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Advocacy for Human Rights in the Americas

SUMMARY

The Impact of Financial and Oil Sanctions on the Venezuelan Economy

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PRE-SANCTIONS VENEZUELA

In August 2017, when the United States implemented the first round of financial sanctions on Venezuela, the country was already facing one of the most severe economic crises in the history of Latin America. The nation's GDP was in decline,[1] oil production was plummeting[2] (at 40 percent less barrels per day than production in 1998 and 22 percent less than production in March 2013), the beginning of hyperinflation was under way, and oil production as a percentage of GDP was at similar levels to that of 1990. The Venezuelan economic crisis began far before the arrival of sanctions from the United States.

EFFECTS ON THE OIL INDUSTRY

A. COMERCIALIZATION OF CRUDE OIL AND OIL PRODUCTS

However, the sanctions have had a significant impact on the oil industry. While the 2017 sanctions did not affect the commercialization (export and import) of crude oil and its products between the United States and Venezuela, they negatively impacted Venezuelan oil production due to the fact that it became much more difficult for state oil company PDVSA and its partners to access credit. This not only affected access to financial credit (creating new debt, as well as restructuring and re-negotiating with creditors), but also providers, clients, and partners, which are fundamental to maintain stable levels of oil production in any company.

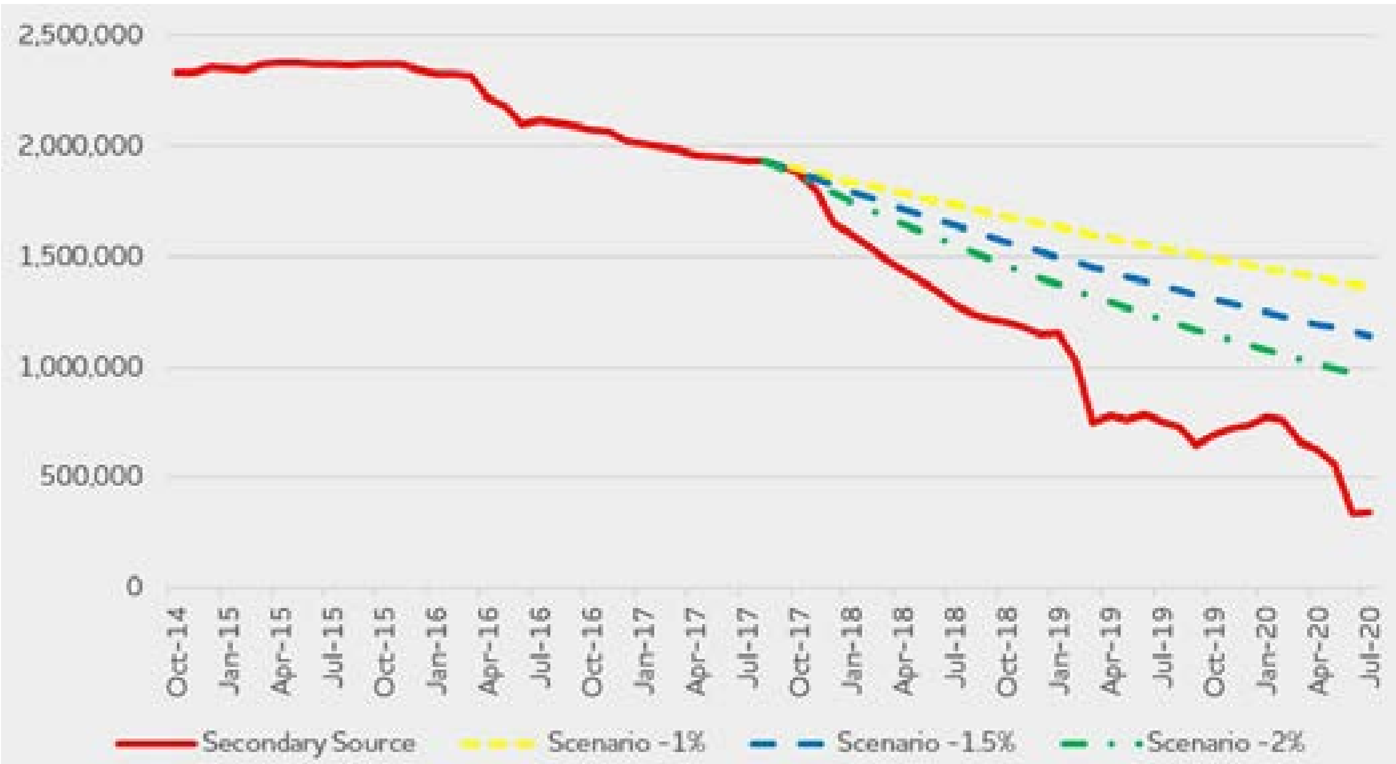
The oil sanctions implemented against PDVSA in January 2019, which prohibited exports to the main U.S. market for Venezuelan oil, resulted in an increase of exports to China, India, and other countries. In a short time, these sanctions produced an accelerated decline in the company's client portfolio and cargo transporters, resulting in a considerable contraction in oil exports from the country. Moreover, PDVSA was forced to provide discounts in order to sell its crude oil and pay a premium to acquire fuel and other needed products (detailed information about this is rather opaque, and thus it is difficult to determine the precise overall loss).

B. CALCULATING THE IMPACT ON OIL PRODUCTION AND FISCAL REVENUES

Since August 2017, the average monthly production of Venezuelan oil has fallen almost 5 times faster than during the pre-sanctions period; in the 18 months prior to the imposition of the 2017 sanctions, the average monthly decline in oil production was 1 percent.

As shown in Graph 1, if the monthly decline of 1 percent were continued, but sectoral sanctions were not imposed, PDVSA would have received roughly an additional $31 billion ($30,949,000,000) in revenue to date. In fact, even if the average monthly decline in production were 2 percent, this author's model indicates that PDVSA would have received an additional $17.57 billion ($17,574,000,000) in revenue to date were it not for U.S. sanctions. When the oil sanctions were announced, then-National Security Adviser John Bolton said that they would cause Venezuela to lose $11 billion annually in revenue from oil exports.[3] Our calculations are in line with this estimate.

GRAPH 1: VENEZUELAN OIL PRODUCTION (PROJECTIONS)

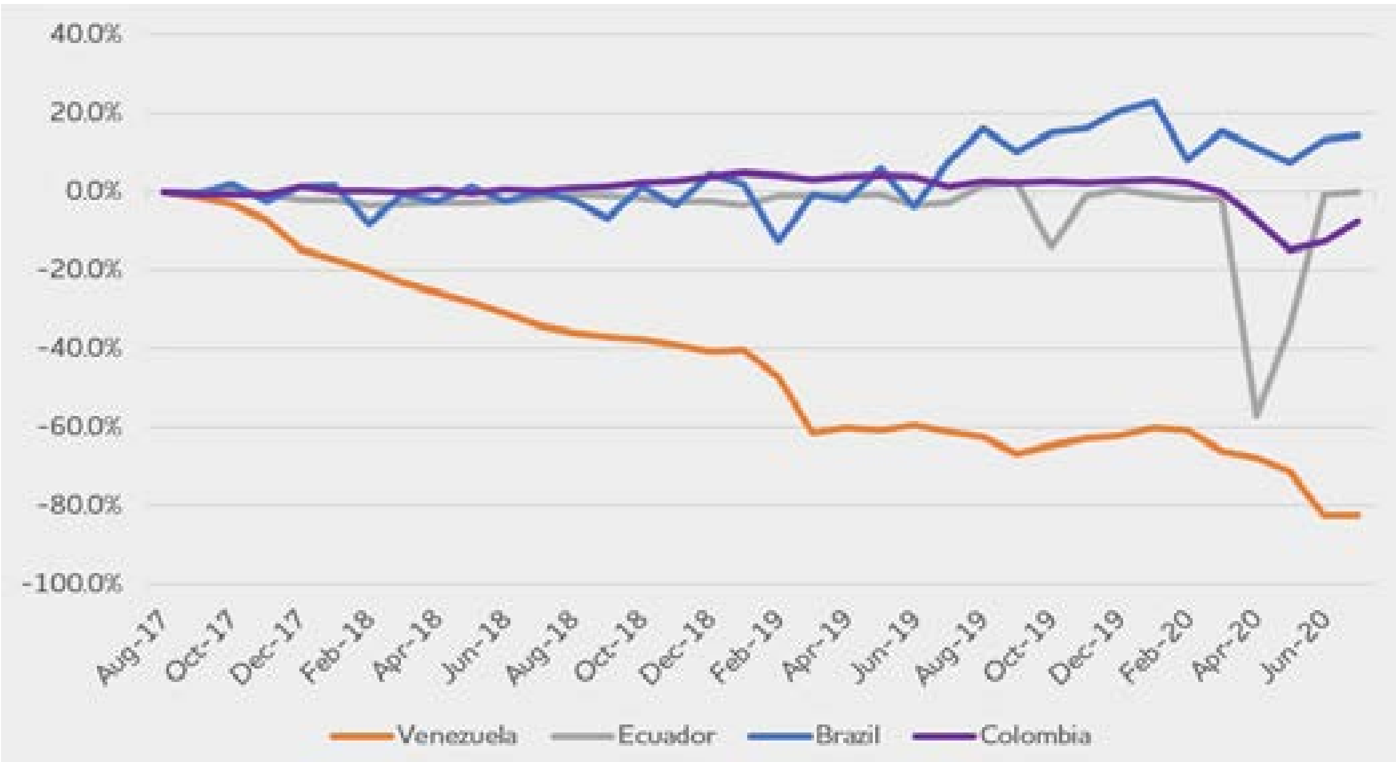


Source: OPEC, monthly reports.

C. COMPARISON WITH OTHER OIL EXPORTING NATIONS

The author carried out an analysis of oil production in Venezuela from August 2017 to July 2020, comparing it with oil production in The author carried out an analysis of oil production in Venezuela from August 2017 to July 2020, comparing it with oil production in 1.) the three biggest oil producing countries in the world, 2.) OPEC countries, and 3.) other oil-producing countries in South America, to identify any similarities in trends with the recent changes in oil production in Venezuela. The results show that, excluding Iran, all countries analyzed saw an increase in oil production during this period except for Venezuela.

GRAPH 2: OIL PRODUCTION IN SOUTH AMERICAN COUNTRIES VS. VENEZUELA (MONTHLY % VARIATION)



Source: OPEC monthly reports; National Agency of Petroleum of Brazil; National Agency of Hydrocarbons of Colombia

HAVE U.S. SANCTIONS BEEN EFFECTIVE?

This analysis provides a response to each of the most common arguments defending U.S. sectoral sanctions. These include:

I. THE SANCTIONS DON'T RESTRICT THE PURCHASE OF FOOD AND MEDICINE BY THE VENEZUELAN STATE, NOR DO THEY HAVE A NEGATIVE EFFECT ON THE GENERAL POPULATION.

Although sanctions do not impose explicit restrictions on the importation of food and medicine, foreign currency is needed to obtain these goods. With the fall in oil production, foreign currency revenues for the government have also fallen, generating a contraction in imports (Table 1), and ultimately affecting the most vulnerable Venezuelans. It is important to recognize that Venezuelan public imports began to fall in 2014, later stabilizing from 2016-2018, but then experiencing a steep decline in 2019 and 2020.

TABLE 1

Year	Public Imports (Millions of USD, monthly average)	% Variation
2010	1,368	
2011	1,589	16%
2012	2,207	39%
2013	2,247	2%
2014	1,954	-13%
2015	1,520	-22%
2016	825	-46%
2017	739	-10%
2018	860	16%
2019E	500	-42%
2020E	250	-50%

Source: Central Bank of Venezuela (until 2018), BCV estimates (2019 and 2020).

Comparing the data presented in Table 1 (most notably the average monthly public imports between 2016 and 2018) and the oil revenues that Venezuela received prior to sanctions, one can conclude that the country did not have the capacity to increase its rate of importation due to the sanctions. As a result:

- In scenario #1 (a 1 percent contraction of monthly oil production, similar to the decline experienced before the implementation of sectoral sanctions), the income that Venezuela would have generated is almost the same as the average monthly public imports between 2016 and 2019.

- In scenario #2 (a 1.5 percent contraction of monthly oil production), the average monthly income that Venezuela would have received is equivalent to 84 percent of the average monthly public imports in the country.

- In scenario #3, which simulates the steepest drop in Venezuelan oil production (an average monthly decline of 2 percent), the income generated would be equivalent to 62 percent of the average monthly imports.

In whichever scenario, even the most extreme, the impact of the fall in imports is notable. The main Venezuelan imports in recent years include cereals, machinery, and dairy products (the three representing 33.5 percent of all imports) were the most important in 2018, with pharmaceutical productions making up close to 6 percent.[4] Table 2 (Source: INE) shows the principal markets for imports from 2016-2018.

The Pharmaceutical Federation of Venezuela (La Federación Farmacéutica de Venezuela) says that more than 90 percent of the supplies they use and nearly 30 percent of all the medicines in the country are imported.[5] Furthermore, roughly 75 percent of food products consumed by Venezuelans are imported. Ricardo Cusanno, President of the Venezuelan Federation of Chambers of Commerce (Fedecámeras) claims that sanctions have caused as much harm to the economy as the expropriations of 2007-2008, while Reinaldo Quintero, director of the Venezuelan Oil Chamber (Cámara Petrolera de Venezuela) notes that the sanctions cause many problems for private firms in Venezuela, as well. UN High Commissioner for Human Rights Michelle Bachelet has reiterated that sanctions have exacerbated the effects of the economic crisis and, consequently, the humanitarian situation.[6] The International Monetary Fund (IMF), Amnesty International, and the United Nations Development Programme (UNDP) have all expressed the same opinion.[7]

TABLE 2

Goods	2016	2017	2018
Cereals	6.8%	12.2%	16.3%
Machines, mechanical devices	15.8%	16.4%	9.0%
Milk and dairy products	3.5%	1.6%	8.1%
Vegetable/animal oils and fats	2.1%	4.3%	7.1%
Machines, electrical devices and parts	6.2%	5.3%	6.7%
Pharmaceutical products	5.6%	6.3%	5.8%
Food for animals	2.9%	1.7%	4.3%
Manufactured iron and steel products	4.0%	3.6%	4.1%
Prepared meats/fish	0.1%	0.3%	3.1%
Sugar	1.6%	5.3%	3.0%
Vegetables	2.3%	4.9%	1.9%
Mineral fuels	11.7%	3.6%	1.7%
Organic chemical products	7.4%	5.5%	1.3%
Vehicles	2.0%	1.7%	1.0%
Iron and steel	1.0%	0.6%	0.3%
Total	72.9%	73.4%	73.8%

Source: National Institute of Statistics, Venezuela

Other negative effects of the sanctions include delays and obstacles in transferring funds, receiving donations and remittances, and the closure of bank accounts. These effects have been felt not just by private firms, but also NGOs addressing the humanitarian crisis and thousands of Venezuelan individuals. The sanctions have also had the effect of increasing costs and creating logistical problems for those that travel to and from Venezuela.[8] This overcompliance has become a large issue for Venezuela. The sanctions and the government's response have produced a transformation in the Venezuelan economy, contributing to the informalization of the economy, the propagation of illegal actors, expansion in illegal mining, and more, that reduce the possibility of economic recovery.[9]

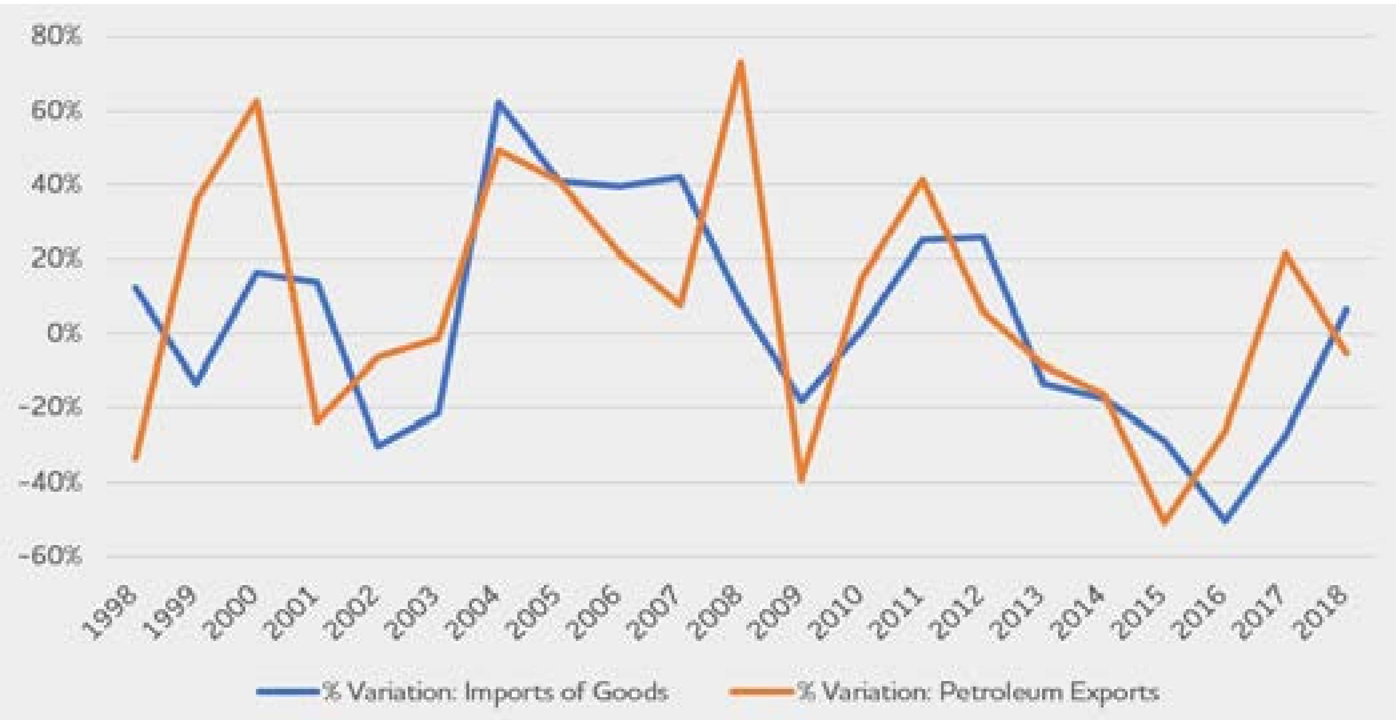
II. WITHOUT OIL SANCTIONS, REVENUES FROM OIL EXPORTS WOULD ADD TO THE CORRUPTION OF THE MADURO GOVERNMENT

Despite the abundance of corruption cases within the Maduro government,[10] pressuring the country to run out of revenue with the argument that resources are being diverted by those in power is a radical measure that puts the lives of many Venezuelans at risk. It is like saying "in view of the fact that relatives are stealing the patient's medicine, the patient should not be allowed to buy medicines even if this leads to their death."

It is important to remember that according to Central Bank (BCV) data for the first semester of 2019, public imports represented 78 percent of the total. A good part of these imports are essential goods that reach sectors of the population with limited ability to purchase goods. Even if the corruption in Maduro's government meant it would have kept a portion of the revenue that has been lost due to sanctions, the increase in the supply of goods via imports or subsequent boost in national economic activity (or lower fiscal pressure due to greater income), would certainly have increased the well-being of the Venezuelan population.

Graph 3 shows the percentage variation in imports of goods and exports of oil. The similarities in trends are evident, but it also tells us that if the ruling elite "stole" all of Venezuela's oil resources, imports (both public and private) would be zero.

GRAPH 3: % VARIATION: IMPORTS AND EXPORTS



Source: Central Bank of Venezuela, BCV estimates.

The same argument is used by both Venezuelan and international defenders of sanctions when it comes to a possible prohibition of exchange of oil for oil products (most recently, diesel). In the middle of a pandemic and with the weak state of Venezuelan refining systems, to expect that the scarcity of much-needed fuel would not have negative effects for the population is simply flawed thinking. Diesel is fundamental to the Venezuelan energy grid, and although its consumption has diminished in recent years (similarly to the decline in use of other fuels in the country due to the crisis), it continues to be vital in important sectors such as agriculture, electricity generation, water pump maintenances, and for public transit and ambulances.

U.S. sanctions that prohibit swaps of crude oil for fuel will not have an impact on PDVSA cash flows since these operations do not generate much hard currency. But without a doubt they will have an important negative impact on the Venezuelan populace. These sanctions do not look to create an effect on the finances of PDVSA, but instead to cause greater discontent among Venezuelan society.

Diesel is necessary for sectors that are vital in the production and transportation of food, as well as for ambulances. To prevent it from arriving in Venezuela so that some barrels are not stolen is to create an even worse situation for many Venezuelans.

According to available data,[11] in states such as Mérida (an agricultural state), Nueva Esparta, Vargas, Falcón (with fish industries), Carabobo (a formerly industrial state), and even Zulia (a large producer of food and oil products), the consumption of diesel is greater than that of gasoline due to food production and electrical generation, while in Caracas diesel consumption is low compared to gasoline. A measure like limiting diesel flows into Venezuela is detrimental to the quality of life of Venezuelans, exacerbating the already complex problems faced by those that live in the country's interior.

Today, half of the consumption of diesel in the country goes towards the transportation and production of food, public transit, freight transport, and ambulances. Of the other half, 75 percent goes towards thermoelectric plants and the rest to the industrial sector (which is much lower than in previous years due to the collapse in private-based GDP).[12] As such, sanctions that increase the scarcity of diesel directly impact the most vulnerable Venezuelans.

Another important point to understand about the importance of diesel: due to the sensitivity in production and transport of foods, its use in public transport, freight, and ambulances, the Maduro government has not raised the price of diesel—even as it has risked political backlash by raising gasoline prices.

III. THE SANCTIONS KEEP VENEZUELAN ASSETS ABROAD SAFE, PREVENTING THE MADURO GOVERNMENT FROM LIQUIDATING THEM IN ORDER TO FUND ITS CLIENTELE NETWORKS.

Sanctions have actually caused the country to lose assets kept in foreign countries. In July 2019, Citibank and Deutsche Bank took control of $1.4 billion dollars' worth of gold as a guarantee for loans, as a result of sanctions levied against Venezuela's Central Bank (BCV). Other examples include the reduction of shareholder participation in the company Nynas, and the loss of three of Venezuela's primary oil tankers.[13] If Citgo is being kept safe, why would OFAC need to keep renewing licenses to prevent creditors from liquidating the company? Venezuelan assets held abroad are, in fact, OFAC-dependent.

IV. THE SANCTIONS WERE DESIGNED TO PUT PRESSURE ON THE MEMBERS OF THE GOVERNMENT AND CAUSE INTERNAL DIVISIONS.

The literature indicates that, far from promoting liberal democracy, sanctions tend to generate more authoritarianism and repression in the countries in which they are applied.[14] As well as reducing democratic spaces, they increase repression and violence in general within sanctioned countries,[15] contributing to increasing poverty while the elites of the country remain shielded from the majority of the sanctions' impacts.[16] Sanctions also run the risk of causing a "rally around the flag" effect, entailing an increase in popular support for the government as a result of the prolongation of the sanctions program and the economic difficulties they cause.[17] Moreover, international sanctions do not increase the probability of success of non-violent, peaceful campaigns in search of political change.[18]

Sanctions limit the strategies available to the targeted government, but in the majority of cases they are not decisive enough to force a democratic transition, and the collateral damages on the most vulnerable populations further reduce their efficacy. In Venezuela, sanctions appear to have helped the government coalesce ideologically and become further entrenched in power.

V. THE SANCTIONS ARE AN IMPORTANT TOOL FOR THE OPPOSITION TO MADURO

Unfortunately, the work of the opposition within the country has not been as effective as hoped, generating too much confidence in the role of the international community and sanctions as a way to trigger decisive political change in Venezuela. It should be emphasized that foreign support (for example, in the form of economic sanctions) for a non-violent, peaceful movement can weaken the mobilization of local public support through a kind of a "free rider" effect in which activists in the movement rely more heavily on foreign support than local support, thus losing their ultimate power base. Likewise, the fact that members of that local non-violent movement receive direct assistance from abroad can also contribute to the delegitimization of the movement.[19] This is not to underestimate the importance of having dozens of countries supporting a political change within the country, as well as the effect of the sanctions on the elites in the government, but to instead emphasize the importance of combining the actions of foreign actors with those of local actors in order to make them more effective. This explains the existence of a crucial disconnect between the political rhetoric of some sectors of the Venezuelan opposition and the reality of the Venezuelan people.

RECOMMENDATIONS

Three years after the initiation of sectoral sanctions against the Maduro government, the results have been modest at best. They have not achieved a political transition, but—as predicted by the literature—the economic and social crisis has worsened, and repression of the opposition and general population has increased. While it is true that the sanctions did not cause the economic crisis in Venezuela, they have contributed to its deep decline, and to the further deterioration of the quality of life of Venezuelans.

Keeping in mind how intended objectives compare with actual achievements, and the influence of the sanctions on the economic situation of the Venezuelan population, the author believes that oil and other sectoral sanctions that the United States has imposed on Venezuela should be abandoned. That being said, the author believes that proposals to flexibilize and better instrumentalize existing sanctions should be evaluated. The U.S. government and international community should consider the following recommendations when doing so.

I. OIL FOR HUMANITARIAN AID

One of the proposals by the economist Francisco Rodríguez[20] is to implement a program to allow exchanges of oil for essential goods (food, medicine, fertilizer, and more), due to the precarious situation faced by so many of the Venezuelan people. In view of the current pandemic, the author believes that it is pertinent to include any potential vaccines against COVID-19 and personal protective equipment in such an arrangement. In order to achieve such a program, it is fundamental to have an intermediary (accepted by both the Maduro government as well as the opposition) such as the United Nations that can guarantee the transparency of the operation.[21] Additionally, the author recommends that this program be directed towards clients in the United States (the natural market for Venezuelan goods), searching for the utmost transparency and ease to find a market for Venezuelan crude oil.

II. OIL AS A PAYMENT FOR DEBT

Keeping in mind the elevated levels of global stock and the impossibility of marketing crude oil, Venezuela could make agreements with accredited companies (such as Crystallex, for example) or with firms that represent bondholders, for the exchange of oil for debt. Knowledgeable sources indicate that PDVSA has more than 40 million barrels of oil stocked up, which would have a market value of close to $1.6 billion. Why not negotiate the delivery of part of this stored oil in order to reduce debt? For example, amid sanctions and defaults on existing loans, the Russian firm Rosneft has been able to recover most of PDVSA's debt with the company, while other creditors have not received anything for the credit they have extended. Permitting debt repayment schemes in exchange for oil would achieve at least three satisfactory situations: (1) PDVSA would diminish the quantity of crude oil they have stored and would increase their capacity (and incentives) to increase oil production; (2) this would lower the pressure on creditors to acquire Venezuelan assets abroad(such as in the case of Citgo, Venezuelan tankers, etc.); and (3) creditors would have mechanisms to immediately begin to receive payments for the debts they hold from PDVSA and the Venezuelan government.

III. RESTRUCTURING THE DEBT

Financial sanctions have not permitted the government and PDVSA to begin the processes for a renegotiation and/or restructuring of their debts in foreign currency. To dismantle the sanctions that prevent the sale of Venezuelan government bonds in foreign currency, and to permit citizens, businesses, and institutions to negotiate with creditors, would resolve important problems not just for U.S. investors, but also for Venezuelans that invested in those bonds and have income (and savings) in foreign currency in Venezuela's inflationary economy. It is important to understand that for Venezuela to return to economic growth, a restructuring of debt will be necessary, and without access to international markets, this will be very complicated to achieve.

IV. UNFREEZING RESOURCES TO ALLOW FOR CONDITIONED PURCHASE OF FOOD AND MEDICINE

A large quantity of the government and PDVSA's financial resources are frozen in various entities around the world. The Maduro government has always sustained that this money is for the purchase of food and medicine. What the author proposes is to unfreeze these resources and use them to buy humanitarian resources, as well as goods and equipment, in order to improve public services. The use of these resources should not solely count on OFAC for approval, but should also include OFAC in decision-making about which goods to acquire, seeking to achieve the utmost transparency possible, in conjunction with bodies such as the United Nations and the Development Bank of Latin America (CAF).

V. NEGOTIATE ELECTORAL CONDITIONS IN EXCHANGE FOR SANCTIONS RELIEF

If the sanctions can serve an effective purpose, it is to reduce the asymmetry of power between the government and the country's opposition. Proper instrumentalization of this pressure could facilitate the prospect of negotiations to flexibilize financial and oil sanctions in exchange for concessions such as improved electoral conditions.

FINAL IDEAS

This report does not seek to diminish the responsibility of Hugo Chávez and Nicolás Maduro in the origin of the economic crisis currently facing Venezuela, but instead aims to expose the negative effects of sanctions on the economy. After three years of sectoral sanctions, the results have been mediocre. The economic crisis in Venezuela has worsened, and government repression of the Venezuelan people has increased.

The literature in favor of sanctions as a fundamental tool for regime change or a democratic transition is weak. The revenues that the government has failed to incur as a result of the sanctions are resources that could have served to increase public imports, in spite of widely-documented corruption within the Maduro government. While the sanctions have been financially inconvenient for Maduro, with the help of allies the government has learned to withstand and resist them.

Dismantling the current sanctions regime or establishing mechanisms to make sanctions more flexible must be seen not just as necessary to change a strategy that has failed to achieve its stated objectives, but also important considering the complex situation currently faced by the Venezuelan people.

Finally, the author would like to emphasize the limited official information that is currently accessible. With more recent public data, the analysis contained in this report on the impact of sanctions on the Venezuelan economy and society could have been more robust.

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21 It is necessary to understand that a thorough revision of the failed aspects of similar programs, such as that in Iraq a few years ago, are needed to avoid making the same mistakes.

ABOUT WOLA

The Washington Office on Latin America (WOLA) is a leading research and advocacy organization advancing human rights in the Americas. We envision a future where public policies protect human rights and recognize human dignity, and where justice overcomes violence.

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Luis Oliveros is an Economist with expertise in Oil Politics and Commerce, International Financing, and Financial Management. He is also a Professor at the Universidad Central de Venezuela y the Universidad Metropolitana.

ABOUT THE COVER PHOTO

Image of a sign stating “There is no gasoline” taken in front of a closed gas station in Caracas, Venezuela, on May 24, 2020.

Source: AP Photo/Ariana Cubillos

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