

Area Review: VENEZUELA

Presented by: Javier Solis

October 21, 2017

Venezuela is a country located in the northeastern part of the South American continent, bordered by Colombia, Brazil, Guyana, and the Caribbean Sea. The country was founded in 1830 following the collapse of the country of Gran Colombia and was ruled as a military dictatorship for the first half of the 20th century. Venezuela held its first democratic election in 1959 and enjoyed a four decade-long period of successive, albeit shaky, democratic governments until the populist Hugo Chávez was elected in 1998.

Under Chávez, a new constitution was adopted and the executive branch became increasingly authoritarian, curbing many civil rights and liberties while socializing many key industries like oil, electricity, and telecommunications. While Chávez was revered by many Venezuelans—especially the poor—for his anti-imperialist rhetoric and actions, the same rhetoric and actions made him a thorn in the side of the US, straining Venezuelan-American relations over the past two decades. Aside from his fiery words, Chávez also accumulated and maintained his ardent supporters by using profits from the sole, state-owned oil company Petróleos de Venezuela, S.A. (PDVSA) to fund extensive social welfare programs (Bowman). As seen in figure one, GDP per capita increased three fold under Chávez's reign, while unemployment, poverty, and infant mortality rates dropped noticeably (The Guardian).

Chávez served three full terms as president but succumbed to cancer on March 5, 2013, roughly three months into his fourth term. Following Chávez's death, his Vice President Nicolas Maduro was elected into office on April 14, 2013, largely carried to victory on the popularity of his predecessor. Maduro, however, does not enjoy the cult of personality or charisma that Chávez had, and public support for Maduro's presidency has deteriorated since he took office.

This prompted Maduro to issue a series of presidential decrees which consolidated his power and allowed him to pursue extralegal actions against opposition forces. Maduro's latest decree in January of this year spurred massive protests that have consumed the nation for the majority of 2017 and have also triggered a constitutional crisis (Melimopolous).

Maduro also doesn't enjoy the healthy crude oil prices Chávez did, which is troubling because oil has been Venezuela's proverbial golden goose. Figure two outlines Venezuela's crude oil production throughout the past two decades while figure three highlights the share of oil-related products in Venezuelan exports, which increased noticeably under Chávez. According to the latest data from the Observatory of Economic Complexity (OEC), petroleum—either crude or refined—accounted for an astonishing 89% of Venezuela's 2015 exports, or \$78 billion. The three major recipients of Venezuelan exports are the United States (\$14.6 billion), China (\$6.07 billion), and India (\$5.82 billion) while the three main sources of imports are the United States (\$8.07 billion), China (\$5.31 billion), and Brazil (\$2.99 billion) (OEC).

In terms of proven crude oil reserves, OPEC ranks Venezuela first with over 302 billion barrels compared to its closest competitor Saudi Arabia, which has proven reserves of 266 billion barrels. Venezuela also has 5.7 billion cubic meters of proven natural gas reserves compared to Saudi Arabia's 8.6 billion (OPEC). However, Venezuela is ranked number 11 in crude oil production despite having superior reserves (CIA World Factbook). This disparity is largely a result of government protectionism that prevents much outside expertise and capital from flowing into the country. Even when outside money ekes in from investment companies like Halliburton and Schlumberger, PDVSA's squanders it because of unpaid debts and mismanagement of resources. The inefficiency of PDVSA also means that despite being oil-rich,

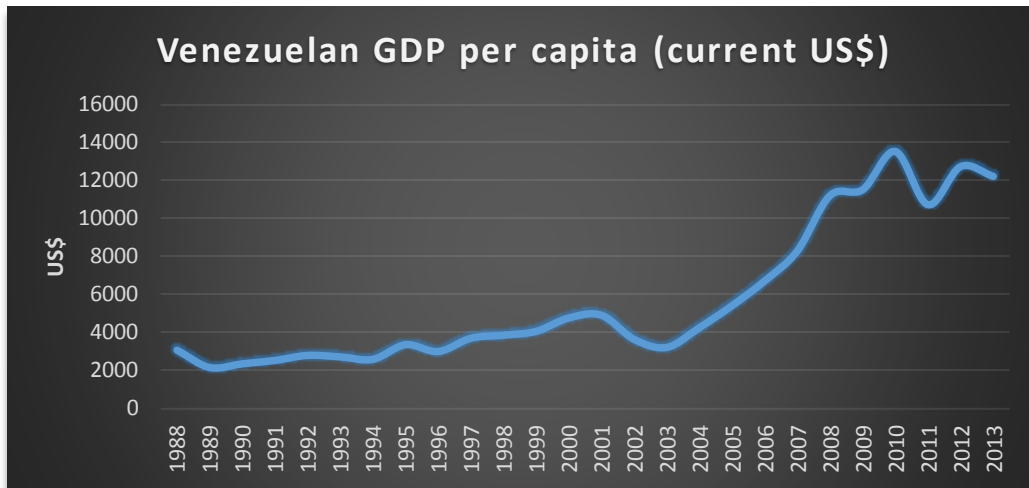


Figure 1: Data sourced from the World Bank.

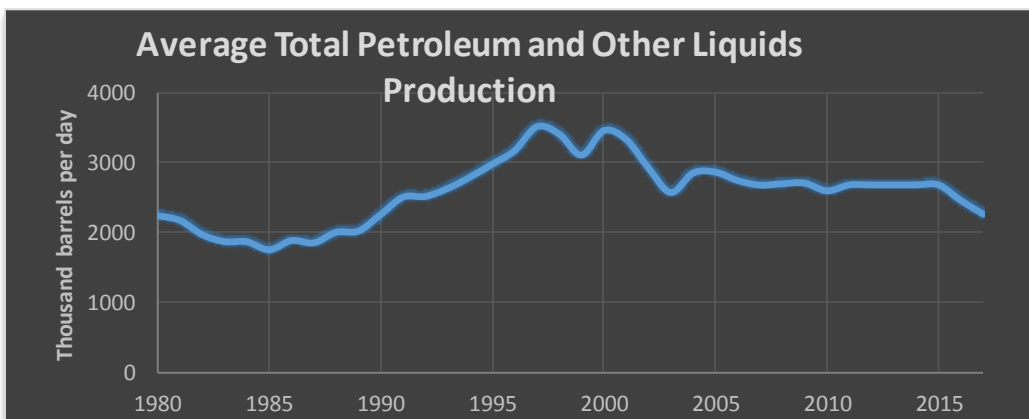


Figure 2: Data sourced from U.S. Energy Information Administration.

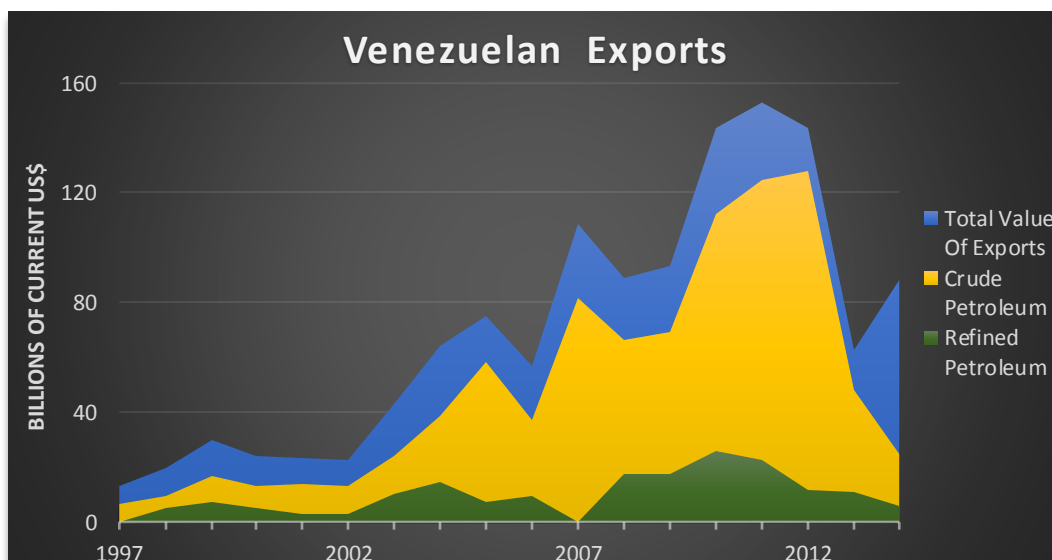


Figure 3: Data sourced from the Observatory of Economic Complexity

Venezuela must import hundreds of thousands of barrels of refined petroleum per day to meet domestic demand (Colasante).

The ongoing constitutional crisis has upheaved Venezuela's domestic policies and compromised future development, though its outlook wasn't much better prior to it. Relations with the west were greatly strained under Chávez and have deteriorated further under Maduro, placing Venezuela in a corner with few allies. Furthermore, Venezuela's overreliance on exported oil meant the country thrived when oil prices grew, but also meant that it suffered when prices tanked—precisely what has happened in the past three years. Due to increased production from the U.S., Russia, and Saudi Arabia, the price of West Texas Intermediate (WTI) crude has faltered from \$110 a barrel in June 2014 to \$52 as of the writing of this report (Macrotrends).

The Venezuelan people and economy have languished terribly as a result. The government issued heavy cuts to domestic social welfare programs while inflation soared from 57.3 percent to an astonishing 652.7 percent in these three years (IMF). Many Venezuelans have been unable to purchase food, medicine, or other basic necessities, leading to increased frustration and protests against the government, which, in turn, has prompted a heavy-handed crackdown by Maduro and his loyalists. As a result of Maduro's fraudulent constitutional assembly in July 2017, President Trump administration levied harsh sanctions against Venezuela in August, which prevent US entities from conducting any new financial agreements with PDVSA. These sanctions, coupled with already-falling output and oil quality issues from PDVSA production plants and refineries, have discouraged many international buyers from purchasing their crude, further reducing the flow of outside capital into the country and further deteriorating the domestic social institutions.

Venezuela has responded to the sanctions by ditching the petrodollar, pegging their oil prices on the Chinese yuan, and looking in other markets for customers or financiers. Earlier this month, Maduro met with officials of Russia's state-owned oil company Rosneft to discuss possibly restructuring Venezuela's debt to Russia. They were able to come up with an agreement that provided the Venezuelan government several billions of dollars as an advance payment for future crude oil production (Tanas). This injection of Russian money was much needed, but only provides a short-term fix. If global production continues to rise and prices continue to drop, Venezuela is unlikely to bounce back and will remain at the mercy of fellow OPEC members and other large oil producers like Russia and the United States, who dominate the oil market.

Though Venezuela has plenty of potential for investment due to its strategic location and vast oil reserves, it would be extremely unwise to place any sort of investment into the country's oil industry. Potential investors face a litany of political risks due to the instability of Maduro's government and their chokehold on Venezuelan oil. Any investments should be preceded by lobbying activities that persuade the government to institute free-market reforms—once the democratic institutions of the country are fully operational again, that is. Privatization of Venezuelan oil will greatly facilitate outside investment into the country and will allow for better utilization of the country's extensive reserves, but it must be executed carefully. The Venezuelan people are wary of multinational corporations, but a coordinated propaganda campaign can change public opinion by highlighting the failures of the oil industry's socialization while promoting the benefits privatization would bring. Any investors would be wise to continue the PDVSA's social programs in one way or another, lest the locals greet them with pitchforks and torches. This is a battle of hearts and minds as much as it is a battle of strategy and capital, a point which cannot be stressed enough given Venezuela's current state of turmoil and upheaval.

References

- Bowman, Michael. "Venezuela's Oil Wealth Powers Social Programs, Drives Divisions." 4 August 2010. *Voa News*. 16 October 2017.
- Central Intelligence Agency. "Country Comparison: Crude Oil - Production." 2016. *The World Factbook*. 16 October 2017.
- Colasante, Luis. "Venezuela is importing oil despite having the world's largest oil reserves." 22 May 2017. *Business Insider*. 17 October 2017.
- "Crude Oil Prices - 70 Year Historical Chart." 17 October 2017. *Macrotrends*. 17 October 2017.
- "How did Venezuela change under Hugo Chávez?" 6 March 2016. *The Guardian*. 16 October 2017.
- International Monetary Fund. "Inflation rate, average consumer prices: Annual percent change - Venezuela." n.d. *IMF Data Mapper*. 16 October 2017.
- Melimopolous, Elizabeth. "Venezuela: What is a National Constituent Assembly?" n.d. *Al-Jazeera*. 17 October 2017.
- "Member Countries: Saudi Arabia." 2017. *Organization of the Petroleum Exporting Countries*. 16 October 2016.
- "Member Countries: Venezuela." 2017. *Organization of the Petroleum Exporting Countries*. 16 October 2016.
- Simoës, Alexander. "Country Profile: Venezuela." 2015. *The Observatory of Economic Complexity*. Digital. 16 October 2017.
- Tanas, Olga. "Russian Government Drafts Terms to Restructure Venezuelan Debt." 14 October 2017. *Bloomberg Politics*. 17 October 2017.
- U.S. Department of Energy. "International Energy Statistics: Total Petroleum and Other Liquids Production - Venezuela." 2017. *U.S. Energy Information Administration*. 10 October 2016.