

Declassified in Part - ¹NEZUELI 25X1
Sanitized Copy Approved for
Release 2011/10/31 :
CIA-RDP85T00875R00160003

Declassified in Part -
Sanitized Copy Approved for
Release 2011/10/31 :
CIA-RDP85T00875R00160003

~~Confidential~~

25X1



DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Problems Of The Venezuelan Petroleum Industry

ARCHIVAL RECORD
RELEASED TO
[REDACTED]

25X1

~~Confidential~~

ER IM 70-79
June 1970

Copy No.

54

WARNING

This document contains information affecting the national defense of the United States, within the meaning of Title 18, sections 793 and 794, of the US Code, as amended. Its transmission or revelation of its contents to or receipt by an unauthorized person is prohibited by law.

GROUP 1
Excluded from automatic
downgrading and
declassification

CONFIDENTIAL

25X1

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
June 1970

INTELLIGENCE MEMORANDUM

Problems Of The Venezuelan Petroleum Industry

Introduction

Petroleum development has provided the decisive impetus for Venezuelan economic growth during much of the post-World War II period. The industry has given Venezuela the largest export trade and foreign exchange reserves in Latin America, the highest economic growth rate, and the highest per capita income after Argentina. Since 1958, however, petroleum exploitation and general economic growth have slowed markedly because of government policies, growing competition for oil markets, and other obstacles to export expansion. Economic momentum in the 1970s will depend mainly on the government's ability both to revitalize petroleum development and to reduce the economy's heavy dependence on this one resource. This memorandum examines the petroleum industry's problems, their repercussions on the economy, and prospects for accelerated growth during the next several years.

The Industry's Deteriorating Position Since 1958

1. In 1969, Venezuela with a crude oil output of about 3.6 million barrels per day (bpd) still ranked next to the United States and the USSR as a

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.

CONFIDENTIAL

25X1

CONFIDENTIAL

producer. But the dynamism characteristic of the Venezuelan petroleum industry from 1945 through the Suez Canal crisis in 1956-57 has given way to 11 years of sluggish growth. In 1970 Saudi Arabia and Iran and in 1971 Libya will almost certainly surpass Venezuela, which will then fall to sixth place. Venezuelan output has risen an average of only 3% annually since 1958 and only 1% annually since 1964 in contrast to the 9% rate of 1946-58. World output meanwhile has risen much more rapidly than Venezuelan output, which made up only 8½% of the total in 1969, compared with 14% in 1958 (see Figure 1).

2. Venezuela's position as a petroleum exporter has suffered even more. Even though -- with shipments of about 3.3 million bpd of crude oil and refined products in 1969 -- the country still ranks first, its share of world exports has now slipped to about 15%, compared with an impressive 33½% share in 1958 (see Figure 1). Saudi Arabia, Iran, and Libya probably will soon outrank Venezuela in exports.

3. Petroleum exports to the United States, Venezuela's principal customer, have grown an average of only about 3½% annually since 1958, and exports to Western Europe (the second most important market) have declined in recent years (see Table 1). Exports to Argentina and Brazil also have slipped because they have boosted their own output considerably and have been able to get Middle East oil at lower prices. Although Venezuela and Canada are strong competitors for sales to the United States, Venezuela ironically has been able to expand exports more to Canada than to any other country. This gain was possible because, rather than building a pipeline from its western oilfields to its industrial east, Canada adopted a policy of importing oil for the eastern area and shipping the rapidly rising output of the western provinces to the United States. Growing sales of petroleum products to Japan have offset Venezuela's sales difficulties somewhat in its traditional markets.*

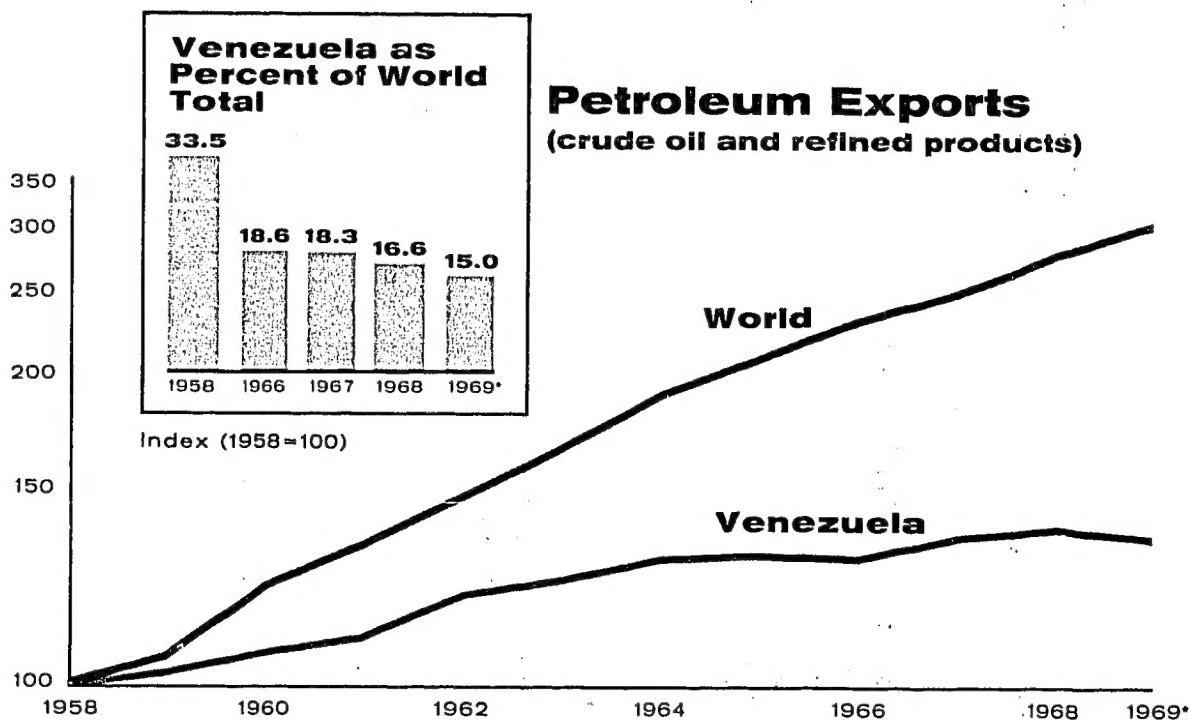
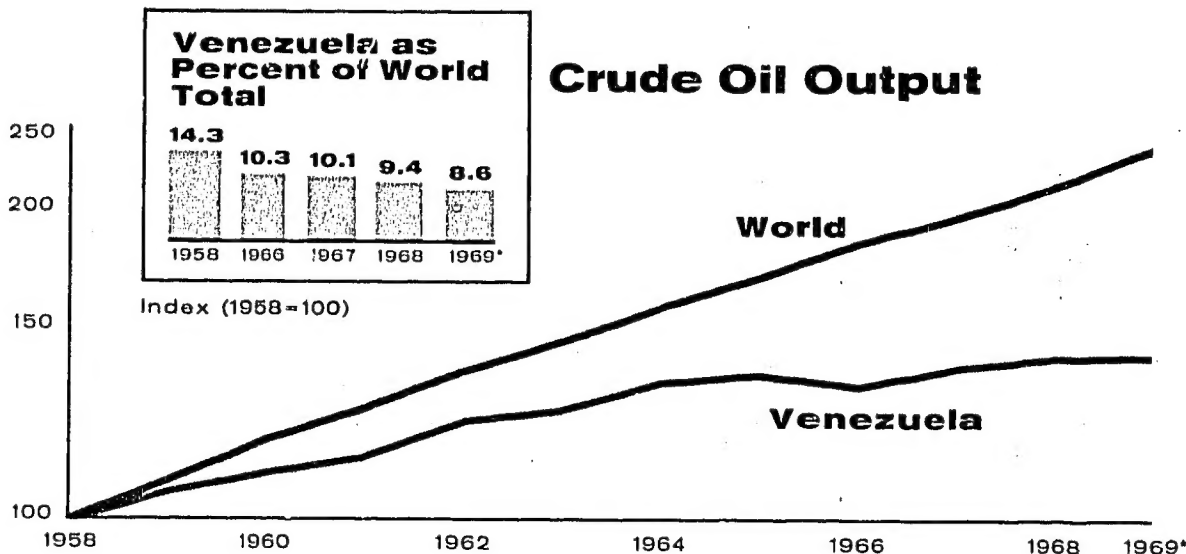
* *Venezuela plans to export crude oil to Romania during 1971-75, but the amounts are very small. The trade agreement signed in September 1969 calls for deliveries of only about 28 million barrels -- 60% less than the amount scheduled in the 1968 agreement in principle and only 2% of current Venezuelan output.*

CONFIDENTIAL

CONFIDENTIAL

Figure 1

Venezuela's Declining Position in World Oil Output and Exports



78422 5-70

*Estimated

CONFIDENTIAL

Table 1

Venezuela: Exports of Petroleum (Crude Oil and Refined Products) a/

Thousand Barrels per Day							
	1958	1961	1965	1966	1967	1968 <u>b/</u>	Jan-Sep 1969 <u>b/</u>
Western Hemisphere	1,882	1,937	2,348	2,370	2,466	2,600	2,674
Of which:							
United States (including Puerto Rico)	1,224	1,370	1,622	1,707	1,716	1,762	1,802
Canada	236	277	351	288	389	425	421
Panama	19	11	79	88 <u>c/</u>	99 <u>c/</u>	107 <u>c/</u>	N.A.
Argentina	112	68	25	16	19	19	33
Brazil	145	129	93	77	58	68	59
Europe	482	630	715	622	679	597	575
Of which:							
European Economic Community	181	236	222	208	271	211	N.A.
United Kingdom	211	244	293	230	219	222	190
Japan	0	5	41	49	68	63	40
Other countries	79	104	66	69	71	66	55
Total	2,444	2,677	3,170	3,110	3,285	3,326	3,344

a. Because of rounding, components may not add to totals shown. The data exclude exports of crude oil to Aruba and Curacao in the Netherlands Antilles and include their exports of refined products. The refineries in Aruba and Curacao are operated by Venezuela's major oil producers and process Venezuelan crude oil almost exclusively for export to the United States. Some Venezuelan crude oil also is shipped to Trinidad for refining and export mainly to the US market. These crude oil shipments are treated as exports to the United States in this table.

b. Provisional.

c. Including the Canal Zone.

CONFIDENTIAL

Causes of the Industry's DifficultiesVenezuelan Oil Policy

4. Because of the very rapid increase of lower cost petroleum exports elsewhere in the world, the growth of Venezuela's oil exports could have been expected to slow in the 1960s regardless of the government's efforts. Growth was further hampered, however, by the conservation-oriented policies of the Venezuelan government. Following the overthrow of the Perez Jimenez dictatorship in 1958 and the inauguration of Romulo Betancourt as President in 1959, the government has striven for only a moderate pace of petroleum exploitation -- and for the largest tax share compatible with it. The new policy was predicated on the assumption that petroleum, being a wasting asset, would become scarcer and more valuable over the long term. Externally, Venezuela has tried unsuccessfully to persuade other members of the Organization of Petroleum Exporting Countries (OPEC)* to fix crude oil prices and prorate production.

5. Petroleum companies in Venezuela -- mostly US-owned -- traditionally have had considerable freedom of action, but they have been subjected to growing government control and financial demands under the new policy. The maximum corporate income tax rate (affecting mainly the petroleum companies) was raised from 28½% to 47½% at the end of 1958 and further increased to 52% in 1966. In 1966 the government also began to receive payments in settlement of its claim for back taxes and instituted a more lucrative system in valuing petroleum exports for income tax purposes. As a result of these measures, the government's share of the industry's gross profits rose from 65% in 1958 to 70% in 1969. As the following tabulation shows, government petroleum revenues jumped by about one-fourth during 1965-68 even though petroleum export earnings stagnated:

* OPEC's members are Venezuela, Saudi Arabia, Iran, Iraq, Kuwait, Qatar, Abu-Dhabi, Libya, Algeria, and Indonesia.

CONFIDENTIAL

	Million US \$				
	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>
Petroleum exports	2,319	2,260	2,158	2,262	2,294
Government petroleum revenues	1,069	1,073	1,132	1,299	1,326
<i>Ratio of government revenues to petroleum export earnings (percent)</i>	46	47	52	57	58

Government revenues equaled about \$1 per barrel produced in 1969, making Venezuela's profit share and revenue per barrel among the highest in the world.

6. Since 1959 the government has also pursued a publicly stated policy of granting no additional petroleum concessions. Because many concessions granted during the early 1940s will expire in the early 1980s, petroleum companies have been uncertain about their future operations and hesitant to make large development expenditures. The industry drilled an average of only 460 wells annually during 1965-68, compared with nearly 1,200 in 1958, and new investment averaged only \$158 million, compared with \$579 million in 1958. In fact, net disinvestment occurred each year from 1960 through 1966, as depreciation allowances exceeded new investment. Although crude oil production has risen only slowly since 1958, proved reserves have dropped somewhat and the reserve/production ratio has slumped from 17½ to 11½ (see Table 2).

7. Venezuela's net foreign exchange earnings from the petroleum sector stagnated during most of the 1959-68 period. Petroleum exports were 36% higher in 1968 than in 1958, but a drop in the average realized price from about \$2.55 to \$1.90 per barrel prevented any gain in export value. Although the Venezuelan government's tax take from petroleum rose during the 1960s, reduced production costs also allowed gains in net company profits. This improvement enabled the companies to restore the 1958 level of profit remittances of about \$600 million during 1964-68; moreover, sharp cuts in investment permitted the companies to repatriate depreciation allowances totaling several hundred million dollars in 1962-66.

CONFIDENTIAL

Table 2
Venezuela: Indicators of Petroleum Development Activity

	<u>1958</u>	<u>1961</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>
New fixed capital investment (million US\$)	579	171	152	117	119	242	N.A.
Wells drilled (number)	1,184	477	694	394	319	438	487
Proved reserves (billion barrels)	16.8	16.9	17.2	16.9	16.0	15.7	14.8
Ratio of reserves to production	17.7	15.9	13.6	13.7	12.4	11.9	11.3

CONFIDENTIAL

- 7 -

CONFIDENTIAL

CONFIDENTIAL

Growth of New Sources of Low-Cost Oil

8. Rapid growth of production in other oil-rich countries also has weakened Venezuela's competitive position. Between 1958 and 1969, Venezuelan output increased by only 38% while world output more than doubled -- rising from 18.0 million bpd to 41.6 million bpd. Leading this growth was the Middle East, where production rose by 190% (to 12.4 million bpd) despite political turmoil. Important petroleum discoveries in Libya, Algeria, and Nigeria since the mid-1950s also have made Africa a major producing area. African production of crude oil rose from only 85,000 bpd in 1958 to 5 million bpd (12% of the world total) in 1969.

9. Venezuela's oil industry is falling behind partly because its costs considerably exceed those in the Middle East and Africa, where new investment is being concentrated. In the Middle East, for example, exploration and operating costs are very low because vast oil deposits were discovered and the average well produces about 4,600 bpd compared with 400 bpd in Venezuela. Although the Middle Eastern and North African governments have now increased their profit share almost to the Venezuelan level, lower production costs generally still enable the companies to earn substantially more per barrel than those in Venezuela. Net profit per barrel in Venezuela is estimated to be about 40-45 cents.

Development of the Supertanker

10. The cost advantage of Middle Eastern and North African oil has also improved with introduction of supertankers. Use of these tankers has significantly reduced long-distance transportation costs and sharply diminished Venezuela's ability to compete in West European markets. Closure of the Suez Canal in 1956 and again in 1967 benefited Venezuela temporarily, but the longer term result of the two Suez closures has been to hasten widespread use of supertankers, thus eroding Venezuela's competitive position even further.

US Import Restrictions

11. Expansion of oil exports to the United States -- still the most important market -- has been impeded by US import controls and concern over air

CONFIDENTIAL

CONFIDENTIAL

pollution. The United States initiated mandatory import controls in March 1959, following two years of unsuccessful attempts to obtain voluntary limitations.*

12. Since the imposition of US import controls, Venezuela has supplied a declining share of US crude oil imports. Venezuelan deliveries dropped from 550,000 bpd in 1960 to only 305,000 bpd in 1969, and their share of total US crude oil imports fell from 50% to 22%. The decline would have been even sharper if the import program had not been modified in 1965 to require that petroleum refineries in Puerto Rico and the Virgin Islands use Venezuelan crude oil. The special treatment accorded Canada as an overland supplier, on the other hand, has permitted its exports to quintuple since 1960. As a result, its share of US crude oil imports has risen from 10% to 40% -- about as much as Venezuela's has declined. The change reflects Canada's expansion of exports far beyond the voluntary limits negotiated with the United States in 1967. African producers also have won an important share of the US market (see Table 3).

13. The decline in Venezuelan crude oil exports to the United States has been partly offset by larger exports of residual fuel oil, but problems are arising in this field also. Although these deliveries reached a record level of 880,000 bpd in 1969 (compared with 615,000 bpd in 1960) and made up about 70%

* Imports of crude oil and petroleum products (other than residual fuel oil) into the region east of the Rocky Mountains are now limited to 12.2% of domestic production of crude oil and natural gas liquids. Imports of crude oil into the West Coast are permitted in quantities sufficient to balance supply and demand. Because US refining is geared to the demand for the lighter, higher valued petroleum products, demand for fuel oil is satisfied mainly by imports, which are exempt from the quota. Overland imports of crude oil -- chiefly from Canada but also including small amounts from Mexico -- and petroleum products shipped from Puerto Rico and the Virgin Islands also are exempt but are deducted from the overall quota and thus enter at the expense of imports from other sources.

CONFIDENTIAL

Table 3
Share of Venezuela and Other Producers in US Crude Oil Imports

<u>Year</u>	<u>US Crude Oil Imports (Thousand Barrels per Day)</u>	<u>Source of Imports (Percent)</u>				
		<u>Venezuela</u>	<u>Canada</u>	<u>Africa</u>	<u>Middle East</u>	<u>Other Areas</u>
1960	1,100	50	10	1	28	11
1965	1,240	35	24	5	27	9
1966	1,225	33	28	7	24	8
1967	1,130	32	36	5	17	10
1968	1,295	27	36	12	13	12
1969	1,390	22	40	15	12	11

CONFIDENTIAL

- 10 -

CONFIDENTIAL

CONFIDENTIAL

of all such US imports,* several large US east coast cities have begun to restrict the sulfur content of fuel oil in order to reduce air pollution. The 1%-2% sulfur content of most Venezuelan oil exceeds the present limits, which will be lowered during the next few years. Consequently, importation of low-sulfur oil, notably North African crude with a sulfur content of less than ½%, is becoming increasingly desirable. Nearly all of the growth in US imports of residual fuel oil in 1968, for example, came from African producers or West European producers using African crude oils.

Economic Repercussions

14. Since petroleum activity accounted for 92% of Venezuela's export earnings, 62% of government revenues, and 29% of GDP by 1958, the industry's subsequent slowdown has cut the economic growth rate considerably and had other important repercussions. Export surpluses have been shrinking, budget expenditures have outpaced the growth of revenues, and the investment rate has slipped from the previous high level. Venezuela has, however, avoided large budget deficits, balance-of-payments constraints, and serious inflation.

15. Value-added in the petroleum sector rose an average of only 4½% annually during 1959-64 and 1% annually in 1965-69, compared with 7½% in 1951-58 (see Figure 2). Venezuelan governments have tried to compensate for the petroleum sector's sluggishness by stimulating production elsewhere. Price supports, protective tariffs, import quotas, and land colonization programs have brought an impressive 75%-80% gain in agricultural output since 1958, sustaining the previous growth rate. Continuing import substitution helped to double manufacturing output, but at the cost of creating various high-cost operations requiring protection from foreign competitors. Growth in manufacturing and the non-petroleum sectors

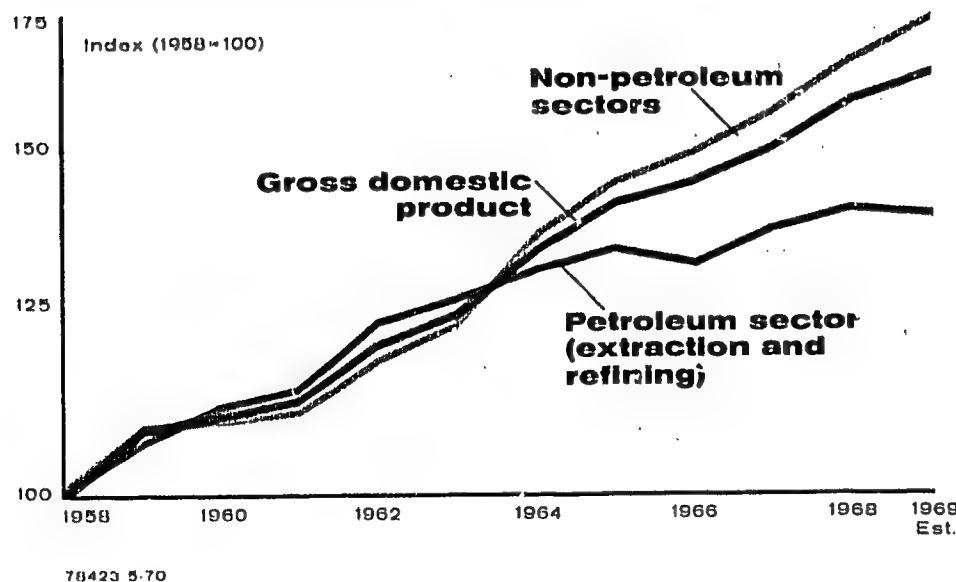
* Including exports of fuel oil from the Netherlands Antilles and Trinidad by companies that ship Venezuelan crude oil there for refining.

CONFIDENTIAL

CONFIDENTIAL

Figure 2

Venezuela: Output Growth in Petroleum and Non-petroleum Sectors



as a group nevertheless slipped below the boom levels of 1951-58 and contributed to the decline of nearly one-half in average annual gains in GDP, as the following tabulation shows:

	Average Annual Increase (Percent)	
	<u>1951-58</u>	<u>1959-69</u>
Petroleum sector	7½	3
Non-petroleum sectors	8½	5
Of which:		
Agriculture	5½	5½
Manufacturing	10½	6½
Gross domestic product	8½	4½

CONFIDENTIAL

16. Traditionally strong by Latin American standards, Venezuela's balance of payments has absorbed the impact of sluggish petroleum activity without great strains so far. Despite lagging exports, no shortage of foreign exchange developed because of continued opportunities to substitute domestic production for imports and because Venezuela's foreign exchange reserves were large. Imports were held down by controls in the early 1960s, and although they have risen fairly rapidly since 1964, the average growth rate since 1958 is well below that of GDP. The relatively slow growth of imports permitted Venezuela's traditionally large trade surplus to be held at about \$1 billion in 1968, compared with an average of \$1.3 billion annually in 1960-64.

17. To balance its foreign payments, Venezuela had to draw down its foreign reserves from \$1.0 billion in 1958 to about \$583 million in 1962. Most of these losses were recouped in the late 1960s, however, when the oil companies started building desulfurization plants and both private foreign investment in other sectors and foreign aid increased. By December 1969, foreign exchange reserves reached \$933 million -- enough to pay for eight months' imports.

18. Slackening growth of petroleum and other revenues has not led to large budget deficits, primarily because investment spending has been held below earlier levels. Rapidly rising current expenditures, especially for education, health, and national defense, have absorbed most of revenue growth. Recent governments have chosen to keep deficits small -- a policy that helped hold cost-of-living increases to an average of only 1% in 1963-67 and 2½% in 1968-69.

19. The cuts in public investment, however, were a major cause of the decline in economic growth. Real investment expenditure did not surpass the 1958 level until 1968, when it still made up only 18% of GDP including petroleum investment and 16% excluding petroleum investment, compared with the 27% and 20% averages of 1951-58. Although

CONFIDENTIAL

CONFIDENTIAL

public investment has been growing rapidly in recent years, its 7% share of GDP in 1968 remains far less than the 12% average of 1951-58. Private non-petroleum investment has held up fairly well, absorbing 8% of GDP in 1968, as in 1951-58.

20. Despite the slowing of economic growth, job opportunities have been sufficient to absorb the new entrants into the labor force (which is growing about 3% annually) and reduce the still large pockets of unemployment and underemployment. Employment in the non-petroleum sectors has been expanding at an average rate of about 5% annually. This relatively rapid growth was possible because of the continuing agricultural colonization program and because gains in output per worker in the manufacturing and services industries were fairly meager.

Efforts to Revitalize the Industry

21. Although Venezuelan economic growth slowed during the 1960s, it was on the whole satisfactory by Latin American standards. By the middle of the decade, however, the government was becoming increasingly concerned about the petroleum industry's deteriorating international position and the sharp decline in investment that was allowing the ratio of reserves to production to decline. Realizing that the economy would have to depend heavily on petroleum for many years to come to provide funds for both economic diversification and social development programs, both government officials and businessmen questioned the wisdom of the moratorium on new concessions and urged that a new legal basis for petroleum exploitation be devised. The Leoni government's solution, approved by the Venezuelan Congress in 1967, provided for negotiation of service contracts with private firms instead of traditional concessions. Under service contracts, companies would form partnerships with the government-owned Venezuelan Petroleum Corporation (CVP).

22. The Caldera government, inaugurated in March 1969, is trying to carry out and extend the program of the Leoni government, hoping to invigorate the

CONFIDENTIAL

CONFIDENTIAL

oil industry by negotiating service contracts, encouraging construction of desulfurizing plants, and obtaining more favorable US import measures. Although Venezuela has been getting a large cut of oil revenues, service contracts are legally required to be basically more favorable to the country than concessions have been. Within this limit, the details of each contract are to be determined by negotiation. Although they would be partners of CVP and receive only a small share of any profit, petroleum companies would be expected to provide all the funds for new ventures and to assume all the risks. Service contracts normally will extend for 23 years (including 3 years for exploration) as contrasted with the 40 years granted for concessions. In special cases, upon recommendation of CVP and Congressional approval, contract periods may be extended to 30 years. At the end of the contract period, all facilities and equipment revert to the CVP.

23. Progress toward concluding service contracts has been slow because the companies want to keep full operational control and the government has been unable to obtain a Congressional blessing of their terms. CVP called for tenders by March 1968 to negotiate service contracts covering five blocks of acreage in southern Lake Maracaibo, an area that heretofore has not been open for exploration. From their geological knowledge of the Lake Maracaibo basin, which accounts for about 80% of production, the companies believe that the new area has an excellent petroleum potential. CVP received 11 offers from foreign companies. The more acceptable offers generally provided that the central government would receive the same royalties and taxes as in recent years and that CVP would receive 10% of crude oil production, a depletion payment equal to 5% of the central government's royalties, and bonus payments as production increased beyond certain levels. Venezuelan officials estimated that the offers would give Venezuela 85% of profits; some of the companies estimate 90%. Although the tenders improved upon the present financial terms for concessions, they fell short of the government's aspirations, particularly in the area of operational control of exploration and production. The government wants CVP to have a voice in decisions concerning production rates, pricing, and marketing. The companies, however, appear willing only to keep CVP fully informed.

CONFIDENTIAL

CONFIDENTIAL

24. Upon taking office, the Caldera government extended the deadline for final tenders to July 1969 in the hope that more generous terms could be extracted in a second round of negotiations. Although several companies improved their offers, most did not. The government then submitted the best offers for Congressional approval. President Caldera had hopes of signing the first contracts before the end of 1969 and giving the economy a needed psychological boost. Caldera's Christian Democrats, however, are a minority in Congress and could not win the approval of the Democratic Action Party, the largest opposition force. The latter group claimed that the offers lacked sufficient assurances that CVP would have a prominent management role and succeeded in having a decision postponed until the next Congressional session, which began in March 1970.

25. To maintain Venezuela's dominant position in the US fuel oil market, the Leoni and Caldera governments have strongly encouraged the industry to build desulfurization facilities. In 1968 the two largest petroleum companies agreed to build desulfurization plants at a total cost of \$136 million. As incentives for this step, Shell of Venezuela and Creole Petroleum Company (a subsidiary of Standard Oil of New Jersey) are allowed to reduce their taxes by accelerating depreciation of their investments and are granted import duty exemptions on materials and equipment not manufactured domestically.

26. Shell's plant, which can turn out about 50,000 bpd of oil annually with no more than 1% sulfur, began operations in December 1969. The Creole facility has a capacity of 100,000 bpd annually and is scheduled to commence operations in July 1970. Because the two facilities can process only about one-fifth of US imports of Venezuelan residual fuel oil, the government anticipates that additional capacity will have to be constructed. Some US east coast cities have stretched out their schedules for tightening restrictions on sulfur content to give consumers more time for compliance, but Venezuelan authorities still are concerned that the geographic coverage of the restrictions will be broadened and the acceptable sulfur limits reduced faster than fuel oil shipments can be desulfurized. Moreover, the government fears that the US oil import program will be changed to encourage construction of desulfurization facilities in the United States, which would deter investment in Venezuela and encourage the import of high-sulfur oil from other producers.

CONFIDENTIAL

CONFIDENTIAL

27. Venezuela has been pressing for changes in US oil import policy for several years. The program is viewed as strongly favoring Canada at Venezuela's expense, and Venezuela's treatment under it has become a highly charged political issue. The Caldera government also was dissatisfied with the differential tariff system recently proposed by a US Cabinet Task Force as a substitute for import quotas. Venezuelan officials claimed that the differentials for Venezuela were too small to give it a sufficient competitive edge in the US market. Although the Task Force recommended that tariff differentials be fixed to produce volumetric parity between crude oil imports from Canada and Venezuela, the Caldera government was skeptical that parity would be enforced.

28. As much as the Caldera government disliked the recommendations of the Task Force, it still remains opposed to the present import quota system and has not reduced its efforts to change it. Although pleased by President Nixon's decision in March 1970 to impose a formal import quota of 400,000 bpd on imports of Canadian crude oil, which were running at an annual rate of 730,000 bpd in January-March 1970 compared with Venezuelan exports of some 255,000 bpd, the Caldera government still questions what benefits if any will accrue for Venezuelan exports.* Because of its objections to the Task Force recommendations, the Caldera government also welcomed President Nixon's decision to defer action. Pending further study of the import program by the US government, Venezuela is proposing multi-national discussions among the United States, Canada, Mexico, and itself to press its case for a system that would accord Venezuelan petroleum equal access to the US market. Venezuela contends that only on this basis would it be assured of participating in some reasonable share of the growth in petroleum demand in the United States.

Prospects

29. During the next few years, Venezuela probably will not be able to improve much upon the 4½% economic growth rate achieved since 1958. A rate of 4½%-5%

* Canada has strongly protested imposition of the quota. If the quota becomes a permanent feature of US import policy, it would spur Canadian construction of a pipeline from the western provinces to the east coast and jeopardize Venezuelan exports to Canada.

CONFIDENTIAL

CONFIDENTIAL

seems likely -- approximately the expected Latin American average but well short of the level still believed to be feasible by Venezuelans if only the United States would cooperate. Barring a major improvement in access to the US market (or in world market conditions), petroleum production and exports are unlikely to increase by more than 1%-2% annually during 1970-72. Economic growth should be stimulated, however, by planned high levels of public investment in petrochemical and steel plants, low-cost housing, and agricultural facilities. Moreover, if the deadlock over signing the first service contracts is broken before long, investment in petroleum should expand, although production would not be affected for some time. Despite the delays so far, the outlook for executive and legislative agreement on minimum terms for service contracts seems favorable.

30. For the government budget, the outlook is for growing deficits financed largely by foreign borrowing. Revenues are likely to grow only slowly unless taxes are boosted -- a step that goes against Caldera's aim of improving business confidence and might be blocked in the legislature. The administration nevertheless favors a moderately expansionist budget and has announced a \$900 million public investment program for 1971-74, which would substantially raise recent spending levels. Because of Venezuela's conservative financial policies since the early 1960s and large foreign reserves, the Caldera government is in a good position to borrow abroad and should be able to incur increased deficits without generating domestic financial difficulties.

31. The balance of payments probably will experience some strains during the next few years, but Venezuela should be able to avoid any major external difficulties. The foreign trade surplus will continue to shrink in 1970-72. Apart from petroleum, the only major new export earnings in sight are petrochemical products, but they will not fully materialize before 1973. Meanwhile, imports will continue to increase to meet industrial demand and support public investment projects.

32. By the mid-1970s, Venezuela may have an appreciably larger petroleum production capability, if service contracts are soon negotiated. But the growth of exports to the United States may be hampered seriously by exploitation of new oilfields

CONFIDENTIAL

CONFIDENTIAL

in Alaska and, less importantly, in Colombia and Ecuador. Shipments to the continental United States from the Alaskan fields will not be subject to quota, and Colombian oil has the advantage of being low in sulfur. If the problems of transporting Alaskan oil to consuming centers can be solved satisfactorily and if exploitation of the new Colombian and Ecuadorian fields proceeds as scheduled, Venezuela's oil industry will confront added competitive pressures starting in about 1973. In addition, prospects for sales to Canada will be lessened if Canada builds a pipeline to supply its eastern seaboard.

Conclusions

33. Venezuela's petroleum exports have stagnated in recent years, dropping from 33½% of world petroleum exports in 1953 to only 15% in 1969. The government's policies of obtaining a larger share of industry profits and of granting no new concessions discouraged investment in exploration and production facilities. Rapidly expanding production of lower cost oil in other countries and the advent of supertankers weakened Venezuela's competitive position in international petroleum trade. Exports have been hindered by US import controls, which have favored Canadian over Venezuelan oil, and by increasing consumer preference for oils containing less sulfur (a major air pollutant) than does Venezuelan oil.

34. Sluggish petroleum development is mainly responsible for the slowdown in economic growth from an 8½% average rate in 1951-58 to 4½% in 1959-69 and for the decline in investment from 27% of gross domestic product in 1951-58 to 18% in 1968. Responsible financial policies have averted large budget deficits and serious inflation, however, and foreign exchange supply has not been a bottleneck, because of rising net inflows of foreign capital into the non-petroleum sectors.

35. The Venezuelan government is now trying to spur exploration and considerably improve the industry's access to the US market. The new means chosen to reinvigorate the industry is the service contract, which calls for private companies to form partnerships with the state oil corporation. Some

CONFIDENTIAL

companies are optimistic about the petroleum-bearing potential of the area being offered under service contracts and have made offers, but no service contracts have yet been signed.

36. Venezuela's efforts to obtain more favorable treatment for its oil in the US market have not yet met with success, but the building of facilities to desulfurize fuel oil destined for the United States has proceeded rapidly. Without improved access to the US market, petroleum exports probably will increase only 1%-2% annually during the next few years, and by the mid-1970s Venezuelan petroleum sales to the United States could be further impeded by development of Alaskan production and exports from Colombia and Ecuador.