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THE RELATIONSHIP AMONG ECUADOR'S PETROLEUM
INDUSTRY, THE ORGANIZATION OF PETROLEUM
EXPORTING COUNTRIES (OPEC), AND THE LATIN
AMERICAN ORGANIZATION OF ENERGY (OLADE).

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THE RELATIONSHIP AMONG ECUADOR'S PETROLEUM INDUSTRY
THE ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES
(OPEC), AND THE LATIN AMERICAN ORGANIZATION
OF ENERGY (OLADE)

A Dissertation

Presented to
The Faculty of the Graduate School
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In Partial Fulfillment
of the Requirements for the Degree
Doctor of Professional Studies in Management

by
German E. Ortega
September 1976

THE RELATIONSHIP AMONG ECUADOR'S PETROLEUM INDUSTRY,
THE ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES
(OPEC), AND THE LATIN AMERICAN ORGANIZATION
OF ENERGY (OLADE)

PREVIEW

ABSTRACT

OF DISSERTATION TITLED

THE RELATIONSHIP AMONG ECUADOR'S PETROLEUM INDUSTRY,
THE ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES
(OPEC), AND THE LATIN AMERICAN ORGANIZATION
OF ENERGY (OLADE)

This study examines Ecuador's oil industry problems, and the viability of OPEC and OLADE as instruments for their solution.

Oil companies operating in Ecuador possess a high leverage of financial and technological power. This study shows that use of that power during the latter part of 1974 and the beginning of 1975 was detrimental to the progress of Ecuador's oil industry. The decision of the oil companies to stop oil production and exportation during that time because of the government's tax increases prompted a deficit to the country and a loss to the multinationals. The author maintains that the success of the oil companies and of the government depends on maintaining an equilibrium of power between them. Therefore, this study attempts to find out whether OPEC or OLADE can supply the host country with enough strength to attain this equilibrium.

Interviews and surveys conducted in the United States and in Ecuador among diplomatic and consular representatives of various countries around the world, as well as with sample populations of citizens of Ecuador, the government, and private

and public institutions indicate that the tax increases were reasonable, that Ecuador had the right and the obligation to defend its economic interests, that the price of its oil was competitive, and that the host country's association with OPEC proved to be beneficial to its industry. Therefore, primary sources of information confirm in this study that there is a relationship between Ecuador's oil industry and OPEC. A lower degree of importance is given to OLADE because it is an institution of recent creation and it is not specialized in the petroleum business..

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¹ Faculty of Economic Sciences.

² Institute of Economic Investigations.

³ Central University of Ecuador.

⁴ Ecuadorean Petroleum Corporation.

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⁵Chamber of Commerce of Quito.

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CHAPTER I

INTRODUCTION

The field of international business has been explored by scholars and practitioners during the last two decades,¹ and while it is true that a great deal of knowledge has been thus far gained, especially regarding the organizational activities of multinational and transnational organizations, it is also true that much more remains to be learned. Perhaps the key to a new concept of gathering knowledge and experience in international transactions might be the study of an industry in a given country where its people and their history must by necessity also be studied. This study was undertaken based on this idea. It analyzes the operations of foreign enterprises engaged in the exploration for, and exploitation of, petroleum in Ecuador and shows the relationship among Ecuador's petroleum industry, the Organization of Petroleum Exporting Countries (OPEC), and the Latin American Organization of Energy (OLADE).

The historic and political occurrences of the host nation must be studied, not only because they engender the

¹Endel J. Kolde, International Business Enterprise (2d ed.; Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1973), p. 10.

seed which prompts the success or failure of the multinational companies operating in Ecuador, but also because only a true examination thereof could bring about environmental changes that could prove beneficial to the interests of both, the multinational firms and the host country.

Statement of the Problem

The author believes that there has been a fundamental misunderstanding of these concepts on the part of the multinational companies engaged in the petroleum business in Ecuador. Because of this, they have not only failed to attain their own economic objectives, but also those of the government of Ecuador.

In this study emphasis is placed on the managerial philosophy of the Texaco-Gulf consortium which is the major oil producer in Ecuador, and whose decision to stop production and exportation of the Ecuadorean crude during the latter part of 1974 and the beginning of 1975 prompted a deficit of approximately \$212,000,000 to the government of Ecuador, and a loss of revenue of approximately \$72,000,000 to the consortium. Such decision was based on the consortium's belief that the government's tax increases of 1974 placed the Ecuadorean crude in an uncompetitive position in international markets.²

²"Documentos Especiales de CEPE" (Special Documents of CEPE), Corporación Estatal Petrolera Ecuatoriana (August 1975), p. 2.

The reference price of the Ecuadorean oil was gradually increased from \$8.79 per barrel to \$9.20 in July 1974, and to \$9.91 in October of the same year. By January 1, 1975, it was to be raised to \$10.12 per barrel in order to equalize for the first time the reference price adopted by all members of OPEC prior to the July 1974 tax increase. The Texaco-Gulf consortium refused to be bound by the said tax increases and unilaterally suspended operations until the Government of General Guillermo Rodríguez Lara reduced the taxes on July 2, 1975. When the Ecuadorean oil reference price of \$9.20 per barrel was established in July 1974, the consortium was exporting it at \$13.94 per barrel.³ The Ecuadorean government felt that the consortium was earning an ample margin of profitability and proceeded to assess the second tax increase in October 1974, but the \$0.71 per barrel tax increase met with further resistance from the consortium. The then Minister of Natural Resources, Captain Gustavo Jarrín Ampudia, was removed from his post during the month of October 1974 apparently as a "direct result of pressure from Texaco."⁴ The increase of \$0.21 per barrel which was intended to take place on January 1, 1975 never materialized, as the new Minister, Colonel Jorge Salazar Landeta, adopted a conciliatory approach toward the

³"Ecuador--Estadística Petrolera 1974" (Ecuador--Petroleum Statistics 1974), Ministerio de Recursos Naturales del Ecuador (May 1975), p. 93.

⁴Phillip Berryman, "Ecuador's Oil: No Bonanza for the People," The Christian Century (June 11-18, 1975), p. 604.

consortium.

Total oil production in Ecuador during 1973--which was the first year that the host nation became a net petroleum exporter, and a member of OPEC--reached 76,220,979 barrels.⁵ At that time oil companies were exporting crude from OPEC members at prices exceeding in some cases the \$20.00 per barrel mark.⁶ This margin of profitability on the part of the oil companies was considered by the OPEC members to be very high. The Ecuadorean government, however, did not substantially raise its petroleum taxes in 1973 because the Texaco-Gulf consortium was not obtaining such unprecedented price from their foreign refineries and customers. The government also considered it unwise to raise oil taxes in 1973 because it desired to increase production in 1974 to reach 228,000 barrels per day, or 83,220,000 barrels during the said year.⁷ Instead, total production in 1974 declined to 64,615,573 barrels⁸ because the Texaco-Gulf consortium refused to accept the government's tax increases that were assessed in

⁵"Production Developments in South America, Central America and Caribbean Area in 1973," Bulletin of the American Association of Petroleum Geologists (October 1974), p. 1965.

⁶"Price Levels," Annual Review and Record 1973, Organization of the Petroleum Exporting Countries (OPEC), p. 8.

⁷"Política Petrolera" (Petroleum Policy), Cámara de Comercio de Quito (March 1975), p. 1.

⁸"Production Developments in South America, Central America and Caribbean Area in 1974," Bulletin of the American Association of Petroleum Geologists (October 1975), p. 1787.

July and October 1974 and the most recent tax increase of \$0.21 per barrel that was to take effect on January 1, 1975.⁹ The consortium argued that, while the 1973 tax increases which finally established a reference price of \$8.79 per barrel by the end of that year were reasonable, the tax increases of 1974 were not. Production and exportation of the Ecuadorean crude were stopped by a unilateral decision of the consortium which argued that such tax increases placed the Ecuadorean oil in an uncompetitive level in international markets.¹⁰

Petroleum output in that country further declined in 1975. The target for that year was estimated at 236,000 barrels per day, or 96,140,000 barrels for the entire year;¹¹ however, the actual average of production--calculated up to and including November 14, 1975--reached only 138,488 barrels per day.¹² Total production figures for the entire year of 1975 were not available until June 1976 when this study was completed.

The demands of the Texaco-Gulf consortium to reduce the above-mentioned oil taxes were not met by the government

⁹"Brève Análisis de la Reducción del Precio del Petróleo" (Brief Analysis of the Oil Price Reduction), Instituto de Investigaciones Económicas de la Universidad Central del Ecuador (1975), p. 2.

¹⁰"La Rebaja de los Impuestos Petroleros en el Ecuador" (Reduction of Petroleum Taxes in Ecuador), Instituto de Investigaciones Económicas de la Universidad Central del Ecuador (1975), p. 1.

¹¹"Política Petrolera," loc. cit.

¹²Cámara de Comercio de Quito, personal letter.

of General Guillermo Rodríguez Lara, whereupon the consortium stopped production and exportation from October 1974 until July 2, 1975 when the president of Ecuador reduced the taxes by \$0.43 per barrel.¹³ The multinationals had demanded that taxes be reduced by a total of \$0.741 per barrel, and in addition suggested that the government accept a series of recommendations designed to benefit their economic and administrative interests.¹⁴ Among other recommendations, the following were made by the consortium:

1. That oil taxes be reduced by the government to the extent of 11 percent for contributions made to the universities, and 2 percent corresponding to the Coca concession located in the Oriente.
2. That the participation received by the government for the transportation of oil through the pipeline be reduced.
3. That the amortization of the cost of the pipeline be reduced to ten years.
4. That the taxes assessed at the Ecuadorean ports of embarkation be made part of the cost of production.
5. That the cost of the pipeline be maintained at \$103.5 million, rather than reducing it to \$70 million, as intended by the government.

¹³"Documentos Especiales de CEPE" (Special Documents of CEPE), Corporación Estatal Petrolera Ecuatoriana (July 1975), p. 2.

¹⁴"La Rebaja de los Impuestos Petroleros en el Ecuador," op. cit., p. 2.

6. That the price of the oil consumed within Ecuador be increased from \$1.45 per barrel to \$2.60.

7. That foreign exchange be freely handled by the consortium without limitations from the government.¹⁵

A study made by the "Instituto de Investigaciones Económicas de la Universidad Central del Ecuador"¹⁶ after the government reduced the oil taxes on July 2, 1975 reveals that Ecuador lost a total of 5,088,585,000 sucres which is equivalent to approximately \$212,000,000, because of the consortium's paralyzation of the industry during the lapse of time previously mentioned.¹⁷

The author believes that an understanding of the Ecuadorean government's economic aspirations--which were not above those already accomplished by all other members of OPEC --would have prevented the losses sustained by the consortium and by the government. But the consortium failed to do so and prevailed over the government of General Guillermo Rodríguez Lara. This brought about a wave of discontent among the Ecuadorean people and within the Armed Forces, and September 1, 1975 a revolution took place in that country for the purpose

¹⁵Ibid.

¹⁶Institute of Economic Investigations of the Central University of Ecuador.

¹⁷"La Rebaja de los Impuestos Petroleros en el Ecuador," op. cit., p. 14.

of deposing the president. Even though the revolution was not successful, Rodríguez Lara was finally forced out of the government in February 1976. A new Military Junta, headed by Contralmirante Alfred Poveda, then took control of the Republic.

The political history of Ecuador shows that it has always had nationalist governments because of the country's economic condition as a developing nation. The overthrowing of Rodríguez Lara was but another example of the concern displayed by the Ecuadorean people and their Armed Forces in the defense of their economic and political rights as a sovereign nation. Failure of the Texaco-Gulf consortium to understand these implications caused not only economic and political disequilibria in Ecuador, but also a sense of doubt about the integrity of the consortium. This, in turn, could lead to more serious consequences in the future, such as, the nationalization of the Ecuadorean oil industry. This thought has already been advanced by Frank J. Gardner who believes that Ecuador will follow the example of Venezuela.¹⁸

Purpose of the Study

The purpose of this study is to ascertain whether there is a relationship between Ecuador's petroleum industry and the Organization of Petroleum Exporting Countries (OPEC).

¹⁸Frank J. Gardner, "Watching the World," The Oil and Gas Journal (January 13, 1975), p. 25.

The incidents that occurred in Ecuador during the latter part of 1974 and the first half of 1975 have caused not only economic and political disequilibria in that country, but also financial losses to the Texaco-Gulf consortium, as it was seen in preceding pages.

The tax increases of 1974 were approved by OPEC because Ecuador had not yet reached the \$10.12 per barrel reference price that had already been adopted by all other members of OPEC.¹⁹ In so doing, the international organization felt that the economic interests of the Ecuadorean oil industry were being protected because the price obtained by the consortium in international markets averaged \$13.94 per barrel prior to the July, 1974 tax increase when the reference price established by the government was \$8.79 per barrel.

OPEC was founded in 1960 for the purpose of protecting the economic interests of its member nations. According to Resolution I.1 which is incorporated in the Charter of the organization the principal objectives are:

1. To be concerned with the attitudes adopted by the oil companies in effecting price modifications; and
2. To formulate a system to ensure the stabilization of prices through oil production regulation with due regard to the interests of producing and consuming nations and to

¹⁹"La Rebaja de los Impuestos Petroleros en el Ecuador," op. cit., p. 6.

the necessity of ensuring a steady income to the producing nations.²⁰

In this study the question whether Ecuador's oil industry could have been more successful had that country not increased the oil taxes under the auspices of OPEC will be examined in some detail. At the same time, the question whether the consortium would have allowed the assessing of any tax increase had Ecuador not been a member of OPEC will also be examined because, in spite of the consortium's objections, the host country ultimately obtained a net tax increase of \$0.69 per barrel: \$0.41 tax increase per barrel assessed in July 1974 plus \$0.71 per barrel increase that took place in October of the same year equals a total increase of \$1.12 per barrel, minus \$0.43 per barrel tax decrease in effect as of July 2, 1975 equals a net increase of \$0.69 per barrel.

Review of the Literature

A research of the literature available on the Ecuadorean petroleum industry indicates that nothing has been written about the relationship of that industry and OPEC except for what is discussed in this chapter. Ecuador's oil industry is still in the infancy stages. On the other hand, it appears that little attention has been given to that industry and its implications because the volume of oil produced in Ecuador is still comparatively small.

²⁰Mana Saeed Al-Otaiba, OPEC and the Petroleum Industry (New York: John Wiley & Sons, Inc., 1975), p. 58.