

The Future of Hugo Chavez's Petro-Diplomacy

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Origin of Hugo Chavez's petrodiplomacy.

During the 1990's the oil price had averaged \$20 per barrel, reaching \$10 a barrel in 1998, as a result of the Asian financial crisis. That year Hugo Chavez came into power. He can be partially credited with persuading OPEC to engage in a rigid production quota reduction that took 3 million barrels per day off the market. As the Asian economy improved, demand increased while supplies remained tight. As a result prices recovered in 2002, to about \$30 per barrel. By 2004 prices had already reached \$40 per barrel and were well under way to what became a wild increase that ended in mid-2008, when they reached almost \$140 a barrel. Reasons: expanding demand outpacing the supply; non-OPEC production affected by natural disasters (Katrina, Prudhoe Bay); geopolitical instability (Nigeria, Iran, Iraq, Venezuela); refining bottlenecks in the U.S.; generally low inventories, and, in later stages, financial speculation due to the weakening of the dollar and the intense demand for commodities.

Producing countries started to receive an oil income windfall. Some countries used it in a conservative manner (Norway, Saudi Arabia, Arab emirates). The leaders of Russia and Venezuela used it to further their political agendas. Putin and Chavez behaved in almost identical manner, in order to gain political control over institutions and the economy in their countries and to become main geopolitical actors. Early in 1999 Hugo Chavez, coached by Fidel Castro, started to outline the essential strategies that he has put in place during the last 8 years.

The basic political strategies of Hugo Chavez.

They have been: (1), the utilization of oil income and oil in kind to gain followers in the Western Hemisphere for his political project; (2), the structuring of global political and economic alliances against the United States; (3), the consolidation of political power in Venezuela, by means of: (a), a policy of handouts to the poorer sectors of the population, that make up the majority of Venezuelans and, (b), the systematic harassment and intimidation of the middle-class and the rich. For almost ten years these strategies have served him rather well.

- He has distributed over \$35 billion to his ideological friends in the hemisphere (see annex) in order to keep their loyalties and count on their votes in the OAS and the U.N.
- He has promoted the creation of political and economic organizations that are designed, in essence, to weaken U.S. influence in the hemisphere and drive wedges between Latin America and the United States: ALBA, UNASUR, The Bank of the South, PETROSUR, PETROCARIBE. Most of them have failed to crystallize, although PETROCARIBE has given him, so far, excellent results in Central America and in the Caribbean Anglo- speaking states.
- He has acquired some \$8 billion in sophisticated weapons from Russia and China, in order to establish strong political links with these two countries and to create a strong military force to be used against his foreign and domestic enemies.

- He has formed an alliance with Iran, based on their only common interest, hatred for the United States.
- He has established a strong basis of support for his authoritarian and undemocratic government in the most democratic country on earth: the United States, including a program of fuel oil subsidies for the poor in which CITGO has already spent about \$400 million and the seduction of influential congressmen, notorious public figures, academicians, think tanks, lobbyists and Hollywood actors. For some time he even controlled the company (Sequoia) that operated the voting machines in about 10 states in this country.
- He has openly intervened, through illegal financing, in the presidential races of Peru, Mexico, Argentina, Nicaragua, Bolivia, Ecuador, El Salvador and Paraguay. Five of his ambassadors have been expelled from some of these countries for their open partisan activities. The scandal of the moneybag smuggled into Argentina is only the tip of the iceberg.
- In Venezuela his policy of handouts, throwing fish at the masses but not teaching them how to fish, has created an illusion of prosperity that has allowed him to maintain high levels of popularity. With enough money at hand he has been able, so far, to keep most everyone happy, although happiness exists as long as the money keeps flowing. He has given many Venezuelans a feeling that he cares for them and that they are now in power against the rich and the educated middle class. He has obtained significant control over the nation at the high cost of dividing society into almost irreconcilable segments.

Declining oil prices and his own errors now threaten the success of his strategies.

Two factors now exist that threaten the continued success of Hugo Chavez's strategies and put his permanence in power at high risk. One is political and the result of his own behavior and errors. The other is economic and is related to oil prices.

(1). Loss of followers.

The first has to do with his increasingly arrogant and authoritarian manners, his open abuse of power and his virulent rhetoric, all of which have convinced many Venezuelans, including many of his followers, that he is not, after all, the answer to their prayers. The last two electoral events, in 2007 and 2008 have produced defeats. His attempt at modifying the constitution to become president for life was defeated in December 2007. In November 2008 he lost political control of the most populated urban centers of the country, where half of the Venezuelan population lives. In spite of these defeats he keeps trying to become president for life and has proposed a new referendum to approve a change in the constitution to that effect, although this is both illegal and unethical. If he wins this referendum it will be for a narrow margin, which would render it illegitimate given the radical nature of the change he is proposing. The climate of opinion prevailing in the country is now one of progressive dissatisfaction with his government.

(2). The economic factor.

The average price of the Venezuelan oil basket stands today at some \$34 a barrel, about one third of the price of July 2008, when Chavez's government was putting together the 2009 national budget. This budget, now approved by a compliant National Assembly,

calls for expenditures of about \$90 billion, although year after year Chavez has been over spent by 15 percent or more. The official estimates of income were made on the basis of an oil production of 3.6 million barrels per day and exports of 2.9 million barrels per day and an average price for the year of \$60 a barrel. This is science fiction! According to OPEC and the IEA the average production of Venezuela is closer to 2.4 million barrels per day. The figures that seem to be closer to the truth are:

Production: 2.4-2.5 million barrels per day

Domestic Consumption: 0.8 million barrels per day, selling for about \$9 per barrel!!!

Net volume left for exports: 1.7 million barrels per day, of which:

To Cuba: 0.1million barrels per day

To Central America: 0.06 million barrels per day

To Caribbean countries: 0.150 million barrels per day

To China: 0.2 million barrels per day

To South America: 0.1 million barrels per day

Other: 0.05 million barrels per day.

A total of some 0.66 million barrels per day (660,000 barrels per day)

All of these volumes above go to clients that do not pay (Cuba), partially pay in kind (Central America and the Caribbean), or pay in an irregular manner (China, South America). It is difficult to estimate an average price for these volumes but is very low. Therefore, *the net volume for export at really commercial prices is only close to 1.2 million barrels per day. Almost all of this oil is coming to the United States.*

The other assumption, a \$60 a barrel average export price, is also significantly optimistic. All indications suggest that the 2009 average price for the Venezuelan basket will not be above \$50 a barrel, if that much.

Venezuelan Oil income for 2009, therefore, cannot be expected to be above some \$30 billion, as compared to the \$ 60 billion estimated by the Chavez government. This will produce a significant fiscal deficit of some \$30 billion.

Impact of this deficit on Chavez's Petrodiplomacy.

Some of the actual and possible results of this deficit include:

- Mounting pressures for devaluation of the Bolivar. The longer Chavez delays it due to political reasons, the higher this devaluation will have to be. I estimate that it will be in the range of 30-35 percent, coming at midyear.
- Increasing reluctance on the part of the government to pay due compensation to the companies that have been taken over, in amounts of about \$12+ billion (oil companies, steel mill, cement companies).
- Reduction in the level of imports, which stood at \$50 billion last year. This cannot be sustained under current conditions. This mean less food available, since most of the Venezuelan food, some 65 percent of consumption, is being imported.
- Cutting down on the handouts to hemispheric "allies". This will be very damaging for Chavez's objectives of hemispheric leadership since Morales and, possibly, Ortega, are his only two unconditional allies. Others will not be loyal if the money does not keep coming, in special, Argentina's Kirchners and

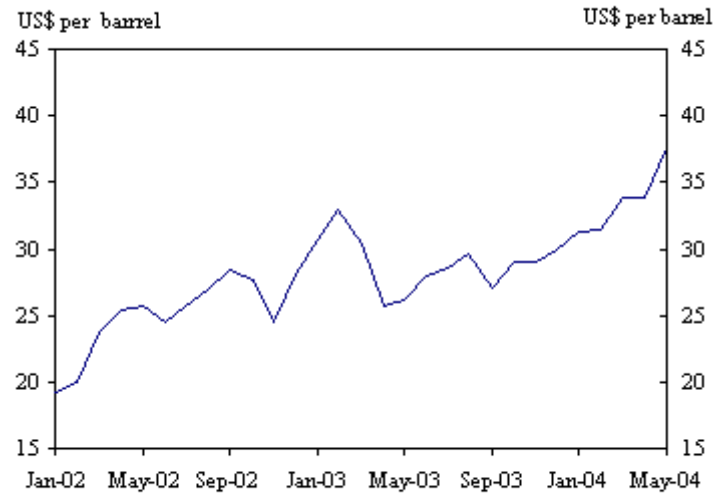
Ecuador's Correa. On the other hand, it is true that these countries require relatively small amounts of money and/or oil to keep them going.

- Reduction in acquisition of weapons and in state takeovers of industries. Slow payments of Chinese loans and Russian weapons, damaging the relationships. In fact, the deliveries of oil to China are already faltering. This, in turn will mean no more loans or lines of credit from these countries.
- Reduction in social expenditures within the country. In fact, this has already started. Direct cash handouts have practically disappeared and the money allotted to eight of the Misiones, including Barrio Adentro, has been reduced. Almost all of the money is being dedicated to free or subsidized food handouts, a program which is being managed by... the Venezuelan petroleum company!!!
- Economic crisis in Petroleos de Venezuela, the state-owned petroleum company. The company is falling behind in its payments to contractors and two drilling companies: Helmerich and Payne (Tulsa, Oklahoma) and EnSCO have stopped operations altogether, awaiting payment of about \$70 million. The company obtained loans for about \$15 billion during 2007 and 2008 but the money went to the central government, not to meet company requirements.

Outlook.

The combination of political losses and economic deterioration is significantly weakening Hugo Chavez's grasp on power. I estimate that he now has just an even chance of ending his normal term in office, although there is no organized political or popular pressure to oust him. The pressure will come spontaneously due to Chavez's continued erratic performance, increasing financial disarray, high crime rates and lack of essential food and other requirements for the Venezuelan population. Protests will take place, the armed force will not repress the protesters, civil violence might erupt and the army will invite him to step down, as they already did in the so-called CIA inspired "coup" of 2002. This is a scenario that I perceive as becoming more and more likely as time goes by and as the general situation in the country becomes more volatile and, even, desperate.

Chart : Oil prices*



Source: Bloomberg.

* Monthly average spot price of West Texas Intermediate, UK Brent and Dubai Crude

Annex.

Table 1.

An estimate of Hugo Chavez handouts

USA.

Million U.S. dollars.

River Hudson cleaning program	0.1
Oil subsidies for the “poor”	400.0
Donation to a Danny Glover film	18.0
Venezuelan Information Agency expenses	10.0

428.1

Cuba.

Oil subsidies, 2004-2008	11,000.0
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Cienfuegos Refinery	45.0	
Houses, other infrastructure	150.0	
Over-payment to Cuban personnel	600.0	
		11,795.0

Nicaragua.

Oil subsidies, mostly diesel	150.0	
Electrical plants	80.0	
Promised refinery	5,000.0	
		5,230.0

Argentina.

Acquisition of government bonds	5,000.0	
Diesel subsidies	200.0	
Oil bartered for food	300.0	
Illegal money to the Kirchners	12.0	
		5,512.0

Bolivia.

Diesel subsidies	85.0	
Cash given to Evo Morales	10.0	
Infrastructure given or promised	50.0	
		145.0

Ecuador.

Refinery promised	5,000.0	
Acquisition of government bonds	300.0	
Oil subsidies	100.0	
		5,400.0

Paraguay.

Promised expansion of refinery	100.0	
Oil subsidies	50.0	
		150.0

Uruguay.

Upgrading refinery La Teja	500.0	
Social handouts	30.0	
		530.0

PetroCaribe.

Oil subsidies for Caribbean countries	2500.0	
		2500.0

Africa.

Handouts to Niger, Mauritania, Mali and Burkina Fasso.	5.0	
		5.0

United Nations, expenses connected with

efforts to obtain a seat in U.N. Security Council	1000.0	
		1000.0

Brazil.

Promised Pernambuco refinery, 50%	1500.0	
40 oil tankers, promised	2000.0	
Donation to Rio samba school	1.0	
		3501.0

Estimated total: U.S \$, millions	36,196.1	