

P E R S P E C T I V E  
LAW AND OIL

By David Hults '08

What happens to the law in resource-rich developing countries?

I have spent some time researching Venezuela trying to find out, thanks to support from Stanford's Program on Energy and Sustainable Development and a summer public interest fellowship from the law school. Working with Professors Thomas Heller and David Victor,

I have been examining how Venezuelan oil revenues and regulatory framework interact.



VENEZUELA'S HISTORY SHOWS THE UPS AND DOWNS of legal institutions in a developing country. For decades, Venezuela was a stable—though corrupt and elite-controlled—democracy, with several governments fostering a pro-business regulatory environment. But the poor had received little of the country's oil wealth, which accounts for one-third of its gross domestic product and nearly half of government revenues. In 1999, however, Hugo Chávez became Venezuela's president, largely on the strength of votes from the

Venezuelan poor and working class. Once in power, Chávez began rewriting the Venezuelan rulebook. Meanwhile, oil continued to fuel the Venezuelan economy.

To better understand Venezuela today, I visited the country to learn more. I first lived in Venezuela during the summer of 2006 to work on rule of law issues at the World Bank and to study the country's oil industry. I went to the country again during the 2007 spring break to conduct follow-up research. Each time my experiences were wonderful. The country has a

# C T I V E S I N V E N E Z U E L A

relaxed, Caribbean-flavored feel. Venezuelans flock to the shore each weekend, and beat-heavy reggaeton music fills the city streets. During the summer, I lived with Venezuelan university students who loved talking politics and preparing local dishes (my personal favorite is a simple, Cheese Whiz-smothered arepa).

My research was equally fruitful. With the Stanford name behind me, I had the opportunity to meet with government officials, academics, and foreign investors. And despite the recent animosities between the U.S. and Venezuelan governments, my nationality never became an issue. Venezuelans of all political stripes—whether they were high-level contacts or taxi drivers—enthusiastically offered their views to me.

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## Government Control

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These interviews gave me sharply contrasting portraits of Venezuela. Government officials argued that Chávez established effective government control of the oil industry. Foreign investors, on the other hand, warned that Chávez's changes to the regulatory environment would eventually come back to haunt the country.

My sense is that Venezuelan oil revenues have allowed Chávez to control the regulatory environment, at least for the short term. Surging oil prices have helped give Chávez enough popular support to govern the country with almost no legal constraints. He has broad-ranging powers to rule by decree. Where his decree powers fall short, Chávez has pushed through new legislation, thanks to his near-complete control of the legislature. And if the constitution ultimately proves too meddlesome for

Chávez's ambitions, he may have the popular support to rewrite it; he has already done so once. His efforts to eliminate presidential term limits are a recent case in point.

And Chávez is increasingly using his powers to bypass legal institutions altogether. He obtains a growing share of government revenues in the form of extra-budgetary quasi-taxes on PDVSA (Petroleos de Venezuela S.A.); by my rough estimate, nearly half of government monies flow outside the preliminary official budget. Chávez has used some of these funds to stifle, rather than regulate, perceived threats to state power.

Over the long run, I believe Chávez's disregard for stable regulatory institutions may damage the country's oil revenues. The Venezuelan takeover of key foreign-owned oil interests and unstable regulation of the oil sector have antagonized many foreign investors and, in some cases, prompted them to seek international arbitration remedies. And punishing government quasi-taxes may have deprived PDVSA of the necessary resources to maintain oil production levels.

Looking beyond the oil sector, some of Chávez's initiatives have helped correct the country's long-standing income inequality and economic mismanagement. Chávez has, notably, implemented innovative health and food programs as well as improved tax collection and debt policy.

Yet he has also used his powers to shut down sources of dissent. The government launched its own television network in 2005 and purchased controlling stakes in major telecommunications and electric companies in early 2007. Earlier this year, it forced a major television network off the air because it had been

critical of the government.

Although my research is not yet complete, I have begun sharing my findings with the academic community. During the spring of 2007, several Stanford Law students and I presented our initial research at two academic conferences, attended by academic and industry experts from across the world.

I remain cautious but hopeful about Venezuela's future. The Chávez government may receive most of Venezuela's headlines, but the country's story is more complex. American culture and baseball are widely popular, almost overshadowing the war of words between the current U.S. and Venezuelan governments. And although Chávez's concentration of power is serious cause for concern, his tenure has given the poor a more assertive role within Venezuelan society. With luck, Venezuela's newfound voices will eventually give the country a stronger rule of law and better prospects for development. **SL**

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*David Hults '08 is interested in international law, particularly the relationship between the rule of law and international development. He has worked at the World Bank and as a summer associate at Cleary Gottlieb in New York and Washington, D.C. His research on Venezuela was funded, in part, by the Freeman Spogli Institute for International Studies' Program on Energy and Sustainable Development (PESD), a Stanford program that examines energy markets worldwide, sponsors field seminars and courses, and recently gained a new \$7.5 million gift from the BP Foundation to support such research. His work has been supervised by PESD Director David Victor, professor of law, and FSI senior fellow Thomas Heller, the Lewis Talbot and Nadine Hearn Shelton Professor of International Legal Studies.*