China's Oil "Adventure" into Venezuela

By Mamdouh G. Salameh*

Introduction

Venezuela is one of the world's largest exporters of crude oil and the largest in the Western Hemisphere. In 2009, the country was the eighth-largest net oil exporter in the world with exports of 1.83 million barrels a day (mbd). The oil sector is of central importance to the Venezuelan economy: it accounts for more than three-quarters of total Venezuelan export revenues, about half of total government revenues, and around one-third of total gross domestic product (GDP). As a founding member of the Organization of Petroleum Exporting Countries (OPEC), Venezuela is an important player in the global oil market.[1]

However, Venezuela's oil industry, hampered by years of mismanagement and shortage of highly trained cadre of engineers and technical staff, is a mess.[2] Even allowing for OPEC's production cuts, Venezuela is currently producing less than 60% of its production potential.[3] Moreover, its refineries are inadequate and long-term plans for expanding production capacity may have to be scaled back because of lack of investments.

Reserves

According to the *Oil & Gas Journal* (OGJ), Venezuela had 99.4 billion barrels (bb) of oil reserves in 2010, the sixth-largest in the world and the largest in South America.

In January 2010, the United States Geological Survey (USGS) estimated that there may be more than 513 bb of extra-heavy crude oil and bitumen deposits and 135 trillion cubic feet of natural gas in Venezuela's Orinoco belt region. That is twice the proven reserves of Saudi Arabia.

Venezuela is pressing forward with plans to become the world's leader in crude reserves. It has been making an enormous energy power play lately, certifying massive oil deposits in the country's Orinoco Belt and increasing ventures with foreign nations particularly China. In 2008, Venezuela announced that it had already certified 50 bb of new reserves.

If all goes according to plan, Venezuela will overtake Saudi Arabia in proven reserves to become the most oil-rich country in the world. President Chavez said recently in a statement that "Venezuela hopes to end 2010 with the incorporation of another 105 bb of proven reserves. With this achievement, Venezuela would become the country with the biggest proven reserves (316 bb) on the planet".[4]

Experts, however, note that Venezuela will struggle to develop its extra-heavy oil reserves in a timely fashion given its lack of infrastructure investment and the ongoing nationalizations. Oil industry experts suggest that Petroleos de Venezuela S.A (PDVSA), the country's state-run oil and natural gas company, needs to invest at least $3 bn annually in its existing fields just to maintain current production levels.[5]

Crude Oil Production & Exports

Venezuela's actual level of oil production is difficult to determine, with the government and independent industry analysts offering different estimates.

In 2009, Venezuela's crude oil production averaged 2.44 mbd with net exports amounting to 1.83 mbd (see Table 1). This is a far cry from the production level of 3.24 mbd in 2000. Numerous causes were responsible for the lower level of production, including natural depletion at older fields, maintenance, and compliance with OPEC production cuts. As of January 2010, Venezuela's OPEC production target was 2.21 mbd.

Acording to industry estimates, about 600,000 barrels a day (b/d) are converted from the extra-heavy crude and bitumen with approximately 9 API to lighter, sweeter crude known as syncrude.

Venezuela nationalized its oil industry in the 1970s, creating a national oil & gas company known as PDVSA. Along with being Venezuela's largest employer, PDVSA accounts for about one-third of the country's GDP, 50% of the government's revenue and 80% of Venezuela's export earnings.[6]

In the 1990s, Venezuela re-opened its upstream oil sector to private investment. This policy facilitated the creation of 32 operating service agreements and four strategic associations, each operated by a non-PDVSA entity. In recent years, Venezuela has moved to largely undo most of these initiatives, including mandating PDVSA majority ownership of all oil projects and increasing tax and

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See footnotes at end of text.

	2000	2005	2006	2007	2008	2009	2010	2015	2020	2030
Production	3.24	2.94	2.81	2.61	2.50	2.44*	2.21*	3.20	4.00	4.50
Consumption	0.50	0.58	0.61	0.60	0.61	0.61	0.63	0.71	0.82	1.05
Exports	2.74	2.36	2.20	2.01	1.89	1.83	1.58	2.49	3.18	3.45

Sources: BP Statistical Review of World Energy, June 2010 / Platts, www.platts.com / US Energy Information Administration (EIA) / Author's projections.

* Compliance with OPEC production cuts.

Table 1
Venezuela's Current & Projected Oil Production Consumption & Exports (2000 – 2030) (mbd)

royalty rates on new and existing projects.[7]

In 2002, nearly half of PDVSA's employees walked off the job in protest against the rule of President Chavez. The strike severely impacted PDVSA, largely bringing the company's operations to a halt. PDVSA fired 18,000 employees following the strike. Industry analysts believe that the strike did permanent damage to PDVSA's production capacity and human resources and remains a major contributing factor to continued declines in production in recent years.

In 2009, Venezuela embarked on a further nationalization of the oil sector when PDVSA took control of many service contractors in the Lake Maracaibo region.

U.S.-Venezuela Oil Ties

The United States is still the largest destination of Venezuela's oil exports. However, Venezuelan oil exports to the United States have steadily declined from 1.74 mbd in 1988 to about 950,000 b/d in 2009 (see Table 2). Historically, Venezuela has been one of the most important suppliers of foreign oil to the United States, but that importance has diminished over time.

One of the fastest growing destinations of Venezuelan crude oil exports has been China. In 2008, China imported 120,000 b/d of crude oil from Venezuela, up from 39,000 b/d in 2005. China is projected to expand its Venezuelan oil imports to 1 mbd by 2012.[8]

Though Venezuela has repeatedly threatened to cut off its oil exports to the United States, analysts say the two countries are mutually dependent. Venezuela supplies around 1 mbd of crude oil to the U.S. market according to the EIA. However, in order to wholly replace the U.S. market – home to refineries that can refine Venezuela's heavy crude oil into a marketable product – Chavez must expand his domestic capacity to refine heavy oil as well as transport it to alternative markets where there are customized refineries. According to the O&GJ, Venezuela's refining capacity currently stands at 1.28 mbd.

	1988	1996	2002	2007	2008	2009	2010
Oil Imports	1.74	1.69	1.42	1.36	1.19	0.95	0.92*
As a % of US imports	26	18	12	10	9	8	7

Sources: BP Statistical Review of World Energy, 1989-2010 / EIA.

* Estimate

Table 2
US Oil Imports from Venezuela (1988 – 2010) (mbd)

PDVSA also wholly owns five refineries in the United States and partly owns four refineries, either through partnerships with U.S. companies or through PDVSA's U.S. subsidiary, CITGO.[9]

The World Bank says that Venezuela will continue in the short term to be a key player in the U.S. market and that it will be difficult in the short term for Venezuela to make a significant shift in supply from the United States. Nonetheless, Chavez has been trying hard to diversify his oil clients in order to lessen his country's dependence on the United States.

China's Oil Involvement in Venezuela

Under the cloak of Washington's indifference, President Chavez is making steady progress in cementing strategic relations with China, which is eager to establish a strong presence in a key, mineral-rich South American economy. China has funnelled money and expertise into Venezuela's oil industry. With so much to gain in trade and oil, China will strive to keep Chavez in power.[10]

In the last six years, China has increased its presence in Venezuela's oil industry dramatically, filling a void as Chavez muscles out U.S. and even local expertise. China's growing role in Venezuela is a direct result of Chavez's systematic drive to supplant U.S. influence in his country.

Bilateral trade between China and Venezuela has grown very significantly from $85.5 million in 1999 to about $9 bn in 2008.[11] Due in part to Chavez's moves to strangle commerce with Colombia to punish it for its close relationship with the United States, China edged out Colombia in 2009 to become Venezuela's second-largest trade partner (behind the U.S. oil market). And while China's exports to Venezuela have grown over 30% per year from 2000 to 2009, U.S. exports have grown by only 6% per year during the same period.

Recent bids by Chinese companies in Venezuela's Orinoco Belt represent a significant leap forward in the size of Chinese investment in the country and the quantity of oil that the Chinese expect to extract.[12]

A series of recent investments and loans totalling $44 bn will expand China's Venezuelan oil imports from 120,000 b/d in 2008 to 1 mbd by 2012.

Although Venezuela continues to discuss oil concessions with Western oil companies, only a few are prepared to invest billions of dollars in Venezuela in light of the regime's expanding nationalization drive. Given its voracious appetite for oil, China is willing to deal with Chavez and is able to extract favourable terms for its investment.

China's payment in July 2010 of $4 bn to Venezuela is the latest tangible evidence of this mutually beneficial relationship. This first payment is part of a deal in which China will lend $20 bn to Venezuela in exchange for oil deliveries over the next ten years. Venezuela is servicing this debt by shipping 200,000 b/d to China.[13]

China's Thirst for Oil

China consumed 8.63 mbd in 2009 and imported 4.42 mbd, making it the second-largest oil consumer and importer in the world behind the United States.[14] China's projected oil consumption in 2010 could reach 9.20 mbd. By contrast, China's oil production in 2010 is forecast to remain relatively flat at around 3.7 mbd. These factors make China crucial to Chavez's strategic objective of ending his country's dependence on oil exports to the United States.

However, in order to wholly replace the U.S. market, Chavez must expand his domestic capacity to refine heavy oil as well as transport it to alternative markets where there are customized refineries.

That is where China comes in. Starting from a minuscule role in Venezuela's oil market at the time of Chavez's election, China is today involved through "upstream" operations, massive capital investments, long-term purchase agreements and strategic planning, in the exploration, exploitation, transportation, refining and distribution of Venezuela's heavy crude oil.

China's National Petroleum Corporation (CNPC) is driving a hard bargain for its participation in the exploration of the "Junin Block 4" in the Orinoco Belt, but it is clearly eager to tap this new oil. Moreover, China is set to begin shortly the construction of a new $8-bn refinery in Guangdong Province that, when it becomes operational in 2013, will be capable of receiving oil produced at the Junin 4 site. This refinery is one of several that would boost China's capability to receive and process more than 1 mbd of Venezuela's crude oil. To open up this new supply chain, China is bankrolling the urgent purchase of four to six oil tankers for the transport of Venezuelan oil exports, with the first of these set for delivery late in 2011.[15]

China's Global Oil Diplomacy

China's growing involvement in Venezuela is an integral part of its global oil diplomacy. China is very aware that its robust economic growth would falter without secure oil supplies. China's global oil diplomacy is, therefore, geared towards ensuring that this never happens.

The growing dependence on oil imports has created an increasing sense of 'energy insecurity' among Chinese leaders. The Chinese military argue that China's energy security needs to be taken 'seriously and dealt with strategically'[16] That means less reliance on the Middle East, less transportation of oil via sea lanes policed by the U.S. Navy, more oil brought in by pipeline across Asia and by tanker across the Pacific and more capability for the Chinese navy to protect Chinese tankers. Henry Kissinger has warned of a potential great-power conflict over oil: this is it.

For decades the doctrine of peaceful rise has meant that China has tried to secure energy and raw materials without confronting the United States and the West. China's long-standing willingness to deal with states that the West regards pariahs is in part a recognition that dealing with Sudan, Angola, Iran or Uzbekistan allows China to avoid direct confrontation with Western interests. However, the larger China has become, the sheer scale of its energy needs has forced it more and more to intrude into areas that the United States regards as its own sphere of influence such as Venezuela.

China's penetration into the U.S. backyard could have profound political and economic implications for the U.S., as it is dependent for one-third of its oil on imports from South American oil suppliers that it can't afford to lose to China. China's global oil diplomacy could bring it into conflict with the United States unless both countries find a constructive accommodation that allows them to do business.

Conclusions

Under the cloak of Washington's indifference, President Chavez is making steady progress in cementing strategic relations with China principally in the oil field. For Chavez, such a strategy enables him to achieve his political ambitions of eliminating U.S. political influence in his country and also reducing his country's dependence on oil exports to the United States.

For China, its growing involvement in Venezuela is an integral part of its global oil diplomacy. China is very aware that its robust economic growth would falter without secure oil supplies. China's global oil diplomacy is, therefore, geared towards ensuring that this never happens.

Though China's involvement in Venezuela could be construed by some political analysts as an intrusion into the U.S. back yard, China has no interest in supplanting U.S. influence in Venezuela. Its only interest is oil supply security and the diversification of its oil supply sources.

Historically, Venezuela has been one of the most important suppliers of foreign oil to the United States and the U.S. government would have liked to keep its relationship with Venezuela on an even keel. If this is not going to be, it is not a great loss to the U.S. oil market since Canada with as great oil reserves as Venezuela could easily fill the gap.

China's presence in Venezuela should not, therefore, be treated as a threat to U.S. national interests but a purely commercial venture by a country seeking to quench its thirst for oil.

Footnotes

[1] U.S. Energy Information Administration (EIA), Independent Statistics & Analysis, 30 November 2010.

[2] PDVSA fired about eighteen thousands experienced technical personnel in the wake of the 2002 strike.

[3] Calculated by the author on the basis of available data from different sources.

[4] Venezuela Oil Reserves Could Be World's Largest: What It Means for the U.S., AOL News, Surge Desk, p.2.

[5] Cesar J. Alvarez & Stephanie Hanson, Venezuela's Oil-Based Economy, Council on Foreign Relations, February 9, 2009, p. p.5.

[6] EIA, Country Analysis: Venezuela.

[7] Ibid.

[8] Roger F. Noriega, Chavez & China: Challenging U.S. Interests, Latin American Outlook, American Enterprise Institute for Public Policy Research (AEI), No.3, August 2010, p. 2.

[9] CITGO is a wholly-owned subsidiary of PDVSA that has some 14,000 branded outlets (both directly owned and affiliates) in the United States. CITGO operates three refineries (Lake Charles, LA; Corpus Chrisiti, TX; Lemont, IL) with a combined crude refining capacity of 755,400 b/d.

[10] Roger F. Noriega, Chavez & China: Challenging US Interests, p. 1.

[11] "Venezuela Pares China Debt with $20 bn Oil Accord", Bloomberg, August 4, 2010 at www.bloomberg.com/news/print/2010-08-05.

[12] China & Venezuela Sign Agreements on Junin-4 & a Long-term Finance Loan, Your Oil & Gas News, April 20, 2010.

[13] Simon Romero, Chavez Says China to Lend Venezuela $20 Billion, New York Times, April 18, 2010.

[14] BP Statistical Review of World Energy, June 2010, pp. 8-11 & also p. 21.

[15] Roger F. Noriega, Chavez & China: Challenging U.S. Interests, p. 3.

[16] Mamdouh G Salameh, China's Global Oil Diplomacy: Benign or Hostile? (a Paper given at the 31st ISEE International Conference, 18-20 June 2010, Istanbul).

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