TRANSPARENCIA
Venezuela

April 2022

GOVERNANCE PRACTICES THAT ENCOURAGED CORRUPTION AT PDVSA

GOVERNANCE PRACTICES
THAT ENCOURAGED
CORRUPTION AT PDVSA

Investigation
of Transparencia Venezuela
April 2022

Some pictures were taken from
www.freepik.com - https://unsplash.com/

Av. Andrés Bello con 1era transversal de Los Palos
Grandes, Edif. Multicentro Empresarial Los Palos
Grandes, piso 6. Chacao. Caracas. Venezuela.
Tlfs.: 212 286.24.10 / 286.49.47

CONTENT

GOVERNANCE PRACTICES THAT ENCOURAGED CORRUPTION AT PDVSA

7 **INTRODUCTION**

8 **BACKGROUND** Chapter 1

10 **OVERVIEW OF CHANGES IN THE ENVIRONMENT THAT FOSTERED CORRUPTION** Chapter 2

10 Evolution of PDVSA's Operating Environment

Political and Economic Context

13 International Sanctions

Internal and external events that impacted the company

15 Politicization of PDVSA

16 Diversification and Oversizing of PDVSA

16 Compensation

17 Parafiscal Funds and Social Projects

19 Energy Agreements

20 The Second Nationalization of the Industry

20 Duplicity of Managerial Roles

21 Weak Oversight Mechanisms

22 Changes in laws and regulations

22 Amendments to the Constitution

22 Changes in the Oil Industry Legal Framework

24 Changes to the BCV Law and Foreign Exchange Agreement

Main weaknesses of internal oversight bodies

26 PDVSA's Internal Comptroller's Office

26 Tender Committees

27 Management oversight

TRANSPARENCIA Venezuela

CONTENT

Chapter 3 **OVERVIEW OF CHANGES IN THE RELATIONSHIP WITH EXTERNAL OVERSIGHT BODIES** 28

People's Ministry of Petroleum 28

Office of the Comptroller General of the Republic 28

PDVSA's relationship with the BCV and the Ministry of Finance 29

Accountability to the National Assembly 30

Cessation of SEC reporting 30

Relationship with Independent Auditors

Relationship with joint venture partners 31

Chapter 4 **OVERVIEW OF MAIN OPERATIONAL AREAS WHERE CORRUPTION MATERIALIZED** 32

Exploration and Production 32

Refining and Upgrading 33

Trade and Supply 34

Finance 35

Others 36

Chapter 5 **SUMMARY OF PDVSA'S RELATIONS WITH SUBSIDIARIES ABROAD THAT FACILITATED CORRUPTION** 37

Citgo 37

PDVSA offices abroad 37

Chapter 6 **OVERVIEW OF SOME PARADIGMATIC EXAMPLES OR CASES** 38

Chapter 7 **CONCLUSIONS AND RECOMMENDATIONS** 42

INTRODUCTION

Venezuela ranked 176th in in the 2020 Corruption Perceptions Index published by the NGO Transparency International. This places it among the five countries perceived as the most corrupt out of a total of 180 countries, along with Yemen, Syria, South Sudan and Somalia.

The organization defines corruption as the "abuse of entrusted power for private gain." The term similarly defined in the Oxford dictionary: "dishonest or illegal behavior, especially of people in authority."

The Venezuelan oil industry, as the main driver of the economy and decade-long generator of more than 80% of the foreign exchange, is not immune to such practices, especially as it is a State monopoly.

This paper makes an overall analysis of the conditions that created the incentives that led PDVSA from being one of the best managed state-owned oil companies in the world to a company directly and/or indirectly involved in around thirty cases of corruption investigated by the United States Department of Justice[1], and almost one hundred[2] if we count the cases handled by the Prosecutor General's Office of Venezuela.

1 www.justice.gov

2 https://transparencia.org.-ve/project/petroleo-historia-6/

BACKGROUND

The first cycle lasted 28 years (1943–1970), during which oil production skyrocketed from 490 mb/d in 1943 to an all-time high of 3.71 mmb/d in 1970 (+3.22 mmb/d), driven by world economic growth after World War II. The Organic Law of Hydrocarbons (LOH) of 1943 attracted foreign investors who operated the fields under concessions and paid 1/6 of the oil extracted (royalty) plus income tax. After several reforms, an additional tax was established that guaranteed an equitable distribution (50/50) between the State and the concessionaires. In the third part of this cycle, OPEC was founded (1960).

In real 2020 terms, during the first cycle, an estimated $1.54 trillion in cumulative oil revenues were generated. However, the oil bonanza and the equitable distribution (50/50) of the revenue created little incentives for corrupt practices by the state or the oil companies.

During the second cycle, which lasted 14 years (1985–1998), production grew by 1.65 mmb/d, from 1.68 mmb/d in 1985 to 3.33 mmb/d in 1998. The discovery of the El Furrial field, in the north of the state of Monagas, in 1986, and the "Apertura," when the industry was opened to foreign companies, in 1992, were the main drivers of this last expansionary cycle. This second cycle—half as long as the previous one—saw cumulative gross revenues of around $758 billion (at constant 2020 prices), despite the combined effect of higher (nominal) prices and lower production.

In between the two cycles, however, the first oil nationalization took place in 1975 and state-owned oil company PDVSA was created one year later. The decision was aligned with the rest of the OPEC member countries that nationalized their oil industry between the late 1960s and early 1970s. After the 1975 nationalization, production fell by 1.91 mmb/d from the historical peak of 3.71 mmb/d in 1970, for an average of 1.80 mmb/d in 1983, the year of the first major currency devaluation, known locally as Black Friday.

In order to avoid the politicization of the sector, PDVSA was created as a parent company to coordinate the activities of the new national oil companies merged into three main operators (Corpoven, Maraven and Lagoven). These subsidiaries maintained the same practices and structure as the international oil companies. In 1997, PDVSA was restructured, with the operating subsidiaries disappearing and becoming a large vertically integrated state-run oil company. However, before and after the restructuring, PDVSA was subject to different internal and external, national

As shown in Figure 1, the Venezuelan oil industry has experienced two major expansion cycles in its history

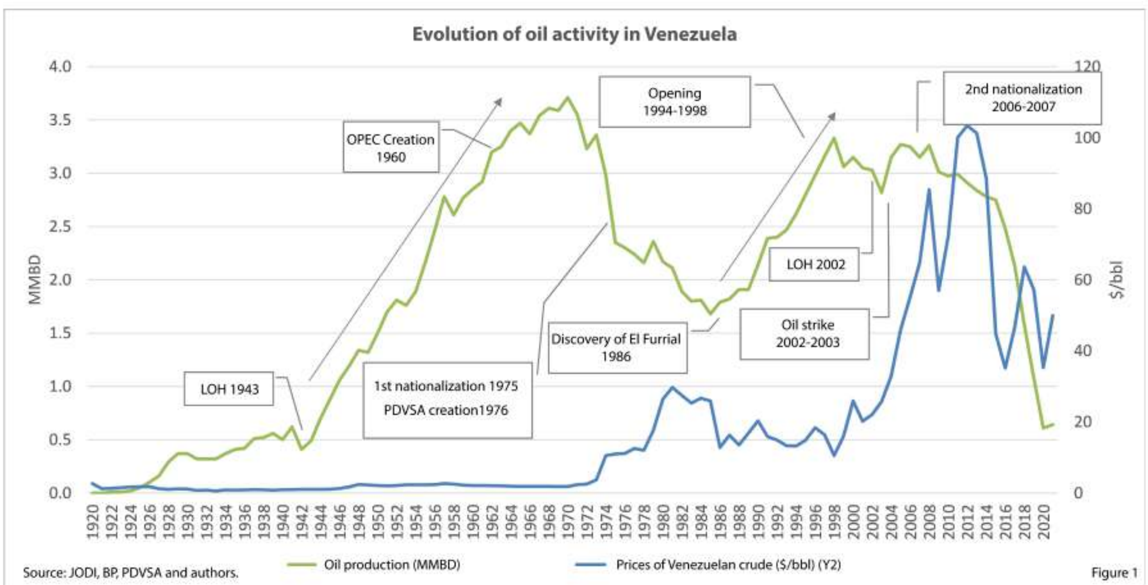


Figure 1

1975

First oil nationalization. PDVSA was created one year later

and foreign oversight mechanisms.

Internally, PDVSA had prior oversight systems, tender committees and an internal audit organization with its respective internal auditor, in addition to the general commissioner, as established in the Code of Commerce. Externally, PDVSA had external auditors such as the firm Espiñeira Sheldon y Asociados, representatives of international auditing firm PricewaterhouseCoopers, at first, and later public accounting firm Alcaraz Cabrera Vázquez, local representatives of KPMG.

In addition, the U.S. Securities and Exchange Commission (SEC) acted as an additional external watchdog as a result of the start of debt (bond) transactions in 2001.

Additionally, the remuneration, career plans and work environment that PDVSA and its subsidiaries offered their workers were comparable to the best international standards, which not only allowed them to attract and retain talent, but also significantly reduced the incentives for corrupt practices, especially considering that PDVSA and its subsidiaries were among the top five best employers nationwide.

However, a series of internal and external events that occurred during the administration of the late President Chávez (1998–2013), and that continued during the current administration of President Maduro, created incentives for an exponential increase in corrupt practices within PDVSA, with nearly a hundred open corruption cases in national and international courts.

OVERVIEW OF CHANGES IN THE ENVIRONMENT THAT FOSTERED CORRUPTION

Evolution of PDVSA's Operating Environment

Political and Economic Context

Chapter 2

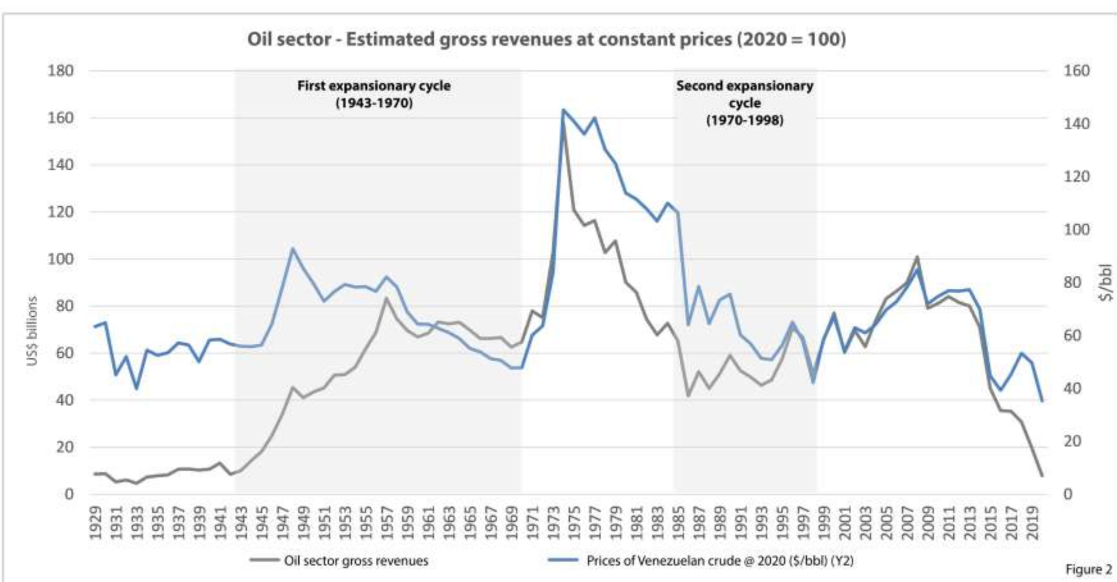
GOVERNANCE PRACTICES THAT ENCOURAGED CORRUPTION AT PDVSA

Although oil production fell by more than 2 mmb/d after the first nationalization of the industry and the creation of PDVSA in the mid-1970s (1970–1985), as shown in Figure 1 above, oil revenues, in constant 2020 terms, increased significantly during that period (see Figure 2 below), thanks to a 122% increase in oil prices in constant 2020 terms from $47.8/bbl (current $1.84/bbl) in 1970 to $106.4/bbl (current $25.89/bbl) in 1985 (+$58.6/bbl in constant terms or +$24.1/bbl in current terms). This helped the economy experience a 40-percent cumulative growth during the same period.

The end of that period (1983) saw the first macro-devaluation (64%) of the bolivar against the US dollar (the bolivar had been pegged to the dollar since 1934) and an exchange control regime was implemented. For this purpose, the Office of Differential Foreign Exchange Regime (RECADI 1983–1989) was established. These events not only marked a milestone in the history of the Venezuelan economy, but, like all foreign exchange controls, led to arbitrage opportunities that encouraged corruption, mainly in the public finance sector. But the oil sector remained impervious to these events, maintaining its role as the main supplier of foreign exchange to the central government.

In addition, the continuous fall in oil prices from their all-time high in 1974 of $145/bbl (in real terms) to $73.4/bbl in 1989, deeply affected the national economy which, together with a package of economic measures recommended by the IMF, and the RECADI corruption scandals, contributed among other factors that year to the social uprising known as El Caracazo.

This event ushered in a period of political instability leading up to two failed coups in 1992, an impeachment trial of President Carlos Andrés Pérez and a transitional government presided over by Octavio Lepage and Ramón J. Velásquez for less than a year between 1993 and 1994. Elections were subsequently held, which were won by



Source: JODI, BP, PDVSA and authors.

Figura No. 2
Oil sector - Estimated gross revenues at constant prices (2020 = 100)

1983

First MACRO-DEVALUATION of the Bolivar vs. the US Dollar

Rafael Caldera—with a 40% abstention—supported by a diverse political platform composed of a coalition of minority parties. During the Caldera administration (1994–1998), the "Apertura" (participation of foreign companies) that had begun in 1992 with the first round of Oil Operating Agreements was expanded, which gave a boost to the second expansionary cycle of oil production that had begun in 1986 with the discovery of the giant Furrial field. The "Apertura" was a policy of increased production designed to mitigate the effect of the drop in prices (revenues) during the previous years. However, the Caldera administration created the Technical Office of Exchange Administration (OTAC 1994–1996) to administer a new foreign exchange control which was implemented in July 1994, keeping the exchange rate fixed at Bs.170/$ until mid- August 1995 and then at Bs.290/$ until April 1996, when it was dismantled, due to a higher revenue flow resulting from the combined effect of higher oil production (>500 mb/d from the 1993 average) and higher prices of the Venezuelan basket (+$13.7/bbl in real 2020 terms and +$5.1/bbl in current terms vs. the 1993 average).

Between 1994 and 1997, the world economy grew by more than 3% per annum, mainly driven by Asian economies. In aggregate, these economies had grown at a rate of more than 8% year-on- year during 1992–1996. The development of infrastructure and manufacturing activity in these economies made them oil-intensive. But the Asian Financial Crisis of July 1997 impacted the world economy and the growth rate fell to 2.6% that year and 2.3% in the Asian economies, which had grown at 4.6% the previous year.

The impact of this crisis was felt in the oil market in 1998, when the growth of world oil demand fell by 380 mb/d (0.5%) after having grown by more than 1 mmb/d per year (2%) during the previous four years. This contraction in world oil demand occurred in the midst of an expansion of Venezuelan production following the rest of the OPEC countries (especially Iraq, which was recovering after the Persian Gulf War during which Saddam Hussein's regime was overthrown in 1991). All these factors put strong downward pressure on crude oil prices, which fell by $15.8/bbl (-$4.3/bbl in current terms) that year from the previous year (1997), reaching levels of $42.2/bbl (-$10.6/bbl in current terms).

Venezuela experienced a period of relative political and economic stability during the first four years (1994–1997) of the second Caldera administration. Although the exchange control administered by OTAC also presented arbitrage opportunities, it did not affect PDVSA directly in terms of corruption, other than the fact that some PDVSA finance employees moved into positions in OTAC and the Ministry of Finance.

The sharp economic downturn of 1998 spurred social unrest, leading in December of that year to the election of Hugo Chávez as president, who was pardoned by former President Caldera, following the failed 1992 coup. During the early years of the Chávez administration, a new constitution was drafted and approved in 1999, and a climate of political instability prevailed, during which a large sector of civil society opposed the policies of that administration.

In 1998 OPEC, in cooperation with other non-OPEC countries (Mexico, Oman, Russia and Norway), cut production by 3.1 mmb/d, followed by an additional 1.72 mmb/d in 1999, for a cumulative total of 5.71 mmb/d. For 2000, the Venezuela basket averaged $67.1/bbl ($25.9/bbl in current terms), which increased gross oil sector revenues to $77 billion, up from $51 billion in 1998. During this period (1998–2000), Chavez began to finance public spending, directed at social programs inefficiently administered by members of the military (e.g., Plan Bolivar 2000).

It should be noted that corruption in the oil sector did not begin immediately after Chávez came to power, since PDVSA's management structure remained intact until the end of 2002 and early 2003, when the Oil Strike took place. During that event, more than 20,000 employees (50% of the payroll), composed mostly of professionals and technicians with more than 15 years of experience, were laid off. This event marked a historic milestone in the oil sector and paved the way for the generalized politicization and corruption of the sector and PDVSA.

In 2002, the new Hydrocarbons Law (LOH) was enacted, which led to the migration of the service agreements signed during the "Apertura" with national and international oil companies to joint venture agreements (2005–2007), leaving PDVSA with a majority shareholding (>60%) in each partnership and with preferred shares. This second nationalization of the oil sector affected the perception of country risk. In this sense, PDVSA and its strategic partners in the Orinoco Oil Belt (FPO) had to offer direct guarantees in order to secure international financing for three of the four pioneer projects of the FPO, among other things, due to the high perception of sovereign risk following the 1975 nationalization.

Between 2006 and 2008, oil prices continued to grow due to an increase in world demand, mainly China, which in just over ten years (1997–2008) doubled its consumption to 8 mmb/d in 2008. This caused crude oil prices to reach an all-time high of $134/bbl in June 2008 (at current WTI), with the Venezuelan basket averaging $84.8/bbl that year ($85.4/bbl in current prices). Gross revenues that year exceeded $100 billion, unprecedented since the 1970s.

Furthermore, the Global Financial Crisis occurred in 2007 as a result of the bursting of a real estate bubble in the United States, which impacted the world oil sector during the second half of 2008, causing oil prices to fall to $41.1/bbl in December of that year. OPEC jumped in again and cut 4.2 mmb/d that year (Venezuela's quota was -364 mb/d). This cut, in practice, did not affect Venezuela because production from mature fields in the West and East had already been falling. Additionally, OPEC cuts are made on the basis of production figures reported by secondary sources, which showed a lower production (600-700 mb/d less) than the official figures.

In 2009, the oil service companies that operated gas compression and injection plants, water injection plants and maritime transport companies were expropriated and nationalized. This did not have an immediate impact on production, but its effects began to be felt two years later (2011), not only on production, but also as corruption.

In 2012 Chávez is re-elected for the last time. To ensure his re-election, public spending increased

Chapter 2

GOVERNANCE PRACTICES

THAT ENCOURAGED CORRUPTION AT PDVSA

2003

Oil Strike
20,000+
employees dismissed

to record levels in 2011–2012 thanks to the recovery of Venezuelan crude prices above $75/bbl (>$100/bbl in current prices). Production remained above 2.9 mmb/d during that period, yielding gross revenues of +$80 billion per year. Chávez died between December of that year and March 2013, with Nicolás Maduro succeeding him in April 2013.

In 2015, the political opposition won the majority of seats in the National Assembly (NA), exacerbating the conflict between the opposition and the ruling party, which had already escalated after student protests were brutally repressed in 2014.

Between 2014 and 2016, crude oil prices fell from $70/bbl ($88.6/bbl in current terms) in 2014 to an average $39.3/bbl ($35.2/bbl in current prices) in 2016, for a $30.7/bbl (today $53.4/bbl) contraction, while production had fallen by about 300 mb/d during that period. As such, gross revenues contracted by 50% from about $71 billion in 2014.

This contraction caused international oil service companies (Schlumberger, Halliburton, Weatherford and Baker Hughes) to cut back their activities in the country to their operational minimum in 2016, as a result of PDVSA's lack of payment.

International Sanctions

Although international sanctions (mainly from the United States) date back to 2006, most of these had been imposed on individuals and officials or former officials of the Venezuelan government in relation to drug trafficking, support for international terrorism and/or human rights violations (repression/torture).

However, it was not until 2017, when the Maduro administration installed the Constituent Assembly to counter/neutralize the National Assembly elected in 2015, that the U.S. government imposed new sanctions against the Government of Venezuela, including PDVSA and the Central Bank (Executive Order No. 13808), closing access to international (traditional) financial markets for these entities. That year (2017), the U.S. government also sanctioned Tareck El Aissami and his front man Samark López. Noteworthy is that El Aissami is one of the highest-ranking and most prominent officials in the Maduro administration and is currently Minister of Petroleum.

The sanctions imposed on the trade of crude oil subsequently impacted the crude oil for fuel (diesel and gasoline) trading schemes (swaps).

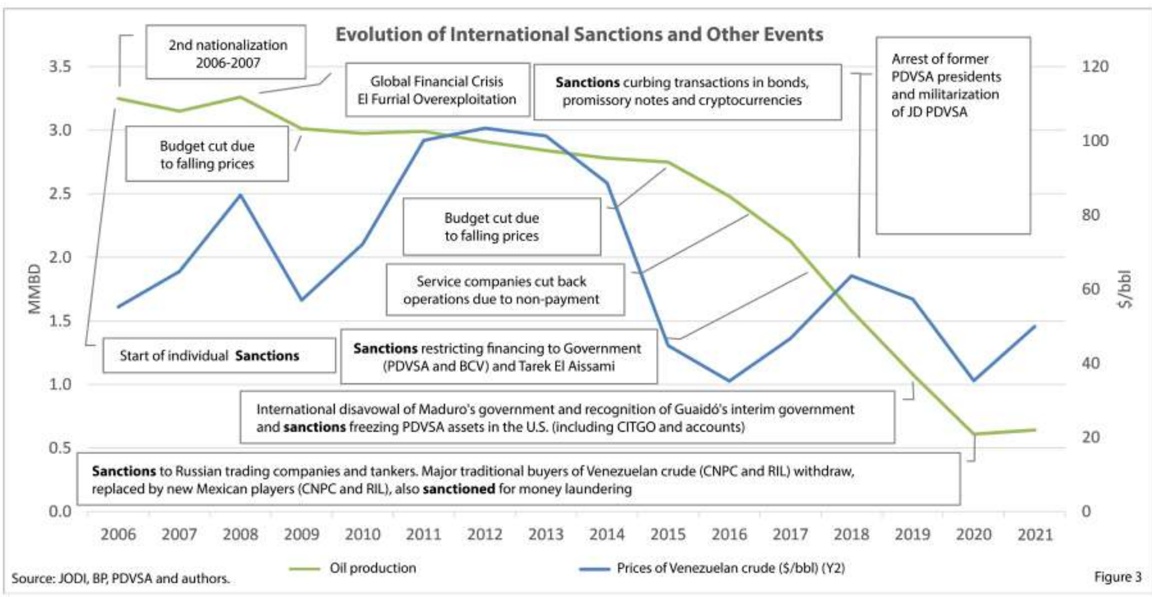
While this set of international sanctions closed access to orthodox financing, it is also true that it exacerbated the incentives for corrupt practices, generating arbitrage opportunities for traders willing to assume the risk of being sanctioned, trading Venezuelan crude oil in the Asian market. Some Chinese independent refineries took the lead in buying Venezuelan crude, consuming a small part and reselling the bulk of the volume to CNPC, the opposite of what they did in the past.

Buyers and traders demanded a risk premium for sanctions, in excess of 25% of the selling price, which is generally around $10-15/bbl below Brent, due to the low quality of Venezuelan heavy crude. Additionally, the sanctions on the oil sector forced the Maduro administration to diversify its traditional sources of financing (oil) towards illegal gold mining, with PDVSA becoming a vehicle for illegal financing and money laundering through triangulation with food import operations (e.g. CLAP), according to data published by the U.S. Department of Justice.

Lastly, during the past seven years (2014–2021), Venezuela has endured probably the longest and deepest hyperinflation and economic downturn in contemporary world economic history.

All these events in PDVSA's context helped provide a breeding ground for the notorious corrupt practices in international courts.

Figure 3 below shows a timeline of the main international sanctions, as well as other events that directly and indirectly impacted the oil sector



Source: JODI, BP, PDVSA and authors.

Figure 3

Internal and external events that impacted the company

In addition to the events described above, there were a number of internal and external events that encouraged corruption within PDVSA.

Politicization of PDVSA

The first step in the expansion of corruption in PDVSA was the gradual but widespread politicization of the company after the oil strike (2002–2003). The company's top and middle management were replaced by a few professionals who never joined the strike and saw an opportunity to climb the ranks quickly. Others joined the strike at first, and then regretted it. Most of these professionals came from Lagoven, Corpoven and Intevep, while very few from Maraven remained (e.g. Eulogio Del Pino, Nelson Martínez, Félix Rodríguez, Luis Marín, Iván Orellana, just to mention a few).

This is partially explained by the restructuring that PDVSA underwent in 1997, from an organizational structure of a parent holding company and operating subsidiaries (Corpoven, Lagoven and Maraven), to a vertically integrated company. While it was a wise decision, this process was led by members of the former operator Maraven; the president of PDVSA at that time was a Maraven professional (Luis Guisti).

This created organizational chaos because many of the key positions in the restructured PDVSA were held by other Maraven staff, with a few exceptions, such as the VP of Exploration and Production (Juan Szabo), who had developed his career at Lagoven. Many other senior professionals were sent to subsidiaries abroad (e.g. Corpoven's Roberto Mandini, who later became the first president of PDVSA during the Chávez administration) or to Intevep (PDVSA's R&D branch), such as Eulogio Del Pino and Nelson Martínez.

After the oil strike, and with Alí Rodríguez Araque at the helm of PDVSA, many of the managerial positions were originally filled by active officers of the National Armed Forces. In addition, some PDVSA retirees returned to provide support (e.g. Eudomario Carruyo, who re-joined as CFO) and many other professionals, and inexperienced non-professionals, were hired under an expedited process, in which priority was given to political loyalty to the Revolution rather than academic credentials and/or professional experience.

The Tascón list[3] was the main screening tool for job applicants at PDVSA. Under the political slogan "Now PDVSA belongs to the people," many young people with little or no experience (with little interest in politics for the most part), flocked to the company in search of job opportunities. The upshot is that, by 2005, the number of PDVSA employees exceeded the number of employees before the strike (45,683 in 2002 and 49,180 in 2005).

[3] List with names and ID numbers of Venezuelans who signed petitioning for a recall referendum against Chávez in 2003 and 2004, which was used as a tool of social segregation and discrimination.

Diversification
and Oversizing
of PDVSA

2014

Exorbitant and disorganized oversizing of the labor force

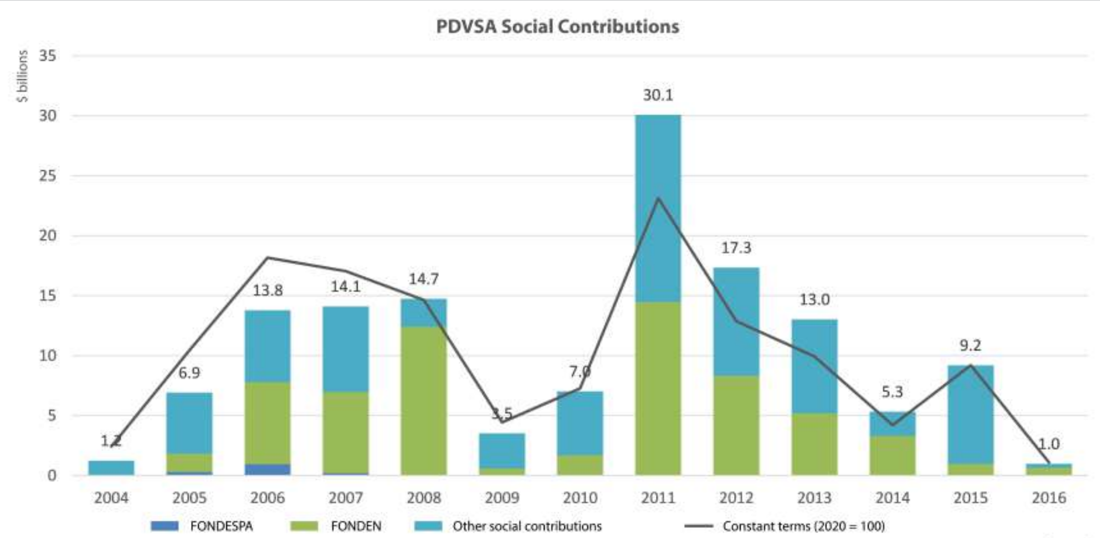
Another issue that fostered PDVSA's corruption was a disproportionate and disorderly increase in the workforce, which grew steadily over ten years, from 49,180 employees in 2005 to a peak of 152,072 employees in 2014. The absorption of staff from service companies that were converted into joint ventures (2006–2007), the service companies that were expropriated (2009), plus all the personnel that were hired to work in the numerous PDVSA non-core diversification projects (2006–2012), were the causes of such growth.

This is how PDVSA went from being an oil and gas company to a "socialist" company, involved in agricultural and food distribution projects, among others. This policy of creating—mostly unproductive—jobs was only sustained by rising oil prices. The uncontrolled growth of the workforce contributed, first, to increasing the company's labor costs and liabilities, which was detrimental to an appealing compensation to attract and retain talent; and, second, to expanding the company to unmanageable levels (organizationally and oversight-wise).

Compensation

In terms of compensation, the elimination of the double social benefits payment scheme in 1998 created incentives for corruption in PDVSA. The old system was the main compensation mechanism that made the company competitive vs. others in the industry. In fact, the multinational companies working in Venezuela offered more attractive salary packages than those paid by PDVSA. After the restructuring, a mixed compensation scheme was implemented (with a fixed and a variable portion), with the variable portion being higher as professionals moved up the organizational structure. The variable portion was based on the company's net income and the employee's performance evaluation. This scheme was only in place until the year 2000, because with the fall of crude oil prices in 2001, this portion disappeared; after the strike, this compensation policy was completely eliminated.

The mixed compensation scheme based on the employee's performance (known as "Meritocracy") was replaced by a flat, totally discretionary salary increase scheme, which has always stood below the annual inflation rate. Consequently, this meant that—in only a few years—oil workers were paid much less than other public officials working in agencies such as the Central Bank of Venezuela (BCV) or the National Integrated Service of Customs and Tax Administration (SENIAT). In fact, PDVSA employees did not receive any salary adjustment during the three years following the Oil Strike (2003–2005), a period when inflation averaged 23% year-on-year. This encouraged staff to seek greater income by moving up the organizational structure, based on political loyalty to the revolution (esp. during the Chávez administration). Political activism was better rewarded than professional performance.



Source: PDVSA audited financial statements

Figure 4

Below, **Figure 4** shows PDVSA's social contributions during the years 2004 and 2016, according to PDVSA's audited financial statements

Parafiscal Funds and Social Projects

2011

All-time high social contribution **USD 30 billion**

However, this expansive diversification was financed through the creation of parafiscal funds and social projects. PDVSA ceased to be just the nation's main fiscal contributor and became also the most important social contributor. In terms of corruption, this had the greatest impact. What began with Chávez's $1 billion request to the BCV in 2003 would later become a whopping $23 billion in 2011 ($30 billion in current terms), according to PDVSA's audited financial statements. This record was reached just one year before Chávez's last re-election campaign, thanks to a partial reform of the BCV law (2005)[4] that authorized, among others, the transfer of the BCV's international reserves to the fund.

In 2004, the Fund for the Economic and Social Development of the Country (FONDESPA) was created, to be replaced a year later by the Fund for National Development (FONDEN)[5]. Both funds were fed with oil revenues considered extraordinary, i.e. if the sale price of crude oil exceeded the price per barrel used for the calculation of the national budget, or exorbitant revenues if the price of crude oil exceeded $70-80/bbl. In addition, PDVSA made substantial contributions to many other social funds and projects, called missions (e.g., rural healthcare centers—Barrio Adentro—, the Misión Ribas education program, the Misión Mercal food program, among others).

These substantial funds managed by these funds, projects and missions were mostly administered by trusts in the Bank for Economic and Social Development of Venezuela (BANDES), an entity that, since its creation in 2001, showed great opacity and discretionality in terms of accountability and administration. Noteworthy is that the financial statements of this bank have never been published, nor was it audited by the National Assembly (even when controlled by the opposition).

Additionally, BANDES administered loan from the China Development Bank (CDB), agreed as of 2007 and repaid with oil shipments to the Asian giant. Between 2007 and 2015, the CDB granted a total of $50 billion, divided into three tranches, and a large fund, which were administered by BANDES.

4 Official Gazette No. 32.832 of 07/20/2005

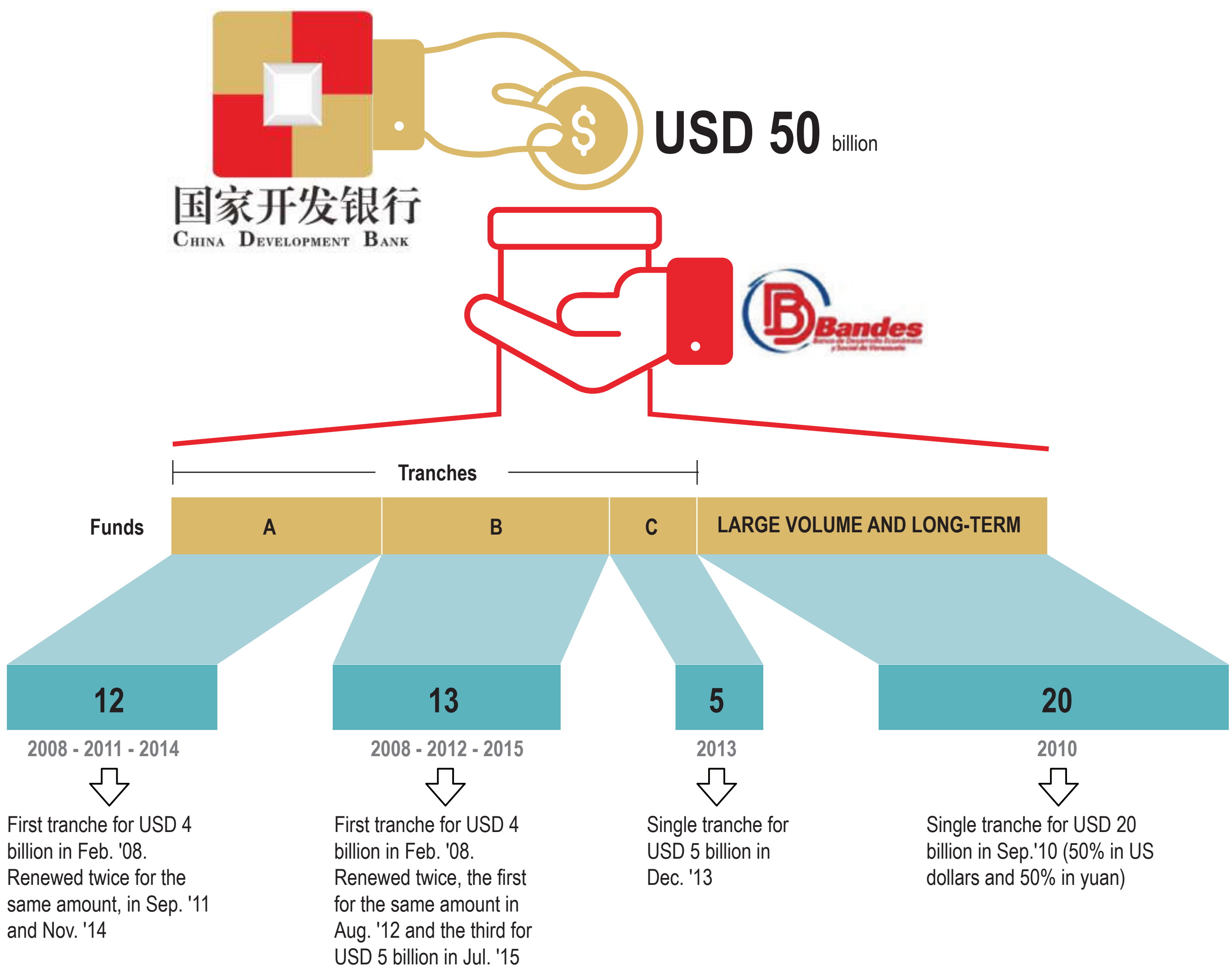
5 Official Gazette No. 38.261 of 08/30/2005

In fact, all exports of crude oil and products to China were deposited in BANDES' receiving accounts at the CDB, and disposing of part of the surplus required a signed authorization by President Chávez, after repayment of obligations and their respective covenants were fulfilled.

Thus, the combination of large funds with little or no transparency, with the lack of independence of branches of government, provided the perfect breeding ground for an overall escalation of corruption. PDVSA was doubly exposed to corruption in relation to these large funds (FONDESPA, FONDEN, Social Contributions and the Chinese Fund). The company generated the money through oil exports, and while administered by BANDES and other funds, PDVSA managed part of the resources once the funds were disbursed to the various social projects in which the company had a stake (e.g. Mercal was the subject of a public scandal when containers of tons of rotting imported food were discovered dumped in the open air).

2001

BANDES was created to manage funds, projects and missions, including loans from CHINA DEVELOPMENT BANK



2000-2005

Oil shipments under unfavorable conditions for Venezuela resulted in economic losses and encouraged corruption in PDVSA

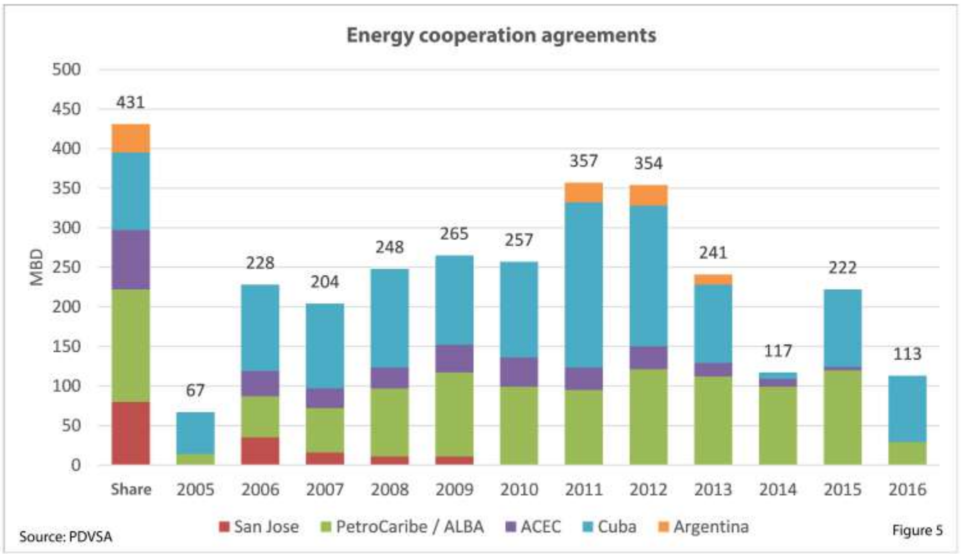


Figure 5
Energy cooperation agreements

Energy Agreements

In addition, between 2000 and 2005, the government signed several energy cooperation agreements with various Latin American and Caribbean countries, as shown in Figure 5 below.

Most of these supply agreements established conditions in which a portion was paid in 90 days (30%–95%), depending on the price level (the higher the price, the lower the portion of short-term repayment), while the remainder was repaid in the long term (15–25 years) with a 1 or 2 year grace period of and at an 1%–2% interest rate.

The volume sent to the Caribbean countries often exceeded the volume of domestic consumption in those countries, which encouraged them to resell the surplus internationally at market prices and conditions. In addition, the payments of the oil bill went to a fund for financing infrastructure projects in those countries. This scheme not only represented an economic loss and an incentive for corruption in PDVSA and Venezuela, but also for the member countries of these agreements.

However, these energy cooperation agreements became an effective diplomatic tool for Chavez and Maduro, as it gave them the political support of member countries in international forums such as the Organization of American States (OAS), which is effectively another type of corruption.

These oil shipments under unfavorable conditions for Venezuela and PDVSA continued even after the fall in oil prices in 2015. However, international sanctions put an end to these deliveries, with Cuba as the only exception.

Chapter 2

GOVERNANCE PRACTICES

THAT ENCOURAGED CORRUPTION AT PDVSA

The Second Nationalization of the Industry

The nationalization of the sector during the period 2006–2007 was another important event that fostered corruption. PDVSA became the majority partner in all joint ventures, with preferred shares more than a 60 percent stake. This resulted in PDVSA taking over boards of directors, operations and finances in each joint venture. These were previously handled by international companies during the time of operating agreements, risk- and profit-sharing exploration agreements, and the strategic partnerships in the Faja.

Because of the capital-intensive nature of the business, all oil companies in the world are exposed to the risk of corrupt practices. However, international companies are generally listed on stock exchanges, which places them under the regulation of government agencies and the watchful eye of shareholders who demand efficiency and transparency. In addition, most international companies are subject to laws that sanction international corrupt practices such as the U.S. Foreign Corrupt Practices Act and the UK Bribery Act.

Under the slogan of "Full Oil Sovereignty," PDVSA progressively took over all the core processes of the joint ventures, including finance and procurement, which came to be controlled by poorly paid and inexperienced PDVSA personnel.

Even when the partners created a scheme of "secondees" or parallel positions in core roles, with the purpose of guaranteeing efficiency of processes and mitigating corruption practices, PDVSA, however, took more and more control of everything. Also, the partners were forced by PDVSA to adopt a passive role as venture capitalists, which would later be criticized by the same PDVSA authorities that forced this situation on them.

Duplicity of Managerial Roles

Another determining factor in the upsurge of PDVSA's corrupt practices was the duplicity of roles in 2004 with the appointment of Rafael Ramírez as Minister of Petroleum and President of PDVSA at the same time. This structure lasted for ten years, until 2014. Although the Ministry of Petroleum did not efficiently exercise its public policy design and oversight role because it did not have enough trained personnel, the Ministry had always maintained its independence. Consequently, merging of the ministry and the presidency of PDVSA in the hands of the same person effectively nullified this independence and the oversight role of the ministry.

Similarly, the combination of the company's extensive expansion and diversification policy, with the limitations of scarce experienced personnel and requirements of political loyalty, meant that members of PDVSA's Board of Directors and senior management were required to hold several positions simultaneously, which worked against their human capacity to control several processes at the same time. In addition, this work overload and increased responsibilities, without associated salary compensation, created incentives for officials to seek other forms of income.

Weak Oversight Mechanisms

Most of the financial debt that PDVSA and its partners had incurred to finance the construction of three FPO projects was cancelled between 2004 and 2006. This was the first step for PDVSA to stop reporting its financial statements to the U.S. Securities and Exchange Commission (SEC) as of 2006, thus eliminating one of the main external watchdogs.

Although PDVSA has always been audited by local representations of international auditing firms (KPMG since 2001, and PricewaterhouseCooper before that), after the SEC obligations were terminated, the publication of audited financial statements became fully discretionary. Such reports, or interim (semi-annual) reports, were generally issued just prior to any bond or other debt issue, which resumed in 2007 with the first issue of $7.5 billion in unsecured bonds. In addition, although audit firms rely on their reputation, at the end of the day it is the client, in this case PDVSA, who pays for that professional service.

The Office of the Comptroller General (CGR), which is entrusted with overseeing all government agencies, was transformed into a vehicle for political persecution, auditing and politically disqualifying candidates or members of the opposition (e.g.: The CGR disqualified interim president Juan Guaidó and twenty-seven other members of the National Assembly on 23/2/2021). Previously, this comptroller body used to conduct thorough monitoring of PDVSA's top executives through sworn statements of assets.

On the other hand, Maduro's administration, and PDVSA as a company, stopped presenting its traditional Annual Report to the National Assembly when the opposition won the majority of seats in 2015. That was the last year in which PDVSA presented such report to the NA. Thus, Parliament, another comptrollership instance, could no longer exercise that role, making PDVSA more vulnerable to corrupt practices.

Additionally, SENIAT used to audit PDVSA annually before the Oil Strike, but ceased such practice because PDVSA was no longer perceived as an independent entity, and the oil bonanza (resulting from the oil price hike between 2003 and 2008, and then between 2011 and 2014) meant that the main contribution to the central government came through transfers to FONDEN, and not through taxes.

Changes in laws and regulations

With President Chávez's rise to power in 1999, a series of changes in the regulatory framework in which PDVSA operated paved the way for corrupt practices.

Amendments to the Constitution

First, Chávez convened a National Constituent Assembly that drafted and approved a new constitution in 1999, thus repealing the 1961 constitution. The new constitution added one year to the presidential term, for a total of six years, and established a unicameral rather than a bicameral legislature, among other changes, which led to a renewal of the branches of government.

As a result, presidential and legislative elections were held, and Chávez and his political platform, formed by the Movimiento V República (MVR) and other minority political parties, were re-elected by an absolute majority in 2000. In addition, a year was added to President Chávez's term of office and he was given full legislative support to pass major legislation.

Among other things, Article 203 of the new Constitution introduced the concept of Enabling Laws which, with the approval of 3/5 of the members of the National Assembly, could grant full powers to the president of the Republic to issue law-decrees for a determined period of time. Between 1999 and 2015, the pro-government National Assembly passed six enabling laws that allowed Chávez, and later Maduro, to rule by decree. This virtually minimized the legislative and oversight role of Parliament.

Changes in the Oil Industry Legal Framework

The new constitution and the Chávez administration's control over the NA facilitated the enactment of a new Hydrocarbons Law (LOH) in 2002, which repealed the following legislation:

- **THE LAW OF HYDROCARBONS OF 1943,** thus increasing the royalty rate from 16 2/3% to 30%, which can be reduced up to 20% for mature fields or extra heavy crude and up to 16 2/3% for bitumen fields, all depending on their profitability.

- **THE LAW ON ASSETS SUBJECT TO REVERSION IN HYDROCARBON CONCESSIONS OF 1971,** which paved the way for the migration of operating agreements, exploration at risk and profit sharing agreements, as well as strategic partnerships on the Orinoco Oil Belt.

1999

NEW CONSTITUTION
Enactment of Enabling Laws that allowed governing by decree

- **THE ORGANIC LAW THAT RESERVES TO THE STATE THE EXPLOITATION OF THE INTERNAL MARKET OF HYDROCARBON DERIVED PRODUCTS OF 1973.**

- **AND THE ORGANIC LAW FOR THE OPENING OF THE INTERNAL GASOLINE MARKET,** , which reversed the process of opening the retail fuel market, centralizing this activity again in the State.

In addition to the above, the new LOH of 2002 established new taxes such as the Superficial Tax, the General Consumption Tax and a Tax on the consumption of fuels in PDVSA's operations.

In 2006, a partial reform was made to the LOH, which established an extraction tax rate of 33.33% that included the previous 30% royalty.

In addition, the 2002 LOH reform paved the way for a process of partial reversal of foreign venture shareholding. The migration of operating agreements and exploration contracts to risk and profit sharing, migrated to a joint venture structure with PDVSA as the preferred and majority partner, while, in the FPO Strategic Partnerships, PDVSA, which was originally the minority partner (in order to secure financing), became also the majority partner in these companies.

Only ExxonMobil and ConocoPhillips rejected the migration proposal and resorted to international arbitration, leaving the assets of these former Strategic Partnerships (PetroZuata and Operadora Cerro Negro, now PetroSanFélix and PetroMonagas, respectively) under the full control of PDVSA.

The shadow tax was also established for joint ventures. This guaranteed that the state would always receive a minimum equivalent to 50% of the gross income from production. If the sum of royalty payments, ISLR, VAT and other taxes did not reach 50% of the gross income, the difference between the sum of the taxes and 50% of the gross income was paid through the Shadow Tax.

Additionally, in 2002, a partial reform was made to the Income Tax Law, in which the income tax rate was reduced from 67.7% to 50% for PDVSA and all companies in the sector.

In 2009, the Law that Reserves to the State Goods and Services Related to Primary Hydrocarbon Activities was enacted, effectively expropriating 76 oil service companies. This had a negative impact not only on the efficiency of PDVSA's operations, but also further expanded the workforce, as PDVSA which absorbed the staff that belonged to those service companies.

GOVERNANCE PRACTICES THAT ENCOURAGED CORRUPTION AT PDVSA

6 Official Gazette No. 32.832 of 07/20/2005

7 Foreign Exchange Agreement No. 9 of 3/2/2006

2005

Foreign currency now managed by PDVSA and FONDEN

Changes to the BCV Law and Foreign Exchange Agreements

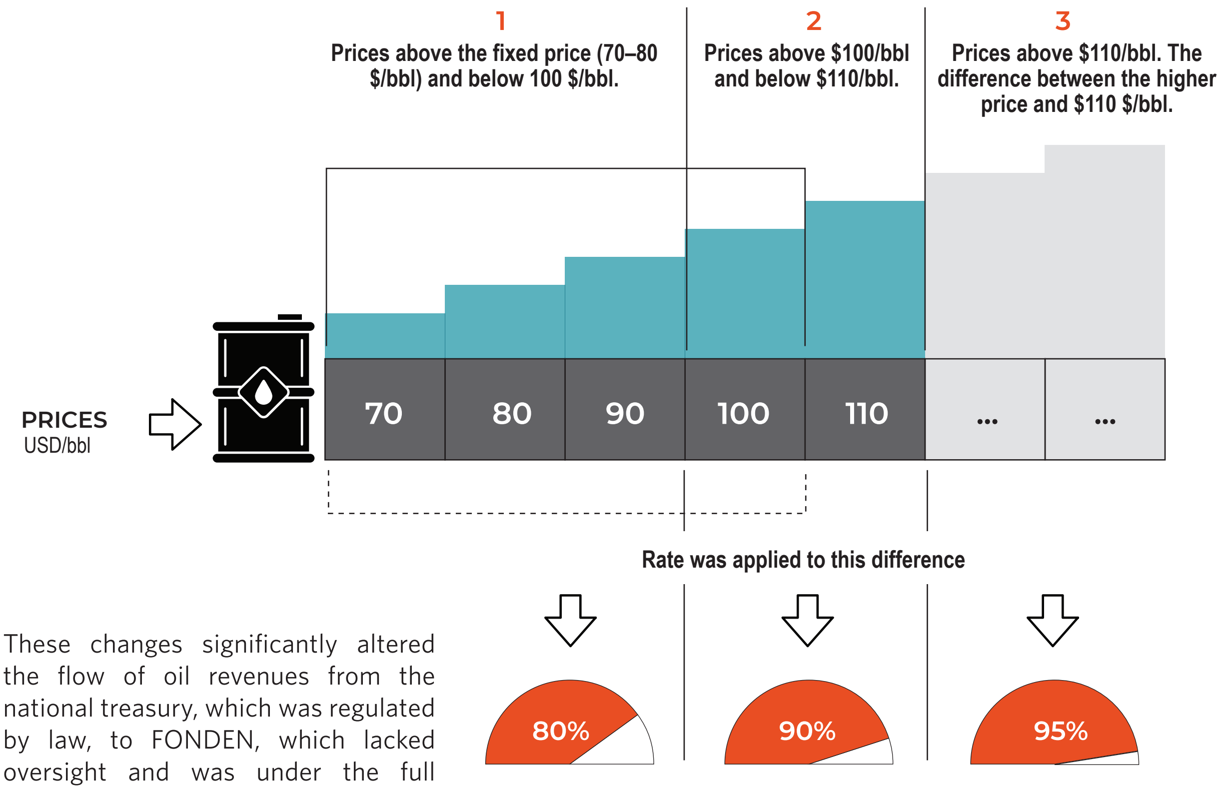
As mentioned above, a partial reform was made in 2005 to the BCV law that radically changed the transactions between the issuing entity and PDVSA. Previously, the company was required to sell to the BCV all foreign currency from oil exports and could only maintain a $600 million revolving fund for working capital. And, in the event that PDVSA required foreign currency to pay any debt, operating costs or investments (according to the annual foreign currency budget, previously approved by the board of directors and the shareholders' meeting), the BCV was required to provide such foreign currency to PDVSA on a priority basis and at the prevailing rate, established by the BCV, at the time of the transaction.

However, the 2005 partial reform[6] completely changed this scheme, taking the administration of foreign exchange away from the BCV and giving it to PDVSA and FONDEN. PDVSA went from being a seller of foreign exchange to the BCV to a buyer of bolivars from the BCV. With this change, PDVSA was now only obliged to sell to the BCV the foreign currency necessary to pay its obligations in local currency (bolivars), while being allowed to use first the foreign currency it requires to pay debt, operating costs or investments, as well as maintain a revolving working capital fund of $2 billion[7], instead of $600 million, as it was before the reform. The rest of the foreign currency was to be transferred to FONDEN.

In 2008, the Special Contribution Law on Extraordinary Prices in the International Hydrocarbons Market was issued, which replaced the calculation basis for contributions to FONDEN. This law established that the contributions to such fund would be equivalent to 50% of the difference between the average monthly price of Venezuelan crude oil and a fixed price of $70/bbl up to an upper limit of $100/bbl; plus 60% of the difference between the average monthly price of the Venezuelan basket of crude oil and the upper limit price of $100/bbl.

In 2013, a partial reform was made to the Law of Special Contribution on Extraordinary Prices of the International Hydrocarbons Market. Extraordinary oil prices were defined as the difference between the average monthly price of the Venezuelan basket of crude oil and the average price established for the formulation of the national budget. A 20% rate was applied to such difference. Additionally, exorbitant prices were defined as the difference between the average monthly price and a fixed price established as a maximum for the payment of royalties and/or extraction tax, originally at $70/bbl, and later raised to $80/bbl.

EXORBITANT PRICES WERE DEFINED IN THREE RANGES



These changes significantly altered the flow of oil revenues from the national treasury, which was regulated by law, to FONDEN, which lacked oversight and was under the full discretion of the central government.

Main weaknesses of internal oversight bodies

PDVSA's Internal Comptroller's Office

On the other hand, PDVSA's commissioners and internal auditors reported directly to the president of the company, but they were part of PDVSA's payroll and their positions were not permanent. This created a natural bias in the discharge of their duties, as well as incentives not to reveal in their reports any anomalies detected, especially if the highest company authorities could be somehow involved.

Additionally, if the reports of PDVSA's Commissioner and/or Internal Auditor reported administrative irregularities, such report remained in the hands of PDVSA's Shareholders' Assembly and the Office of the Comptroller General of the Republic, and were never published.

Anomalies and wrongdoings were handled by the Shareholders' Meeting and the Comptroller General

Tender Committeest

As PDVSA is a state-owned company, it has always been subject to the Public Bidding Law, which sets out various procurement mechanisms. Local suppliers had to be duly registered in the National Register of Contractors and in the National Procurement System, as well as registered in PDVSA's procurement systems (SAP procurement module).

In the past, due diligence was done to ensure that suppliers complied with all the technical, legal, administrative and financial requirements to be able to provide goods and services to PDVSA. But, arguing that it was necessary to give opportunities to entrepreneurs and small and medium - sized enterprises (SMEs), these control mechanisms were considerably relaxed, not only affecting the quality of the services required by PDVSA, but also facilitating corruption.

The Bidding Law also established, depending on the amount and nature of the contract, the use of competitive bidding, minimizing the option of direct contracting. These restrictions were also relaxed over time, maximizing the use of direct awards or facilitating bogus bidding processes, in which several companies bid and then withdrew from the process so that a particular company would be awarded the contract. Another flawed modality was the participation of pseudo-companies, which bid without complying with the technical-financial conditions required in the contract, allowing a predetermined bidder to win the contract.

Furthermore, the tender committees were hierarchically and geographically divided to efficiently guarantee this service to all PDVSA organizations.

These committees had different levels of financial delegation to approve contracts, depending on the amount. The higher the amount to be contracted, the higher the hierarchy of the tender committee that would analyze the case. Larger contracts were presented to the committees at the respective level, then to the Executive Finance Committee and, finally, to PDVSA's Board of Directors, if applicable. Emulating the style and practices of President Chávez, who centralized all decisions, during Rafael Ramirez's administration, PDVSA also centralized procurement decisions in most cases. This not only affected the efficiency of the company, but also centralized corrupt practices.

In addition, the tender committees were made up of PDVSA employees who lacked the experience to screen providers technically or financially. In other cases, members of the tender committees sold privileged information to bidders. Low salaries, combined with high inflation, contributed to this.

Management oversight

In the past, PDVSA had prior oversight organizations in each business unit. These entities reviewed that the proposed transaction had budgetary availability to implement the contract, that the employee authorizing the documents had the proper financial delegation to do so, and that the operation was correctly accounted for, in order to facilitate oversight and guarantee the quality of the data. These entities belonged to PDVSA's finance organization.

Prior oversight was discarded and all decisions were left in the hands of the contracting units themselves. In addition, the multiplicity of roles of PDVSA's managers, mentioned above, reduced the capacity to exercise proper control.

OVERVIEW OF CHANGES IN THE RELATIONSHIP WITH EXTERNAL OVERSIGHT BODIES

2004-2014

Rafael Ramírez
holds a dual role
as Oil Minister
and President of PDVSA

Ministry of Petroleum

The People's Ministry of Petroleum is the entity in charge of setting public policies on oil and gas matters. In addition, this agency is the representative of PDVSA's only shareholder in the General Meeting. This, of course, creates incentives to take over company management. However, as mentioned above, by placing the same person as minister and at the same time president of PDVSA, the role of the Ministry is effectively distorted. And this is what happened during the Chávez administration, with the appointment of Rafael Ramírez as minister and also president of PDVSA between 2004 and 2014.

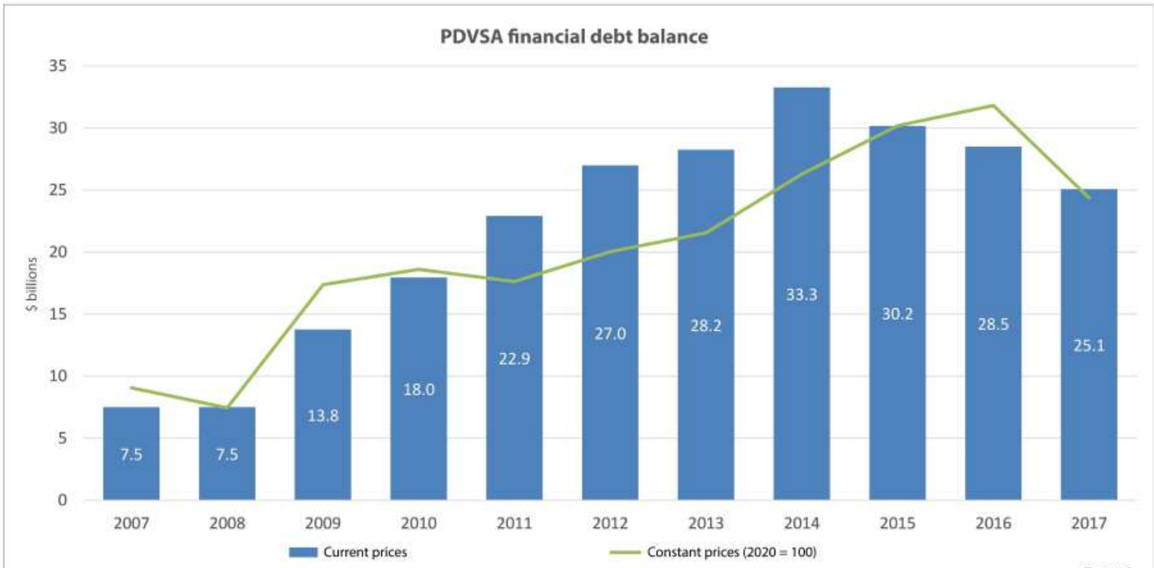
Although the Maduro administration separated these roles again, the dividing line between the Ministry and PDVSA was practically erased and the Ministry was left with a lessened role limited to overseeing the amount of hydrocarbons produced.

Currently, Tarek El Aissami is at the helm at the Ministry of Petroleum, while Asdrubal Chávez (cousin of former President Chávez), is president of PDVSA.

Office of the Comptroller General of the Republic

The capture and politicization of all branches of government by the Executive Branch also caused the Office of the Comptroller General (CGR) to lose its focus as an overseer, and ended up exercising that role only in a selective and biased manner as a political control body to politically disqualify any person or member of the opposition.

The CGR, however, used to monitor PDVSA executives and senior management closely, through their sworn statements of net worth. While PDVSA officials continue to file these statements, they do not seem to be reviewed by the CGR unless the government requests an investigation of a PDVSA official, usually on political grounds.



Source: PDVSA audited financial statements

Figure 6

But bonds issued for the construction of the FPO projects were $1.6 billion, while PDVSA's bond issues from 2007 onwards reached a whopping $33.3 billion in 2014, as shown in Figure 6 below.

Relationship of PDVSA with the BCV and the Ministry of Finance

As previously explained, the relations between PDVSA and the BCV have evolved significantly since the reform of the BCV Law in 2005. However, after the international sanctions imposed on both institutions in 2019, opacity in both institutions increased, and how the foreign currency derived from the meager oil exports is being managed is currently a secret.

The interaction between PDVSA and the Ministry of Finance exists mainly through two of the agencies attached to the Ministry: the National Treasury Office (ONT) and the National Public Credit Office (ONCP).

As for ONT, the relationship with PDVSA revolved mainly around the delivery of foreign exchange from PDVSA to ONT for royalty payments and exploitation taxes. PDVSA's finance organization issued a report known as the "twelve-week report" that showed the estimated delivery of foreign exchange during the following twelve weeks to ONT, with the royalties being the main source of funds. However, the State's fiscal voracity caused PDVSA to decree and pay dividends in advance, even at times when PDVSA was experiencing cash flow problems as a result of the collapse in prices in 2009 or 2014. The central government, through the ONT, was even asking PDVSA to order CITGO to declare and pay dividends or to issue debt to do so. Additionally, PDVSA's lack of liquidity forced the company to borrow from ONT by issuing promissory notes for royalty payments.

In addition, PDVSA strengthened its ties with the ONCP when the Nation's and PDVSA's unsecured bond issues began in 2007. Almost all issuances were coordinated between the two agencies.

Although Venezuelan foreign debt operations have always been subject to rumors of corruption, PDVSA had historically been very conservative in accessing international capital markets since its creation. Firstly, because there was no need, as oil prices remained above $100/bbl ($21.5/bbl in current dollars) since the creation of PDVSA in 1976 until 1985 (+10 years) and, secondly, because the nationalization of the sector in 1975 left an indelible mark on the perception of sovereign risk. Thus, PDVSA actively resorted to the financial markets in the 1990s to finance FPO projects. However, it did so together with its partners, thus reducing the risks of corruption.

The most frequent corruption practices in debt operations are associated with the commissions paid for each transaction; the more transactions took place, the greater the amount of commissions. However, PDVSA's bond issues had an additional component that encouraged corruption, i.e. the fact that these US dollar-denominated bonds could be purchased with bolivars at an exchange rate significantly below the parallel market exchange rate. In addition, the process of assigning the amount to be invested by the bidders was not at all transparent.

2014

USD 33.3 billion record bond issue by PDVSA

Cessation of SEC reporting

With the resumption of debt operations for the financing of FPO projects in 2001, PDVSA was required to file a detailed report (20-F) of the company's financial results and major operations each year with the U.S. Securities and Exchange Commission (SEC). This increased the number of people able to monitor the company's management. In addition, PDVSA also had to make quarterly reports during the year (10-K).

In 2006, PDVSA decided to stop reporting to the SEC as of the debt repurchase transactions made in 2004.

Accountability to the National Assembly

PDVSA was required to present an Annual Management report at the National Assembly every year, providing an account of the management operations and the preliminary financial results for that particular year. In addition, the NA had the authority to demand PDVSA officials to appear before Parliament to render accounts at the various committees, as appropriate.

As mentioned above, this practice ceased once the political opposition won control of the NA in 2015.

Relationship with Independent Auditors

The external auditors used to set up their teams of accountants and consultants at PDVSA's offices to facilitate access to information and interaction with PDVSA personnel responsible for providing such data. Especially after the Oil Strike, KPMG teams kept a permanent presence at PDVSA and not only for the duration of the audit. The external auditors also worked in collaboration with the internal auditors and the Commissioner.

Despite the fact that the external auditors are supposed to continue doing their job, PDVSA has not published its audited financial statements since 2016.

Relationship with joint venture partners

Relations with the joint venture partners began to deteriorate from the very moment of migration, since it was a hostile takeover, to the point that two of the partners (ExxonMobil and ConocoPhillips) resorted to international arbitration.

Given that the LOH established that the commercialization of liquid natural hydrocarbons was reserved for the state, the crude produced by the joint venture had to be sold in its entirety to PDVSA for commercialization. The only exception were the FPO joint ventures that produced synthetic crude in their upgrading facilities. Then, under the argument that they did not produce natural crude, but synthetic crude, they were allowed to continue marketing the crude directly. This mitigated the risk of corruption in the oil trade while guaranteeing cash flow to these JVs.

But PDVSA had a contractual obligation to pay the joint ventures that did not produce synthetic crude on a monthly basis, with the JV being responsible for meeting all of its operational, fiscal, labor and financial obligations. However, PDVSA stopped making these payments in 2009, sequestering their cash flow. In exchange, PDVSA switched to a scheme in which it kept the revenues from the crude oil produced by these companies, paying the royalty in kind (volume) on their behalf and assigning them an operating and investment budget that was generally never executed due to PDVSA's lack of liquidity. As a result, the production of the joint ventures began to fall due to a lack of reinvestment. The upshot was that the exploitation plans originally agreed and approved by Parliament at the time of the incorporation of the joint venture were not being fulfilled.

In this regard, the Ministry of Petroleum and PDVSA threatened the partners with termination of the joint venture contract in 2013. To avoid this drastic measure, they asked them to bring a proposal for a financing plan to increase production (Remediation Plan), where the partner contributed or raised the funding of 100% of the required capital without PDVSA contributing its corresponding 60% share. For this purpose, PDVSA was willing to create a financial structure that would allow the JV to have control of the company's cash flow, by means of a triangulation with a PDVSA crude oil purchasing client who would receive final payment instructions from PDVSA to pay the oil bill in the accounts to be indicated by PDVSA (a trust established by the joint venture). That same year, only two JVs (PetroBoscan and Petrolera Sinovensa) managed to implement the scheme.

Thus, the lack of budget execution due to inefficiency in the procurement or lack of availability of rigs, parts and other equipment limited the ability of these two joint ventures to achieve the production increases proposed with the financial scheme. But when sanctions were imposed in 2019, everything changed. The companies relied on OFAC licenses to operate, which were strict to the extent of only allowing the joint ventures to sign the relevant contracts for minimum maintenance that would guarantee the operational integrity of the assets and the safety of the employees. Since then, several international companies have sold their assets or exited Venezuela (e.g. Equinor, Total, Inpex, etc.).

The progressive reduction of the role of partners in joint ventures and the increasing control of PDVSA have left most joint ventures vulnerable to corrupt practices.

2010

USD 1.2 billion
PDVSA Servicios hires inoperative exploration vessel

Chapter 4

GOVERNANCE PRACTICES
THAT ENCOURAGED CORRUPTION AT PDVSA

OVERVIEW OF MAIN AREAS OF OPERATIONS THROUGH WHICH CORRUPTION MATERIALIZED

Exploration and Production

PDVSA's exploration and production (E&P) business units manage 70–90% of operating costs and more than 70% of asset investments. In 2016, the exploration and production unit reported operating expenses of $6.2 billion ($6.9 billion at 2020 prices) and the asset balance was $85.5 billion ($95.4 billion at 2020 prices) at the end of that year. In addition, these operations are most dispersed throughout the country. Both factors, magnitude and dispersion, encourage the concentration of corrupt practices in this segment of the business.

In turn, well drilling activity takes 70–90% of E&P's investment budget, and thus, for instance, PDVSA created the subsidiary PDVSA Servicios in 2007 to manage PDVSA's entire fleet of drilling rigs and all the rigs that were expropriated that year. In addition, PDVSA imported a fleet of 12 Chinese rigs in 2008 on the grounds that the company could not increase production due to a lack of drilling equipment at a time when world oil demand was growing, before the impact of the Global Financial Crisis. However, the drills turned out to be of very poor quality, requiring major maintenance shortly after they were purchased.
The other type of corruption in E&P was through service contracts, especially services required for PDVSA-owned oil fields. For example, in 2010 PDVSA Services signed a $1.2 billion contract with Petro Saudi Oil Service for an exploration vessel that paid—according to the contract—a rate well above market rates, even though it was not operating.

Between 2010 and 2016, several overpriced service contracts were signed with the contractor Constructora Urbano Fermín, C.A. (CUFERCA) for fields on the FPO. The Venezuelan Public Prosecutor's Office estimated the financial damage of this contract at about $2 billion. Although former PDVSA director Pedro León originally went into exile, it is rumored that he remains at large and is currently living on Margarita Island, his birthplace.

These are just a few examples that illustrate the situation of corruption in PDVSA, as well as the impunity of the Venezuelan justice system.

2019

Most local refineries shut down

Refining and Upgrading

During the construction of the country's four main refineries there were some delays in the execution of some projects (e.g. Cardón Refinery Expansion Project (PARC) in 1990–1993), but there were no corruption scandals at that time. Additionally, the construction of the four upgraders was delayed by the climate of political instability at the time (coups in 1992), but there were no corruption problems because PDVSA, its partners and lenders kept close oversight on the implementation of these projects.

However, corruption in this business segment grew exponentially during the Chávez administration and continued under Maduro.

Internationally, during the Chávez administration, the Cien Fuegos refinery in Cuba was reactivated, and refineries in Jamaica and the Dominican Republic were purchased and revamped. Additionally, funds were earmarked for and invested in the construction of four new refineries in China in partnership with CNPC. Although PDVSA never made significant investment contributions to these projects, expenditures were made on consulting contracts, as well as multiple trips by PDVSA executives to China in connection with these projects.

Domestically, PDVSA planned the construction of two new refineries (Batalla de Santa Inés and PetroBicenteneario) in which funds were invested, but the projects never advanced to a final investment decision stage.

The hiring of contractors without the technical and financial qualifications for the maintenance of refineries, not only led to corruption in this part of the business, but also led to a rapid deterioration of the refineries. In 2012, there was an explosion at the Amuay refinery, leaving dozens of victims. After that event, local refineries continued to deteriorate to the point that almost all downstream units were shut down by 2019, creating total dependence on imported refined products to meet local fuel demand.

However, international sanctions created incentives (limitations to import fuels) for PDVSA to make an effort to recover part of its refining and product manufacturing capacity. During 2021, the total refining capacity showed an average of 16% of the installed capacity, based on the operations of three of the four main refineries (Amuay 12%, Cardón 25% and Puerto La Cruz 25%).

In terms of upgrading, the only PDVSA upgrader in operation during 2020 was the JV PetroPiar, at 28% of its capacity. But PDVSA managed to reactivate PetroCedeño's upgrader in July 2021 to 50% of its capacity and increased PetroPiar's operations above 30% of capacity. This happened in the context of the international sanctions and after Equinor and Total exited PetroCedeño. In this sense, the maintenance contracts used for the reactivation of PetroCedeño were vulnerable to corruption. Additionally, the large mountains of coke produced by the upgraders and stored in Jose's terminal yards are reportedly associated to contractors in charge of coke transportation.

Trade and Supply

In the trade and supply (T&S) segment, PDVSA's corruption has had a national and international scope

Nationally, the re-statization of fuel marketing and distribution exacerbated gasoline smuggling across the Colombian border. The large disparity between gasoline prices in Colombia vs. in Venezuela (due to Venezuela's large fuel subsidy) created incentives for this practice, which accounted for 80–100 MBD.

In addition, the exchange control provided an additional incentive to this practice, since smugglers could buy gasoline in Venezuela in bolivars and resell it in dollars in Colombia, making a profit not only for the trade itself, but also by selling part of the profit in dollars on the black market to obtain the bolivars to buy more gasoline and thus continue the cycle.

Internationally, Bernard Mommer (former vice-minister of hydrocarbons and former member of PDVSA Board of Directors) set up an office in Vienna, Austria, which devised the price formulas used by Venezuela for the valuation of crude oil for export to different international markets. Although the formulas used different crude prices and benchmarks such as West Texas Sour (WTS) and Brent, they also included a "K" variable for discretionary price adjustments to prices for strategic market reasons. In late 2017, however, the Venezuelan Public Prosecutor's Office accused him and other officials of manipulating crude oil sales prices through the signing of a contract with Vienna-based consulting firm JBC Energy. The damage estimated by the Public Prosecutor's Office was USD 4.8 billion.

However, the international sanctions exacerbated corruption practices in the export of crude oil, since PDVSA not only has to grant substantial discounts (risk premiums) to find traders willing to sell Venezuelan crude oil in Asia, exposing themselves to sanctions, but also started triangulations with food imports, the most notable example being that of Mr. Alex Saab, who was extradited to the U.S. by the government of Cape Verde.

Finance

In the corporate finance segment, as mentioned above, corruption has revolved mostly around bond issues and the issuance of promissory notes for payment of dividends and debts to suppliers. The issuance of bonds denominated in dollars, but payable in bolivars in a context of foreign exchange control, was a major source of corruption.

Noteworthy is that in 1991 there was a small corruption scandal at Maraven associated with investments of the Maraven employees' savings and pension fund in shares listed on the Caracas Stock Exchange. Being the workers' pension fund, regulations prohibited risky investments or investments in speculative instruments. Although there was no capital loss, in fact, that was the year with the highest returns reported by the pension fund, PDVSA, the parent company, alerted about this situation and the fund managers responsible for these transactions were arrested (José Petit and Bartolomé Ruggiero) and the president of the subsidiary, Carlos Castillo, the finance director Gustavo Gabaldón and the finance manager Antonio Molina were forced to retire. This is a sign of the effectiveness of the oversight mechanisms and that there was no impunity in cases of corruption.

On the other hand, in 2011 Francisco Illarramendi pleaded guilty to a $382 million Ponzi scheme scam involving money from the PDVSA workers' savings fund. He paid nearly $4 million to PDVSA officials to get approval to use workers' funds in the scheme. This happened during Rafael Ramírez's term as PDVSA president, with Eudomario Carruyo as CFO and Juan Montes as fund manager. Illarramendi was sentenced by a Connecticut court to 13 years in prison in 2015. Unlike the PDVSA Savings Fund scandal, this case was dismissed in Venezuela and none of the PDVSA officials were prosecuted in Venezuela with respect to the Illarramendi case.

Another source of corruption escalated starting in 2014, following the drop in oil prices. PDVSA deactivated the payment module of its SAP system, which managed accounts payable to suppliers based on due dates. PDVSA had a 90-day supplier payment policy and the system automatically generated a list of payments to suppliers according to the due date of the invoices. When PDVSA eliminated this module, the list of payments to suppliers (payment remittance) was made manually. This caused corruption to permeate down to the lowest levels of the organization. Not only were senior managers harassed by contractors to guarantee or at least prioritize their payment, but contracting companies bribed employees in charge of preparing the manual payment lists to include or move their company up in the list.

PDVSA's liquidity problems beginning in 2014 also significantly delayed payments to international service providers, who after accepting promissory notes issued by PDVSA and writing off losses on uncollectible accounts, finally reduced their operations to an operational minimum in April 2016, significantly impacting oil production.

2015

USD 340 million
Annual cost of PDVSA's head office, equivalent to the operation of 110 wells

Others

After the 2010 electricity crisis, when there was a nation-wide power failure due to the interruption in transmission from the Guri hydropower system, PDVSA and FONDEN provided funds for the acquisition of power generation plants in order to increase the thermal power generation park and reduce reliance on hydropower. However, it is now known that high-ranking officials of the Ministry of Energy and Petroleum (Vice Minister Nervis Villalobos) and Javier Alvarado (former PDVSA official, president of Bariven—PDVSA's procurement arm and later president of CORPOELEC) were involved in corruption cases with contractor Derwick, among others. During 2008 and 2010 alone, PDVSA showed in its audited financial statements a balance of accounts receivable from CORPOELEC of $6 billion ($6.2 billion at 2020 prices).

Additionally, as example, PDVSA's headquarters alone (offices located in La Campiña, Caracas) had an annual operating budget of $340 million for 2015. In other words, this thirteen-story building that houses PDVSA's board of directors spent the same amount of resources required to drill and complete more than 110 oil wells that would produce approximately 27.5 MBD. Considering that PDVSA executives' salaries are around $50 a month, this suggests how much discretion and incentives for corruption there is in the company.

SUMMARY OF PDVSA'S RELATIONS WITH SUBSIDIARIES ABROAD THAT FACILITATED CORRUPTION

CITGO

As for PDVSA's relations with subsidiaries abroad, the first and most important is the CITGO refining system in the United States. In terms of corruption prevention, however, this subsidiary is subject to strict checks and balances by U.S. regulatory agencies.

During Rafael Ramirez's tenure, PDVSA was reported to have sold before Chavez crude to CITGO at below-market prices. While this was true, it is also true that this was part of the business scheme originally agreed upon in order to finance the investments that CITGO had to make to the Lake Charles, Corpus Christi and Lemont refineries in order to process heavy Venezuelan crude.

During the Chávez-Ramírez administration, PDVSA not only sequestered CITGO's operating cash flow by forcing it to pay dividends in advance, but CITGO also borrowed in the financial market to pay dividends to PDVSA. In 2015, CITGO issued some $1.87 billion in debt and paid dividends to PDVSA for $2.56 billion. This left CITGO in dire financial conditions, as it is today, in addition to all the legal harassment to which it is subjected by creditors trying to enforce arbitration awards in its favor that have not been paid by the Republic or by PDVSA (e.g. Crystalex and Conoco), trying to capture CITGO's assets.

Additionally, CITGO's corruption was evident in the use of corporate assets for political or personal purposes. For example, the use of CITGO's private plane for purposes unrelated to the company's operations.

However, all these corrupt practices ceased with the sanctions on CITGO.

PDVSA Offices Abroad

During the Chávez administration, PDVSA opened offices in Argentina, Austria and China. These offices have been involved, directly or indirectly, in corruption scandals. In Argentina, with the political support to the Kirchner family, in Austria as already mentioned, with the crude oil price formulation office, and in China with all the equipment purchases, as well as the relations with Chinese companies coordinated out of this office.

OVERVIEW OF SOME EXAMPLES OR CASES OF CORRUPTION

Although some examples of corruption have already been cited throughout this report, perhaps the most outstanding instances are the case related to the 2010 electricity crisis, the bribes associated with the Remediation Plans and the exports of crude oil combined with the import of food after the sanctions, not only because of the magnitude of these fraudulent operations, but also because of their international significance.

Electricity Crisis

Although the case of the 2010 electricity crisis has already been briefly noted in a section above (Overview of the Main Areas of Operations through which Corruption Materialized – Others), it is important to highlight some additional details of this case.

When President Chavez came to power in 1999, the country's electricity demand was 19% lower than the available generation capacity as shown in the bars in Figure 7; but with the growth in demand thanks to increased public spending as a result of the oil bonanza, by 2008 peak demand exceeded available generation. Although for different reasons (e.g. lack of maintenance) the available electricity generation capacity has always been below the installed capacity during the past twenty-two years, that available capacity was only 25–30% before the 2010 electricity crisis.

Seventy percent of the electricity generated and consumed in Venezuela comes from hydropower, which is impacted during long drought seasons (e.g. El Niño). However, the 2010 electricity crisis was the result of years of disinvestment, delays in projects for new thermal generation plants and lack of maintenance in the distribution system (especially the 765 kV system that transmits electricity from the Guri power plant to the central-western region of the country).

That year (2010), there were widespread blackouts that affected fifteen states in the country, while the capital city, because of its political importance, had always been protected by the thermal generation system of Electricidad de Caracas which, along

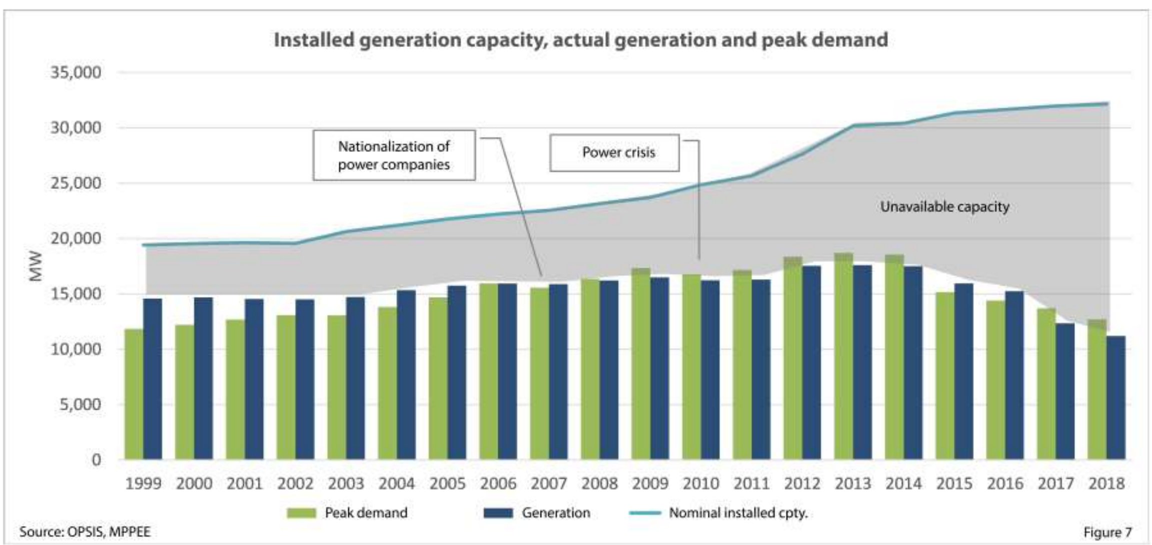


Figure 7
Installed generation capacity, actual generation and peak demand

with three other private electric companies, had been nationalized in 2007. This prompted President Chávez to decree an electricity emergency with a severe rationing plan, which included the capital city, but especially all government institutions. Reduced working hours were established in government offices where, during operating hours, operated without air conditioning.

But this crisis had no impact on PDVSA's operations (production or refining) because the company owned and maintained its own self-generation plants (2,800 MW) that actually allowed PDVSA to contribute some surplus generation to the national grid.

However, as part of this emergency, substantial funds were allocated for the purchase of distributed generation turbines. In 2010, PDVSA received $1.23 billion from FONDEN for this purpose.

Most of this equipment was used and was purchased and installed at an overprice (around twice) for CORPOELEC and the CVC by Derwick Associates, together with ProEnergy (outsourced by Derwick). In addition, the vast majority of all of this equipment required major maintenance shortly after being installed.
Furthermore, this is diesel-run equipment, which runs counter the National Electricity Plan that established the installation of additional thermal generation based only on natural gas, with the aim of replacing the consumption of liquids (diesel) with natural gas, which is not only less polluting, but also allows exporting the volume of diesel consumed by the plants.

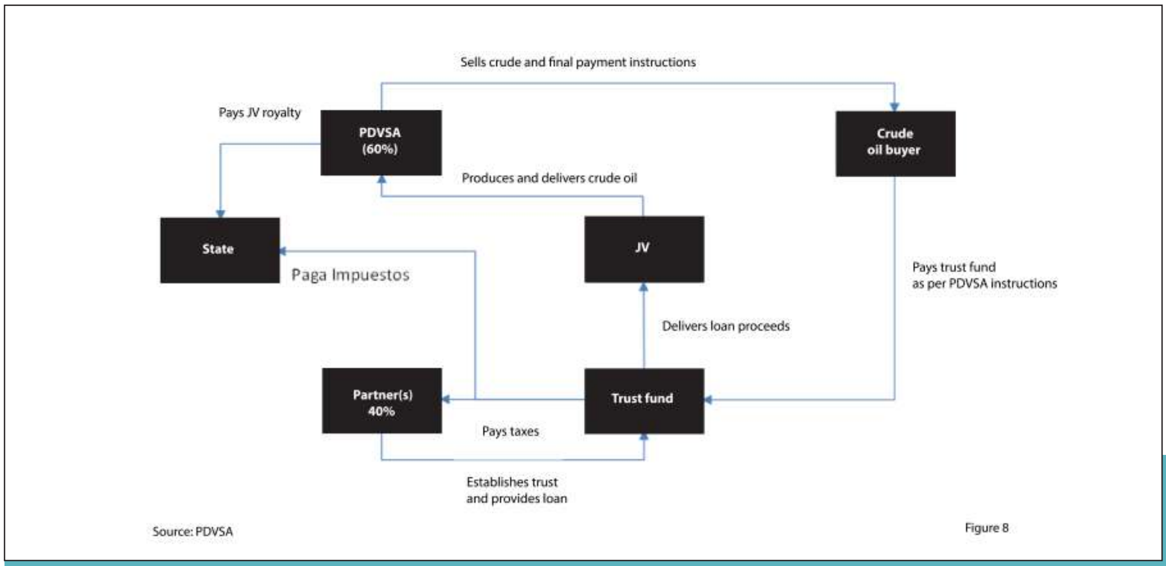
This is how young Venezuelans called "bolichicos" who, thanks to their connections with government officials, appear as partners of Derwick Associates (Pedro José Trebbau López, Leopoldo Alejandro Betancourt López, Francisco D'Agostino Casado, Edgar Romero Lazo, Francisco Antonio Convit Guruceaga, Eduardo Tobías Travieso, Domingo Xavier Guzmán López and Gonzalo Adolfo Guzmán López).

This corruption scandal led the U.S. Department of Justice (Southern District of Texas) to issue indictments against Nervis Villalobos, former Vice Minister of Electric Energy, Javier Alvarado, former president of Bariven (PDVSA's procurement arm) and former president of CORPOELEC, as well as three other officials, on charges of bribery and money laundering. The five officials were detained in Spain. Similarly, and in relation to this case, two American contractors were also accused and arrested (Roberto Rincón and Abraham Shiera).

Make / Model	Capacity (MW)	No. of Units	Plant	State
GE 7FA	170	1	Antonio J. Sucre	Sucre
FE 7EA	170		Juan B. Arismendi	Nva. Sparta
GE LM6000			III Barquisimeto	Lara
GE 7FA	170	1	Thermobarrancas	Barinas
GE TM2500+	90		East	Carabobo
P&W FT8	50		Rafael Urdaneta	Zulia
SIEMENS			Termozulia V	Zulia
Titan 130 Solar Turbine			Caripito	Monagas
Titan 130 Solar Turbine	45		Juan B. Arismendi	Nva. Sparta
N/A	342	1	Josefa R Sánchez Tacoa	Vargas
N/A	132	1	Picure Tacoa	Vargas

Table 2 below shows some of the equipment purchased during the electrical emergency

Figure 8 below illustrates briefly how the financial structure works



Remediation Plan

As explained in the section Overview of Changes in the Relationship with External Controlling Entities - Relationship with Joint Venture Partners, the Remediation Plan consisted of a financial structure that would allow some joint ventures to finance the investments necessary to boost production, which had been declining since 2009 when PDVSA sequestered the cash flow of such companies.

In most cases, the loan agreement provided that, from the agreed loan amount, the partner would first deduct any amount owed by PDVSA to the partner for accrued dividends and the remainder would be used to make the necessary investments to increase production. However, the loan disbursements were contingent on the implementation of the projects associated with the Remediation Plan. In most cases, project implementation was delayed and the disbursements were even below 20% of the agreed amount, but at least partners were able to collect their overdue dividends.

Meanwhile, France's Perenco and Russia's Gazprombank implemented this financial structure for their joint ventures, Petrowarao ($420 million in 2014) and PetroZamora ($1 billion in 2013), respectively. However, former PDVSA CFO Abraham Ortega pleaded guilty in October 2018 to receiving $5 million in bribes from these companies to place them on the priority list for approval of their proposed financing structures. In addition, Ortega received $12 million in bribes to assist in a money laundering scheme of about $1.2 billion. Additionally, Ortega confessed to receiving the payments from Francisco Antonio Convit Guruceaga, a partner at Derwick Associates. Lastly, Abraham Ortega was sentenced to two years in prison in May 2021, according to documents released by the U.S. Department of Justice.

This case of the Perenco and Gazprombank is evidence that corruption is also a possibility at international private companies that are subject to greater oversight. However, the incentives and conditions for this case came from the combination of delayed dividend payments, sequestering the cash flow of the joint ventures, low salaries for oil executives, and a Venezuelan judicial system that ensures impunity through politics, corruption and/or inefficiency.

Crude Oil Exports and Food Imports

Last but not least, we have the case of Alex Saab, who has been perhaps most notorious since his arrest in Cape Verde, in June 2020, when he stopped over on the small island nation to refuel the private plane that was taking him to Iran on a business trip.

On July 25, 2019, the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) sanctioned Alex Saab for a corruption scheme in relation to the state-run Local Supply and Production Committees (CLAP) food program created in 2016.

According to OFAC, the corruption scheme began with the payment of bribes to high-ranking Venezuelan government officials for the awarding of low-income housing construction contracts. The homes were built at a price well above real value.

The scheme then evolved into securing authorization for food and medicine imports through the CLAP program by paying bribes to Maduro administration officials (e.g., José Gregorio Vielma Mora—Táchira Governor—and General Rodolfo Marco Torres—former Minister of Food) who helped Saab and his associate Alvaro Enrique Pulido Vargas (Pulido) secure such contracts by direct award. Once the contracts were awarded, the former director of the Venezuelan Foreign Trade Corporation (CORPOVEX), Iliana Josefa Ruzza Terán, helped Saab and Pulido obtain the food import permit. Notably, Iliana Terán also served as PDVSA's Vice President of Finance.

However, PDVSA's involvement in this corruption scheme is not limited to the participation of Iliana Terán as PDVSA's Vice President of Finance; the payments for the import of food were also guaranteed by exports of heavy crude oil that PDVSA made through companies that were part of Saab and Pulido's network, registered in Mexico (Libre Abordo, S.A. and Schlager Business Group, SRL).

During 2020 alone, PDVSA exported an estimated twenty shipments for a total of 22.9 million barrels to these two companies, with a $810.9 million value at the average price of Venezuelan crude oil for that year ($35.3/bbl).

According to OFAC, Saab and Pulido not only evaded sanctions on the trade of Venezuelan crude oil and secured overpriced contracts by paying bribes, but also issued bogus invoices importing only part of the food billed and charged for. Surely, this corruption network also materialized speculative profits in the purchase and sale transactions of Venezuelan crude oil, although OFAC has not published anything about it and the U.S. Department of Justice has only made reference to payment of bribes and money laundering.

Figure 9, which was published by OFAC, shows the general scheme of the relationship between PDVSA and the Mexican trading companies mentioned above

CONCLUSIONS

The oil sector has always been exposed to corruption by nature and definition. Its wide operating margins and capital intensity create strong incentives for it. For example, a well in the FPO costs about $3 million and produces about 300 MBD; and each barrel sells for $35/bbl (2020), while its production cost is less than 10% of the selling price. This 90% gross margin would yield a ROI in less than a year were, not including taxes.

Furthermore, the highly technical sophistication of the sector, coupled with an asymmetric geographic distribution of oil reserves, means that economic agents, attracted by the wide margins of this business, wish to have access to and control of these reserves, creating incentives for monopolization.

Thus, in places where land ownership grants rights to owners over subsoil resources (e.g. the US), economic actors have incentives to acquire or access land from owners who lack the knowledge or means to exploit such resources, while in places where the state reserves rights over subsoil resources (e.g. Venezuela), then access to such resources is by way of political control (state monopoly).

The nature of the oil business means that any company, public or private, is exposed to corrupt practices. That is why the establishment of the right incentives, independent regulations and public and private, internal and external checks and balances, and a fair and efficient judicial system that guarantees the rule of law, are key to mitigate and curb corruption.

In the case of PDVSA, these three factors dissipated as a consequence of a chain of consecutive decisions that, created a domino effect of wrong incentives, dissolved or neutralized oversight and regulation mechanisms, and politicized the (already inefficient) judicial system, thus providing a breeding ground for one of the best state-owned oil companies in the world to become a money laundering center in less than twenty years.

Although the oil sector in Venezuela has always been a monopoly of the state, as the sole owner of the reserves, the independence of the powers of the state, the oil contracts, PDVSA's corporate structure, the alignment of incentives between the state, oil companies and workers, as well as a judicial system that—although far from efficient—maintained a certain autonomy, kept corruption at bay in the company since its creation in 1976. The few cases of corruption, such as the Maraven Workers' Savings and Welfare Fund scandal, were detected and corrected in a timely manner.

However, when Chávez came to power, the entire regulatory framework that acted as the main oversight mechanism was altered (new constitution, amendments to the Hydrocarbons Law, the BCV law, etc.). Political and economic control, in an environment of oil bonanza, allowed the capture of all state institutions, thus eliminating their independence. PDVSA was exponentially politicized, diversified away from its core business, and oversized.

Noteworthy is that 50% of the knowledgeable and experienced workers were laid off in a matter of days and replaced with staff with limited experience. The exponential and uncontrolled growth of the workforce, coupled with the state's voracity for resources, limited the funds available to attract and retain skilled personnel, thus creating inefficiency and incentives for employees to search adequate compensation in ways other than wages.

In a scheme of power centralized in top management, incentives were created to climb the organizational ladder based on political rather than technical merit. Thus, an oil manager who earns less than $50 a month and is vested with the authority to approve the contracting of a well worth $3 million, in a system lacking checks and balances and protected by his loyalty and political connections, has all the incentives and conditions to engage in corrupt practices.

There was also the change of the Hydrocarbons Law and—as a consequence—the migration of oil contracts to joint ventures that, although they produced only 21% of the national production at the time of migration, by 2018 (before the sanctions) were producing more than 50%, not due to the growth of the production of these companies, but because of the fall in the production of the fields owned by PDVSA. Thus, PDVSA's inefficiency in the management of assets, together with the financial strangulation through taxation and cash flow seizure, thanks to PDVSA's majority shareholding, minimized the participation of the partners, giving space for PDVSA's corruption to also permeate into the joint ventures.

The elimination of PDVSA's payment system, converted into a manual—totally discretionary—system, together with the relaxation of the technical-economic procurement criteria, in an context of limited funds during periods of declining oil prices or as a result of the state's fiscal and parafiscal voracity, created incentives for PDVSA's contractors and partners to seek payment for their services or dividends by means of lobbying or bribery.

The elimination of reporting and accountability to the NA, the Ministry of Petroleum (by merging the roles of minister and president of PDVSA), the SEC and the general public by not publishing audited financial statements, exacerbated opacity, and with it, the opportunities for corrupt practices.

The reform of the BCV law in 2005, in a context of rising oil prices, paved the way to an exponential increase in corruption nationwide. With the reform, institutions such as FONDEN and BANDES were also created, which lacked adequate checks and balances to administer the substantial funds. Although they were not managed by PDVSA, which was only its main contributor, PDVSA also managed huge amounts of funds. In 2011, PDVSA's contributions to FONDEN and Social Development (parafiscal contributions) reached 35% of the company's gross income nationally, fiscal contributions (royalties and taxes) were 22%, leaving a remaining 43% administered by PDVSA, as evidenced in the company's audited financial statements for that year.

Thus, international sanctions only created additional incentives that exacerbated existing corruption practices at the company.

In this sense, the legal framework, the corporate structure, the social contract between politicians, managers and employees, and the judicial system are factors that define corruption.

Based on the above, eliminating corruption from PDVSA seems to be a task of mammoth proportions, but not necessarily impossible, especially considering that the nearly 2 mmb/d fall in production that occurred before the sanctions (1998–2018), should have left a lesson of the consequences of inefficient management of such a company.

Considering that corruption came in and grew in PDVSA from the outside, many have believed that reversing this process must also be from the outside to the inside, arguing that if there is no change in the government and in the regulatory (legal) framework that allows a change in the corporate structure of PDVSA, no changes can be made internally. Although this argument is totally valid, Venezuelan history shows that political agreements in the country are short-lived.

So, alternatively, assuming that the political leadership understands an efficient and transparent company that can raise oil production can bring greater benefits, there should be incentives to allow the restructuring of PDVSA, even within the current framework.

Such restructuring would require a professional and independent board of directors with a sufficient degree of freedom to implement it. It would also imply the sale or transfer of non-oil assets, and with them, and associated personnel, in order to downsize the company to an efficient and controllable level.

Additionally, a restructuring of the compensation scheme would be required to attract and retain talent, depoliticizing and professionalizing the workforce. It would also be necessary to resume automated payment systems to suppliers and professionalize hiring criteria. It would also require the resumption of accountability mechanisms through the publication of—at least—audited financial statements. This increased transparency would benefit the political leadership and the company, as it would eventually allow it to attract investors.

The fact that PDVSA has managed to increase its production by about 300 MBD in less than a year during 2021 (from 520 MBD in January to about 800 MBD in October), even in the context of the sanctions and with the same inefficiencies and current oversize, is an indication that with the changes described above, a significant increase in production and a progressive reduction of corruption could be achieved. Obviously, if the changes are only limited to PDVSA, the problem would simply be transferred to the rest of the institutions (FONDEN, BANDES, BCV and the National Treasury), but PDVSA could become a model of reorganization for the rest of the institutions. If the sanctions are relaxed or lifted, the results should be even better.

In summary, corruption depends on internal and external factors. The latter cannot be controlled, but the former require an alignment of the right incentives that reward efficiency and honesty, while penalizing corrupt practices at a high price.

GOVERNANCE PRACTICES THAT ENCOURAGED CORRUPTION AT PDVSA

TRANSPARENCIA Venezuela

TransparenciaVenezuela @NoMasGuiso nomasguiso Transparencia Venezuela TransparenciaVenezuela