

RICHARD G. LUGAR, INDIANA, CHAIRMAN

CHUCK HAGEL, NEBRASKA  
LINCOLN CHAFFE, RHODE ISLAND  
GEORGE ALLEN, VIRGINIA  
NORM COLEMAN, MINNESOTA  
GEORGE V. VOINOVICH, OHIO  
LAMAR ALEXANDER, TENNESSEE  
JOHN E. SUNUNU, NEW HAMPSHIRE  
LISA MURKOWSKI, ALASKA  
MEL MARTINEZ, FLORIDA

JOSEPH R. BIDEN, Jr., DELAWARE  
PAUL S. SARBANES, MARYLAND  
CHRISTOPHER J. DODD, CONNECTICUT  
JOHN F. KERRY, MASSACHUSETTS  
RUSSELL D. FEINGOLD, WISCONSIN  
BARBARA BOXER, CALIFORNIA  
BILL NELSON, FLORIDA  
BARACK OBAMA, ILLINOIS

KENNETH A. MYERS, Jr., STAFF DIRECTOR  
ANTONY J. BLINKEN, DEMOCRATIC STAFF DIRECTOR

# United States Senate

COMMITTEE ON FOREIGN RELATIONS

WASHINGTON, DC 20510-6225

July 20, 2006

The Honorable Condoleezza Rice  
Secretary of State  
United States Department of State  
2201 C Street, NW  
Washington, D.C. 20520

Dear Secretary Rice:

With the June 27 release of the Government Accountability Office (GAO) report I commissioned entitled "Issues Related to Potential Reductions in Venezuelan Oil Production," I write you to present my initial comments and suggestions regarding the conclusions reached by the GAO. I believe it is a timely report, especially in light of the current turmoil in oil-producing regions.

The GAO's conclusions reinforce the very clear importance of re-evaluating United States Government policy and activities related to international energy activities and of developing contingency plans specifically to mitigate the effects that a disruption of Venezuelan oil would have for the U.S. market and the world. However unrealistic Venezuelan President Hugo Chavez' repeated threats to disrupt oil supply may be, we have a responsibility to plan appropriate contingencies that protect the American people.

The GAO report describes the prominence of Venezuela in supplying petroleum products to U.S. consumers and in global oil markets. It is among the top 10 countries in total proven oil reserves and supplies 11 percent of U.S. petroleum imports. Venezuela also wholly owns five refineries in the U.S. that account for 750,000 barrels per day of refining capacity. Until the United States and other major consuming nations move their economies beyond petroleum dependence, Venezuela and other oil-rich countries will be in a strengthened position vis-à-vis import dependent countries, including the United States.

Venezuela's leverage over global oil prices and its direct supply lines and refining capacity in the United States give Venezuela undue ability to impact U.S. security and our economy. These conditions also give Venezuela a disproportionate level of international influence. My concern over Venezuela's energy-derived political leverage is not limited to reliable supplies of oil. I am also concerned with the real risk of having Venezuela act in concert with other countries to disrupt the price of oil, and the result that



Venezuela's policies could play in affecting financial markets and political outcomes in the region. Among the several important issues discussed in the report, particularly disturbing is the inadequate preparation by the United States government to address the threat of supply disruption from Venezuela, declining oil production in Venezuela, and Venezuelan government influence over CITGO.

First, the report concludes that a six-month disruption that removed "all or most Venezuelan oil from the world market" could raise oil prices by \$11 per barrel and reduce U.S. GDP by \$23 billion. The GAO found that Administration officials do not have Venezuelan-specific contingency plans for a potential loss of oil. According to the GAO, the Administration stated that in the event of supply loss its response would consist of a combination of the Strategic Petroleum Reserve (SPR) and diplomatic efforts to convince other oil producers to increase production. I question the sagacity of relying on other exporting countries to increase production. Currently, little excess production capacity exists, and most of that excess capacity is in politically unstable areas of the world.

The United States SPR and the global coordination system through the International Energy Program are invaluable protective tools, which, incidentally, is why I have advocated expansion of international SPR coordination in S.2435, the Energy Diplomacy and Security Act. However, I am concerned about over-reliance on the SPR system in the current global situation in which oil markets are tight and there are a number of tenuous situations in oil-producing regions around the world. SPRs are designed for short-term supply shortages. A politically motivated supply cut-off may not be of short duration. Further, given targeting of oil facilities in Iraq, Nigeria, Saudi Arabia, and elsewhere, uncertainty over the future of Iran, and the effect of unrest in the Middle East, we must consider that we could face multiple oil shortages at once, which may not be able to be coped with by the SPR system.

While a complete suspension of Venezuelan oil is unlikely due to the economic and political effects it would have domestically in Venezuela, it would be negligent to rely on ad hoc responses to situations which are predictable. It is both appropriate and necessary for the U.S. government to estimate the probable impacts of supply disruption so that proper response strategies can be formulated. Venezuelan President Hugo Chavez has made clear threats to cease oil exports to the United States, and I believe the Administration should create country-specific contingency plans to complement current reliance on SPR draw-down and convincing other oil producing nations to produce more.

Second, the GAO report points to a severe deterioration in the ability of Venezuela to meet its oil production targets in the foreseeable future. This has happened because the Venezuelan oil industry has allowed its technical and managerial expertise to deteriorate after the oil strike that occurred a little over three years ago. Though Venezuelan officials note that supply to the U.S. has continued uninterrupted, they have ignored the fact that declining Venezuelan supply adds to global market volatility and high prices.



The GAO report notes that the U.S. government's activities to ensure reliable long term supply of oil from Venezuela have been discontinued. According to the report, "3 years have elapsed since the last formal discussion between DOE and the Venezuelan Ministry of Energy and Petroleum regarding energy security." Further, officials in the Commerce Department and the Office of the U.S. Trade Representative reported that there is "no current engagement between them and their counterparts in Venezuela regarding energy security." Suspension of bilateral and multilateral activities raises serious concerns about the Administration's ability to effectively advance U.S. energy security with Venezuela.

Diplomacy can enhance our efforts to promote reliable supply of oil from Venezuela when utilized. The Department of State should be playing a central role in identifying the national security imperative for diplomatic engagement on energy security issues and for establishing a framework through which important technical dialogues can continue. I am aware that an effective dialogue requires committed partners, and it may be the case that Venezuela would not be committed, as evidenced by the Venezuelan government continually refusing meeting requests by our Ambassador in Caracas. Dialogue with Venezuela or other producing nations cannot guarantee reliability of supply, yet, in the case of Venezuela, lack of discussion invites further discord.


Third, according to the report, there are no contingencies to deal with the possibility that the Venezuelan government might close its wholly-owned refinery system in the United States. According to the report if this were to occur "the supply of gasoline and other refined petroleum products made from crude oil would decrease and, correspondingly, the prices of these refined petroleum products in the United States would increase. Last summer Americans felt the price impact of refinery shutdown following Hurricanes Katrina and Rita. Preparation for an oil refinery shutdown either because of natural disasters or a targeted and politically motivated refinery shutdown should be considered.

It is my view that private investment between the United States and Venezuelan is of mutual benefit to our countries and peoples. Both governments should respect the market-oriented nature of those investments and provide suitable regulatory frameworks. It is my hope that CITGO is allowed to operate with immunity from political developments in Venezuela and PDVSA. However, I believe it is appropriate that the Administration be vigilant to possible deviations from this course and conduct scenario planning that would account for a shutdown of CITGO refining and distribution.

We must realize that in the geo-politics of energy, market considerations are only one factor driving supply. This new reality demands new thinking on preparedness and response. Venezuela is using oil as a "political weapon" to persuade consumer countries to adopt a posture sympathetic to its interests. To advance our interests effectively, the extensive reliance on a passive approach to energy diplomacy needs to be abandoned. We must not let the past be a precursor to how diplomacy will work in the present or in the future. Not engaging Venezuelan authorities through diplomatic means might harm the United States, as well as our regional and global interests.

I trust that you share my concern for the scenarios analyzed in the GAO report. I look forward to continuing our dialogue on options to strengthen American energy security. If you should have questions, please contact Carl Meacham and Neil Brown of the Committee staff at (202) 224-4651. Thank you for your consideration.

Sincerely,

  
Richard G. Lugar  
Chairman

RGL/cmn

cc: The Honorable Susan Schwab  
The Honorable Carlos Gutierrez  
The Honorable Samuel Bodman