored. When Venezuela finishes its certification process of the Orinoco Belt, more than 230 billion barrels of oil will be added to Venezuela's official proved reserves, which will make Venezuela the largest holder of oil reserves in the world, exceeding even Saudi Arabia. As *Oxford Analytica* explained in its June 2006 report, "If further upgrading investment is undertaken, Venezuela should (subject to funding, engineering, and logistical constraints) be able to increase its oil production very considerably. It has talked about total crude production of 5.8 million b/d by 2012. If this is to be achieved, most of the increase will have to come from extra heavy oil upgrading." Notwithstanding the GAO report's musings about all of the things that have the potential to go wrong, the necessary investment is planned for in PDVSA's budgets and will be undertaken, foreign investment (even if not from U.S. companies) will complement PDVSA's billions of dollars of investments, and our production will be at 5.8 million barrels per day by 2012.

A foreign country at times has trouble discerning precisely what satisfies the United States regarding actions that may be undertaken by that country. I hope you can appreciate the irony in the GAO report's seeming condemnation of the apparent diminution in PDVSA's crude oil production and the greater reliance on foreign private companies (many of which are U.S. companies) in the Venezuelan oil sector at least in the short term, when the United States is constantly telling nationalized oil companies the world over to rely more on foreign participation in their oil industries. When PDVSA did precisely that and production by foreign operators exceeded PDVSA's own production, one would have thought this development would have been viewed positively by the United States – especially when compared to countries like Mexico and Saudi Arabia where foreign participation in upstream activities are totally prohibited. Our confusion only deepens when the GAO report presents serious misgivings about a strengthened and renewed PDVSA that now is planning to produce more oil on its own, with foreign participants likely playing a smaller role.

It also bears noting that the near-destruction of PDVSA by its former employees (not the Chavez Administration) who illegally shut the company's extensive operations down during the turmoil of late 2002 to early 2003 necessarily resulted in our need to place greater reliance on foreign participants as PDVSA regained its footing and to assure that production would be restored to previous levels in a sustainable manner (which has

been the case). PDVSA restored production in only three months by the late spring of 2003 – much to the amazement of industry observers. With welcomed foreign participants, Venezuela has not only maintained production, but increased it since that time. It is somewhat surprising that this unmitigated success story was not described by the GAO in its report. Moreover, this success stands in stark contrast with the situation, for example, in Iraq where the Iraqi oil industry, under the supervision of the United States with all of its impressive talent and know-how, still has not reached the Iraqi pre-war levels of production some three years after President Bush announced cessation of major hostilities and mission accomplished.

Finally, I wish to note a serious logical inconsistency in the GAO report that goes to the heart of your initial request for a report that was set forth in your letter to the GAO of November 29, 2004. Putting aside the fact that Venezuela has never used oil as a political weapon against the United States over the entire history of the supply relationship between our two countries, including the years that Hugo Chavez has been Venezuela's president, the very basis for your letter was an expression of concern of the consequences to the United States if Venezuela were to cut-off oil supplies. In this regard, there is a significant disconnect in GAO's analysis between a described strike scenario in Venezuela causing the cessation of Venezuela's oil exports and a *purposeful* cut-off of supplies by the Venezuelan government.

The GAO could not be more clear, and correctly I might add, that in the event of a strike, for example, Venezuela would try to restore oil production as quickly as possible (as, of course, it did when PDVSA was sabotaged in late 2002, although only noted by the GAO in passing). The GAO set forth its reasoning in this respect, the merits of which cannot be questioned by any thinking person or government. As the GAO explained:

- Venezuela, like any other country that is heavily dependent on oil revenue, is likely to exert a great effort to end any severe disruption of crude oil production.
- The country's economy in general, and government revenues in particular, depend heavily on the revenues that the country obtains from petroleum production and exports.
- Oil revenues accounted for between 45 and 50 percent of Venezuelan government revenues in recent years.
- A severe drop in oil revenues for more than a few months would cripple the economy.
- Venezuelan authorities would consider a prolonged oil industry shut down as a very grave threat to the government and to the country as a whole.

Accordingly, oil exports provide the revenues to the Venezuelan government that are vital for its programs and essential to its very viability. Yet, the GAO does not even make a reference to the absurdity of a unilateral action by the Venezuelan government purposefully to cut off oil exports given the GAO's analysis of the importance of such

exports to Venezuela, and its government, whoever may be president. Similarly, no one can seriously question that a Venezuelan government's unilateral shut down of PDVSA-owned refineries in the United States would be equally absurd.

The United States is Venezuela's natural market – a point recognized by the GAO and fully appreciated by us. The long-standing energy relationship between our two countries has benefited both in innumerable ways and should do so far into the future. As any sensible supplier, we are constantly looking for new customers, as we continue to serve existing, and especially long-standing, customers. This should be no cause for alarm, however, because diversification of customers from a supplier's standpoint is no different than diversification of suppliers from a customer's standpoint.

In sum, dialogue between our two countries is vital. I know you understand this; so do we. I appreciate your consideration of the points I have raised in this letter, and I hope to be able to engage in further direct dialogue with you and the Secretary of Energy, in the weeks and months ahead.

Bernardo Álvarez Herrera
Ambassador

