The Secretary of Energy
Washington, DC 20585

October 20, 2006

The Honorable Richard G. Lugar
Chairman
Committee on Foreign Relations
United States Senate
Washington, D.C. 20510 6225

Dear Mr. Chairman:

Thank you for your letter of July 20, 2006, expressing your concerns, reactions to, and comments on the Government Accountability Office (GAO) report on Venezuelan oil production capabilities. We agree that Venezuela is facing great challenges in its oil sector, and we want to assure you that the Department of Energy (DOE) is monitoring the situation closely and analyzing the implications of this situation on United States energy security.

The GAO finding that a six month disruption of all or most of the Venezuelan oil from the world market would result in an \$11/barrel increase or a loss of \$23 billion to the United States economy overstates the likely impact. It does not take into account the release of strategic petroleum reserves by member countries of the International Energy Agency (IEA), market reallocation and other mitigating factors, such as the activation of underutilized production capacity by other members of the Organization of the Petroleum Exporting Countries (OPEC). In addition, the consequences of completely stopping oil exports would be so devastating for the Venezuelan economy, that this by itself poses a massive deterrent to a political act of this type.

I would also like to address the statement in the GAO report you referenced in your letter that, "United States government programs and activities to ensure a reliable supply of oil from Venezuela have been discontinued…" I hope you would agree that no government activity with any one country could guarantee our energy security. However, we do believe that the comprehensive, global energy policy set forth by President Bush is fundamental to America's energy security.

We share your concern regarding significant declines in production by Venezuela's state oil company Petroleos de Venezuela's (PdVSA). Currently PdVSA is producing almost 50 percent less than its peak production level. The Energy Information Administration reported in February of this year that total Venezuelan crude output is currently around 2.5 million barrels per day. This is the lowest level of total production since the oil workers' strike in Venezuela in 2002-2003 and emphasizes PdVSA's need for investment and technical expertise.

Without new investment, future production is expected to continue to decline. While expansive new programs for refineries, tankers and natural gas have been announced, it is unclear how the country's ambitious agenda will be funded, even at high oil prices, given the lack of expertise and increasing restriction on foreign investment in the oil sector.

One of the most important outlets of PdVSA's product lies on our shores. Venezuela fitted its CITGO refineries in the United States to use Venezuelan heavy, sour crude oil as feedstock, and little additional capacity of this kind exist anywhere else in the world. Therefore, Venezuela has very limited opportunities to divert its oil imports to other markets, and any reduction in throughput at CITGO's United States refineries would deprive Venezuela of an outlet for its heavy sour crude.

In Venezuela, a country blessed with abundant natural resources, the government has reasserted state control over the country's oil and natural gas resources by retroactively changing contract terms and structures and insisting upon greater involvement by PdVSA in energy projects. Contrary to the government of Venezuela and PdVSA's claims, production levels are down and current production is increasingly coming from private sector-sponsored fields. As state company investment and expertise decline, private foreign companies have all but frozen new investment due to the uncertainty of the situation. Ultimately, it is the government of Venezuela's decision how to manage its energy sector, and it is its responsibility to choose the best use for its natural resources. However, the Administration is concerned, as are many investors, about declining production figures and efforts to squeeze out the much-needed private investment necessary to maintain production levels into the future.

Most importantly, I want to assure you that the DOE is taking comprehensive action to address United States energy security. We are striving to increase the diversity of both the types and sources of energy that our economy uses. The President's Advanced Energy Initiative is a major step in promoting technology research we will need to change the way Americans fuel their vehicles and the way they power their homes and businesses. We are working with a number of countries to develop and deploy new energy technologies and to stimulate energy production and improve energy efficiency. These policies will serve to improve our long-term energy security and minimize our exposure to the disruption of energy production in any individual country.

Further, we have policies and plans in place to mitigate any significant oil supply disruption. As you noted, the Strategic Petroleum Reserve is a powerful tool that can be used to mitigate "severe" supply disruptions. As well, through our partnership with our allies in the IEA, we can quickly take collective action in response to supply disruptions as was clearly demonstrated in our response to the effect of Hurricanes Katrina and Rita last year. The global nature of the world's oil market plays a crucial role in responding to any oil supply disruptions by reallocating supplies and sending price signals that encourage conservation and energy efficiency.

We look forward to continuing our dialogue on strengthening United States energy security. If you have any questions, please contact me or Ms. Jill L. Sigal, Assistant Secretary for Congressional and Intergovernmental Affairs, at (202) 586-4967.

Sincerely,

Samuel W. Bodman