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Rising Guerrilla Violence in Colombia's Oil Sector Impeding US Interests [redacted]

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Summary

The National Liberation Army (ELN), Colombia's second-largest guerrilla group, is stepping up attacks against US and other companies engaged in crude oil production and exploration. The rebels bombed a key oil pipeline more than 60 times in 1997, twice forcing producers to delay deliveries to US Gulf Coast refineries. They also continue to harass, kidnap, and sometimes kill oil workers ***with the apparent goal of undermining the government, scoring propaganda points, and enriching themselves by extorting money from foreign firms and subcontractors***:

- ***The attacks deprive Bogota of important tax and foreign exchange revenues, expose US investors to increased risks, reduce demand for US capital equipment exports, and damage fragile ecosystems.***
- The ELN targets the sector because multinational oil and equipment firms have huge investments at risk and the resources to meet guerrilla extortion demands, according to the US defense attaché. [redacted]

Despite the high costs for security and the repair of damaged infrastructure, most firms appear committed to riding out spikes in guerrilla violence, but few are taking steps to discover or develop new fields. Multinational companies spend eight to 10 times as much on security in Colombia as they do elsewhere in the region, and exploration activity is at its lowest level since 1978. [redacted]

Bogota is attempting to reassure investors by beefing up military protection for the sector and by allowing them to keep a greater share of new oil discoveries. ***While such measures may help somewhat, it seems unlikely that the Colombian security services will be able to significantly improve the overall security situation in the foreseeable future—a prerequisite for the country to meet its immense oil-producing potential.*** [redacted]

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Oil Sector Under Fire . . .

Colombian guerrillas of the National Liberation Army (ELN) and, to a lesser extent, the larger Revolutionary Armed Forces of Colombia (FARC) continue to attack state- and foreign-owned petroleum assets as part of their struggle to undermine the government:

- The oil sector is an important source of national income and foreign exchange. Production accounts for about 5 percent of GDP and 27 percent of all export revenues, [redacted] Moreover, the sector attracted 30 percent of the $2.7 billion total foreign investment in Colombia in 1996, [redacted]

- The petroleum industry accounts for about 25 percent of the government's revenue, [redacted] State-owned oil firm Empresa Colombiana de Petroleos (Ecopetrol) accounted for 6.7 percent of combined public-sector revenues in 1996, according to IMF data. In addition, Bogota receives about 83 percent of revenues generated by private firms through various taxes. [redacted]

Scoring propaganda points and pressing for a change in the terms under which foreign companies operate in Colombia appear to be important factors in the guerrillas' calculation. ELN leader Manuel Perez claims that these acts of sabotage—he rejects the label of "terrorist" attacks—are a protest against what the group perceives as unfair contracts that allow foreign investors to reap profits from strategic mineral resources without contributing to the country's national development, according to the ELN Web site. In particular, the ELN charges that these companies fail to provide the type of sophisticated training and experience to local workers that would allow Colombia to become self-sufficient and eliminate the need for foreign expertise. [redacted]

At the same time, however, the presence of foreign firms has come to represent an important source of revenue for the ELN and one they would probably be reluctant to lose. These firms are a particularly attractive extortion target because they have considerable fixed investments at stake and the resources to meet guerrilla extortion demands, according to a defense attaché source. These companies deny paying such extortion fees, locally known as *vacuna*, but acknowledge that their subcontractors and workers may do so without their knowledge or approval, [redacted]

- In early 1997, an official of a US multinational company told the

[redacted]

[redacted] that guerrillas demand protection money from foreign firms equal to 10 percent of their investment—a practice that the Colombian military claims yields $140 million annually.

[redacted]

Against this backdrop of sometimes contradictory motivations, there are signs that guerrillas are becoming more active and sophisticated at carrying out attacks:

- Guerrillas bombed the Cano Limon oil pipeline[1]—one of their most frequent targets—more than 60 times in 1997, one of the highest annual totals since it opened in 1986.

- During two separate series of attacks in July and August—designed to prevent crews from repairing the damage and undoubtedly to inflict additional costs—the pipeline was shutdown for weeks, forcing the US firm Occidental Petroleum (Oxy) and Ecopetrol to declare *force majeure.*[2] Guerrilla violence has forced these companies to resort to such an extreme measure on only two other occasions in the pipeline's 11-year history of operations. [redacted]

Other attacks have targeted oil company personnel. Guerrillas killed six of Oxy's contract employees between April 1996 and June 1997—the most deaths the firm has ever sustained in a 14-month time frame—as well as 20 soldiers and security guards protecting the firm's production areas, according to press reports. [redacted]

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[1] The pipeline, Colombia's second-largest, is operated by a consortium of oil firms including Ecopetrol, a US firm, Royal Dutch Shell, British Petroleum, and the Spanish firm Repsol. [redacted]
[2] *Force majeure* is a standard legal clause in a contract exempting parties from fulfilling obligations as a result of conditions beyond their control, such as an earthquake or war. [redacted]

. . . Raising Production Costs . . .
Multinational companies incur a variety of significant costs as a result of guerrilla violence. For example, on average, each attack on the Cano-Limon pipeline costs Oxy and its partners about $3 million—including $180,000 for cleanup and repair work and about $2.8 million for forgone production—according to an Ecopetrol press statement. Other costs necessary to sustain production during periods of intensified guerrilla violence include giving discounts on oil sold to compensate buyers for increased uncertainty about deliveries. [redacted]

Not surprisingly, multinational firms spend eight to 10 times as much on security in Colombia as they do elsewhere in the region. Most of these firms keep large security staffs and, in some cases, pay the armed forces directly for protection—a practice many firms want to phase out to avoid being linked to human rights abuses committed by some military groups—[redacted] Several firms are currently negotiating with Bogota to establish terms for a joint security fund to be administered by Ecopetrol. [redacted]

Multinationals also fund a variety of local development and public relations projects in an effort to build public support for their operations and discourage attacks. British Petroleum, for example, spent $8 million in 1995 on social development projects—such as educational programs—along the Ocensa pipeline route, and a group of firms, which includes a US firm and Royal Dutch Shell, are funding a nationwide advertising campaign to raise awareness of the sector's importance to the Colombian economy, according to press reports. [redacted]

. . . and Altering Investment Decisions
Despite the increasing security problems, the vast majority of oil companies seem intent on maintaining their existing operations. Oil sector investments in Colombia generally entail multibillion dollar setup costs but relatively low operating expenses. This gives existing producers a significant incentive to remain rather than divest, which would require selling fixed assets at a steep discount or a complete loss if plant and equipment were abandoned entirely, [redacted] Multinationals at Cusiana, Cupiagua, and elsewhere, however, are responding to the deteriorating security situation by extracting oil at a much faster pace than would be optimal in order to maximize their long-term output [redacted] (S NF)

Although production at existing wells continues, few firms are investing the time and money to discover or develop new fields in areas that many experts believe rank among the world's most promising sites for oil exploration:

- Exploration activity in Colombia has declined to its lowest level since 1978, and the country could become a net importer of petroleum products as early as 2005, [redacted]

- Less than 15 percent of the country has been explored, according to Ecopetrol press statements, and experts perceive favorable geology for additional major finds like Cusiana, which represents the largest discovery in the Western Hemisphere since 1979 [redacted]

Bogota Struggling To Improve Security . . .

Goaded by calls from multinational investors and concerns over the growing assault on the country's primary export, Bogota is beefing up its already substantial commitment of military resources to protect oil production and transport infrastructure. Most notable, it is adding a new military unit to the effort—the 18th Brigade and its 2,000-3,000 troops—bringing to five the number of Army brigades that are heavily involved in energy sector protection. This new brigade is headquartered in Arauca Department, where the Cano Limon fields are located and the guerrillas are well entrenched. Bogota granted the brigade tactical control of aviation assets presumably to enable it to better patrol the pipeline and respond to guerrilla attacks. [redacted]

The military's problems confronting the guerrillas in oil regions, however, transcend manpower issues. Units use the bulk of their time and troops guarding refineries and pumping stations rather than actively seeking out guerrillas and preempting attacks on the pipeline [redacted] Moreover, the vast expanse of territory over which oil activities take place leaves open the possibility that guerrillas will always be able to strike at points that are unguarded or lightly defended. The Cano Limon system alone has 135 wells and 485 miles of pipeline in a remote region. Moreover, the Colombian Government alleges the guerrillas have informants in the oil worker's union—Union Sindical Obrera (USO)—who provide information about oil sector security to them to facilitate attacks against the pipeline. [redacted]

At least one multinational company is actively providing intelligence on guerrilla activities directly to the Army. The firm operates an airborne surveillance system along the pipeline to expose guerrilla encampments and intercept guerrilla communications, information it regularly shares with local military units, according to the defense attaché. [redacted] the military successfully exploited this information and inflicted an estimated 100 casualties during an operation against the guerrillas in Arauca in mid-1997. [redacted]

[3] Most of Colombia's 155,000 troops are based in cities or around key industries in a static, defensive posture, reacting to guerilla activity as opposed to taking offensive initiatives. [redacted]

Nonetheless, this type of close cooperation between foreign oil firms and the armed forces has a potential downside. The guerrillas could respond with revenge attacks against the companies or firms' reputations could be damaged if they are linked to human rights abuses committed by security services using company-supplied information [redacted]

. . . and Create New Incentives.

In tacit recognition of the high production costs, dwindling exploration activities, and poor security situation, Bogota recently began easing contract terms for potential oil sector investors to counterbalance the increasing risks associated with exploration and development. In November, for example, Ecopetrol announced changes to its standard contract for future investment deals, offering foreign firms as much as 75 percent ownership in newly discovered fields, reimbursing part of the cost of conducting seismic surveys of "cold" or unexplored basins, and implementing other measures that make development of these fields more profitable.[4] Some companies have already taken Ecopetrol up on this better offer, but most are withholding judgment while they study the changes and gauge public reaction. [redacted]

Bogota is also taking several innovative measures to hedge its exposure to financial fallout from guerrilla attacks. For example, Ecopetrol recently leased storage terminals in The Bahamas to provide a strategic reserve of petroleum to serve customers when attacks on the pipeline disrupt flows to Colombian ports. It has also leveraged some of the risks by selling bonds that have returns linked to the company's production, according to press reports:

- Specifically, Ecopetrol worked through two US investment houses in November 1997 to place $290 million in investment grade bonds with US institutional investors; the notes are backed by rights to production from Cusiana and Cupiagua oil fields.

- Investors reportedly cannot demand payment of principal or interest from Ecopetrol if it is unable to pump oil, and they do not have rights to any future or past output that is not specifically referred to in the bond. [redacted]

Outlook

The guerrillas are unlikely to stop or slow their attacks against the oil sector in the next six to 12 months. An agreement to end to the attacks would probably only come

[4] Bogota historically has required foreign firms to give Ecopetrol a 50 percent stake in any large deposits they find in exchange for a cash reimbursement equal to half of the exploration and development costs for the deposit. This setup has allowed Ecopetrol to profit from oil finds without taking any of the upfront financial risks associated with exploration. [redacted]

about as part of broader talks on peace and reconciliation with the government or trusted intermediaries, a process that seems unlikely to begin in earnest until a new president takes office in Colombia next August, if then.

In the meantime, the recent actions taken by the military and multinational firms to improve security may impede the rebels' ability to mount sustained attacks against oil sector infrastructure but will not prevent attacks altogether or significantly reduce the threat to oil sector employees. Indeed, in view of the expansive and difficult nature of the terrain, the longstanding shortcomings of the military, and the tenacity of the guerrillas, it seems unlikely that Colombian security forces will be able to significantly improve the overall security situation in oil exploration and production areas in the foreseeable future. As a result, we are likely to see more private initiatives by domestic and foreign energy-related companies to combat guerrilla activities, including the deployment of high-technology security devices, the formation of vigilante groups, and the hiring of paramilitary groups.

Ecopetrol's new contract terms will make new investment in Colombia more appealing to companies willing to tolerate high risks, but mainstream oil firms are likely to focus their exploration activities elsewhere until the security situation stabilizes. Venezuela, for example, shares Colombia's immense oil producing potential and close proximity to the United States and is in the midst of an initiative to open more of its oil sector to foreign investment.

Further escalation in guerrilla violence in the form of sustained attacks on pipelines or targeting of crucial elements of the oil infrastructure such as pumping stations, refineries, or export terminals would significantly increase the likelihood that some multinationals—including the country's largest oil investor British Petroleum—would seriously consider exit strategies. In the face of such a threat, Bogota's heavy reliance on oil sector revenues would leave it little choice but to further increase protection for the sector at the expense of decreasing security elsewhere.

Foreign Participants in Colombia's Oil Sector [redacted]

Approximately 60 large multinationals and 100 smaller subcontracting firms participate in crude oil exploration and production activities in Colombia, [redacted]

- The Colombian Government Trade Bureau lists eight US firms among the most important foreign companies involved in the sector—Amoco, Chevron, CMS Nomeco, Exxon, Occidental, Maxus, Mobil, and Texaco.

- The Trade Bureau reports that other key foreign firms involved in the oil sector include Australia's Broken Hill Proprietary (BHP), the British firms British Petroleum and Lasmo, Brazil's Braspetro, Canada's Petro Canada, the French firms Elf Aquitaine and Total, the Netherlands' Royal Dutch Shell, and Spain's Repsol. [redacted]

Colombia has tapped another US firm, Triton, to participate in the consortium that will operate its newest and largest pipeline system, Oleoducto Central S.A. (Ocensa). The system, which is scheduled to become fully operational in mid-1998, has already been bombed by guerrillas and is likely to be a target of future attacks. It will be longer and have more than twice the capacity of Cano Limon. [redacted]

Environmental Impact of Guerrilla Violence in Colombia [redacted]

Guerrilla attacks on Colombia's oil infrastructure are causing significant environmental damage to some of the most biodiverse areas in the world. More than 1.6 million barrels of oil have spilled along the Cano Limon pipeline route since 1986, including fragile wetlands on the country's northcentral plains and tributaries of Venezuela's Lake Maracaibo, according to press reports. Less frequent attacks on other oil infrastructure—such as the pipeline linking oil fields in southwest Colombia to the port of Tumaco—also contribute to the damage. Ecopetrol's security coordinator estimates cleanup crews recover less than 30 percent of spilled oil. [redacted]

Bogota has not given environmental protection in the oil sector a high priority:

- The Ministry of Environment recently fined the consortium building the more than $2 billion Ocensa pipeline only $16,000 for spilling crude during construction and for mislaying the pipeline in several environmentally sensitive areas, according to press reports.

- The government has not listed improving oil sector cleanup as a priority in private bilateral discussions with US officials, focusing instead on urban planning and monitoring the impact of pollution on coral reefs near Caribbean tourist areas, [redacted]

Nevertheless, the Samper administration recently began a public relations campaign to highlight guerrilla environmental damage to discredit the guerrillas in the eyes of the Colombian public and foreign environmental lobbying groups. In mid-1997, Colombia's Environment Minister confided [redacted] the campaign is targeted primarily at European environmental groups, which Bogota hopes will counteract the influence of other foreign human rights groups that it believes are sympathetic to the guerrillas. [redacted]

Petroleum Output Expanding Rapidly

Colombia's petroleum production capacity is growing rapidly, largely as a result of decisions made by US investors in the late 1980s and early 1990s. Government statistics indicate that petroleum output has risen 38 percent since 1994—to about 626,000 barrels per day (b/d)—and could exceed 1 million b/d by 2000:

- US firms have accounted for almost half of foreign investment in the sector in recent years and are providing a wide range of exploration, development, and transportation services, according to US Embassy and press reports.
- Petroleum output of 1 million b/d would place Colombia on a par with Brazil's current production but well behind Mexico, Venezuela, and Saudi Arabia, which produce 3.1 million b/d, 3.4 million b/d, and 8.8 million b/d, respectively.

Colombia's Economic Woes Transcend Oil Sector [redacted]

Colombia is recovering from a recession that began in late 1996—resulting from a tight monetary policy to drive down inflation, declining business confidence related to President Samper's political difficulties, and a slowdown in exports stemming from an appreciation of the peso and a recession in neighboring Venezuela, a key trading partner. GDP growth probably exceeded 3 percent in 1997, up from 2.1 percent in 1996. Both figures are substantially lower than the 4.5 percent average annual growth rate Colombia posted for several decades before Samper's election. [redacted]

Despite this modest recovery, the country faces several economic challenges that the government is unlikely to resolve before next year's presidential elections:

- The recession caused unemployment to surge to nearly 14 percent from under 10 percent in early 1996. Preliminary government estimates suggest unemployment has eased to about 12 percent, but the overall increase under Samper remains a sensitive political subject.
- The budget deficit has increased sharply since Samper took office and probably exceeded 4 percent of GDP in 1997, [redacted] The rise reflects patronage doled out to avoid impeachment, constitutional obligations to transfer revenues—but not costs—to local governments, expenses associated with privatizing pensions, and a failed attempt to end wage indexation. The deficit is drawing criticism from several quarters including the central bank and the IMF.
- Risks for the export sector and foreign investors are rising as a result of increasing guerrilla violence, political uncertainty, and a volatile exchange rate. [redacted]