RICE UNIVERSITY'S
BAKER INSTITUTE
FOR PUBLIC POLICY

Working Paper

U.S. Policy Toward Venezuela's Hydrocarbon Sector

Francisco J. Monaldi, Ph.D.
Fellow in Latin American Energy Policy
Director, Latin America Energy Program, Center for Energy Studies

José La Rosa Reyes, M.Sc.
Research Analyst, Center for Energy Studies

Venezuela faces a historic crisis. Its economy has lost more than 80% of its GDP, while hyperinflation and rising poverty have fueled the second-largest refugee exodus in the world. In 2020, oil production averaged just above 500 thousand barrels per day, under a sixth of the level before Chavismo took power in 1999. Refineries have been unable to supply the limited domestic demand for gasoline.[i] After fraudulent elections, Nicolas Maduro is not recognized as the legitimate president by fifty-seven countries, including the US.

US policy impacting the Venezuelan oil sector

To restore democracy, the US has enacted increasingly harsher economic sanctions. Financial sanctions in 2017 banned Venezuela and its national oil company, PDVSA, from accessing the US financial markets, effectively limiting their capacity to take on new debt or restructure their current obligations. In 2019, oil sanctions banned US entities from importing oil from Venezuela or exporting refined products to it: more than 500 thousand barrels of Venezuelan oil imports were immediately halted. In 2020, the US implemented secondary sanctions to non-US companies trading Venezuelan oil, including two subsidiaries of the Russian national oil company, Rosneft, that marketed most of Venezuela's oil. US oil companies operating in Venezuela were restricted to maintain or wind down their activities. Swaps of Venezuelan crude for refined products were also restricted.

The US has protected one of the most valuable Venezuelan assets overseas: US refiner CITGO, a subsidiary of PDVSA. The US government, supported the Interim government -designed by the democratically elected National Assembly- to take control over CITGO, and temporarily limited creditors from seizing its assets.

Economic sanctions are targeted at Maduro's regime but have also impacted the country's economy, heavily dependent on oil exports, and its population. Polls indicate that a large majority of Venezuelans oppose economic sanctions. The US Congress has provided bipartisan support for actions against Maduro's regime. Most recently, it enacted the VERDAD Act of 2019 that codifies several sanctions and authorizes humanitarian assistance for Venezuela. Some Congress-members, however, have expressed concerns about broad sanction's humanitarian impact and called for their suspension.[ii]

Policy options for the Incoming US Administration

Sanctions have been successful in their stated goal of reducing the revenues received by PDVSA and the Maduro regime, but they have failed to lead to a path to democracy or to avoid Venezuela's continued economic and humanitarian collapse. What policy options towards the oil sector should the new administration consider? Some considerations on existing oil sanctions policy.

- **Try a multilateral approach:** Unilateral sanctions appear to have had limited political effectiveness and have been used by the Maduro regime to shift blame for the economic collapse. A democratic transition would require the active support of European and Latin American partners. Conditional sanctions relief could be a tool to impulse multilateral negotiations.
- **Evaluate humanitarian exceptions:** Options to minimize the humanitarian effects of sanctions should be explored. For example, a program of swaps of oil exports for humanitarian aid, food, and medicine with credible international monitoring.

- **Consider long-term impacts:** The sanctions implementation should take into account the long-term impacts on the oil and gas production capacity of the country. Due to the nature of Venezuelan oil fields, production declines permanently hurt production capacity, making the recovery harder later on.
- **Review swap policy more generally:** Swaps of crude for gasoline or other refined products, that do not generate cash to the regime, can maintain the oil production capacity that is needed for the reconstruction while avoiding some of the negative humanitarian effects of sanctions. These swaps could be also conditioned on external monitoring.
- **Increase pressure on illicit activities:** As Venezuela's formal exports have dried up, Maduro's regime has further resorted to illegal mining, money laundering, and other illicit activities to obtain foreign exchange and reward key members of the ruling elite. These activities have significant negative social and environmental effects and empower criminal groups.
- **Allow foreign oil companies to remain in Venezuela:** US and European companies should play a crucial role in rebuilding the Venezuelan oil sector. A forced exit from the country that hands over assets to oil companies from geopolitical rivals would hurt long-term US interests without accomplishing any goal.
- **Safeguard CITGO:** Preserving CITGO, and avoiding a disorderly auction of its assets, should continue to be a policy priority. Venezuela's reconstruction would require an orderly restructuring of its external debts. CITGO is the most valuable and strategic external asset and should only be sold if required as a coherent part of this process. Auctioning it today would fetch just a fraction of its long-term value and compensate in full just a few creditors. In case it is possible to retain it, CITGO could be a key part of the recovery of the Venezuelan oil industry, guaranteeing a market for its extra-heavy oil.

The recovery of Venezuela and its energy sector: What role should US policy play post-transition?

In case there is a successful political transition in Venezuela, its economic and political recovery would hinge considerably on its capacity to recover its oil sector, at least in the short term. Over the long term, Venezuela must diversify its economy (and energy sources), but oil revenues are the fastest option to obtain: fiscal resources for the country's reconstruction and addressing the humanitarian collapse, foreign exchange to import essential inputs for the recovery effort, and back the multilateral aid package to support the transition (the magnitude of such package would be directly tied to the country's expected repayment capacity). These resources would be critical for the country's economic and political stability.

By any measure, Venezuela has one of the largest hydrocarbon endowments in the world including massive unconventional extra-heavy oil fields, conventional mature fields, and natural gas. Venezuela could increase its oil production to around 1 million barrels per day in the first couple of years, and to 2.5 - 3 million barrels per day within a decade. This recovery requires massive investments estimated at US$ 10-12 billion per year on average – over $110 billion in total. Given the collapse of PDVSA and the country's massive external debt, which exceeds $140 billion, the investment effort must be largely from foreign companies, including from the US.

The recovery of the oil sector requires a new institutional framework with a flexible fiscal and contractual framework that can generate the necessary credibility to attract foreign investment and at the same time maximize the long-term value creation for the nation. The establishment of an independent hydrocarbons regulatory agency could be the cornerstone of such a framework. A new Hydrocarbons Law would be required. A bill along these lines was drafted in 2020 by the Energy Commission of the National Assembly.[iii]

How can the US government help the recovery of the post-transition Venezuelan oil and gas sector? These are some key recommendations.

- **Lift sanctions:** When political conditions make it feasible, the US government should have prepared the necessary Executive Orders allowing it to rapidly lift the sanctions affecting the Venezuelan oil sector. Moreover, the US Treasury should actively help the Venezuelan oil sector in dealing with the likely continued over-compliance by potential partners and suppliers of goods and services.
- **Provide technical cooperation:** The US government, both directly and through multilateral agencies, allied countries, and other expert institutions should provide assistance in the design and execution of a new oil and gas institutional framework, as well as in the areas of technological support and environmental remediation. Another area of cooperation could be in training programs in technical areas, including a focus on natural gas, decarbonization, and integrated energy systems. Finally, support could be provided in the areas of crime reduction and law enforcement.
- **Offer financial support for the energy transition:** While oil and gas investments are funded by private capital, US government agencies and US-supported multilateral agencies, may help fund (or insure) projects connected to the recovery of the energy sector which simultaneously further climate policy objectives. Examples include electricity infrastructure, reduction of gas flaring, carbon-reducing technologies, and environmental remediation. The gasification of the country could help the energy transition by reducing the use of more carbon-intensive fuels.
- **Facilitate access to the US market:** Market access and trade can be reestablished by enabling the preservation of CITGO in Venezuelan hands and reducing any obstacles to the import of Venezuelan crude and the export of refined products and light oil to Venezuela.
- **Encourage US oil and gas operators and service companies to return to Venezuela:** Chevron still has a stake in major projects in Venezuela that should be preserved and could be instrumental in the recovery. Similarly, US oil service and equipment companies would be key actors to execute the massive investments needed. US operators ConocoPhillips and Exxon Mobil, as well as a few service companies, were expropriated by Hugo Chavez and left the country. Some of these companies are still owed significant compensation. As part of the settlement of these claims, it would be desirable if they could consider returning to the country. Creating a rational framework to settle these claims would be key.

---

[i] For background on the collapse of the Venezuelan oil sector, see, Igor Hernandez and Francisco Monaldi, "Weathering the Collapse: An Assessment of the Financial and Operational Situation of the Venezuelan Oil Industry," Harvard University, 2016, https://growthlab.cid.harvard.edu/publications/venezuelan-oil-assessment; Francisco Monaldi, "The collapse of the Venezuelan oil industry and its global consequences." Atlantic Council, March 9, 2018, https://www.atlanticcouncil.org/in-depth-research-reports/report/the-collapse-of-the-venezuelan-oil-industry-and-its-global-consequences/; and Francisco Monaldi, Igor Hernandez, and Jose La Rosa Reyes, "The Collapse Of The Venezuelan Oil Industry: The Role Of Above-Ground Risks Limiting FDI", Rice University's Baker Institute for Public Policy, February 24, 2020, https://www.bakerinstitute.org/research/collapse-venezuelan-oil-industry-role-above-ground-risks-limiting-fdi/.

[ii] Clare Ribando Seelke, "Venezuela: Political Crisis and U.S. Policy," Congressional Research Service, September 15, 2020.

[iii] For a discussion of the proposals for a new institutional framework, see Igor Hernandez and Jose La Rosa Reyes, "Venezuela's Oil and Gas; Proposals for Investment Framework in Comparative Perspective," Chatham House, forthcoming.