

## Venezuela: Beyond a Failed State

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While we can trace almost all Venezuela's current difficulties to the precipitous decline in oil prices in 2014, yet the reality is almost every difficulty can be attributed to or was made worse by governing authorities. Venezuela is a mess: an energy mess, an economic mess, and a political mess. The suffering in the country is almost unimaginable. People are picking through garbage in the streets, hunger is manifestly a nation-wide problem, street riots occur with regularity, even the poor who have typically supported socialist President Nicolas Maduro have turned to protest.<sup>1</sup> Tens of thousands of folks amass and march into Columbia to purchase food and household goods -- when they have money.<sup>2</sup> Store shelves in Venezuela have long been stripped of foodstuffs. The basics: milk, rice, coffee, sugar, corn, flour and cooking oil are all in desperately short supply. Moreover, there are critical shortages of medicines. People are dying from the shortages.<sup>3</sup> Foreign commercial and industrial firms have long ago pulled up stakes and fled, or worse have been arbitrarily expropriated on trumped up charges of not serving the people. And the goose that lays the golden eggs, PDVSA (Petroleos de Venezuela S.A.), the state oil company, is slowly being denuded of its operational and financial resources.

Most of the "immediate" crisis -- that has lasted for two years -- occurred with ascension of Maduro as president. A former bus driver made Foreign Minister under the former president Hugo Chavez, Maduro has stumbled from crisis to crisis since has was annointed 'Big Man' in 2013.

Maduro won the April 2013 election for the Partdio Socialista Unido de Venezuela (PSUV) by the slimmest of margins, 1.5%. With the assistance of Havana, Madura consolidated factions within the PSUV to present a united front for the election. And as we know, he squeaked by.<sup>4</sup>

Within a year, students from the university town of San Cristobol (population: 650,000) in the mountainous western part of the country started protesting the Maduro Government. The students were protesting against "inflation, shortages and corruption," but most of all they were protesting against the brutal "collectivos," literally thugs employed by the government to quell disruptions and protest. Thirteen died and 150 were injured in the demonstrations. Within days protests began to spread across the country.<sup>5</sup> And so the pattern began: protests followed by repression, followed by more protests and more repression.

The oil sector accounts for 95% of the country's exports, 40% of government revenues and 12% of GDP. And PDVSA dominates the oil sector.

But PDVSA is burdened down with all kinds of directives and regulations, which has turned it into another state play thing in South America. The most grievous assault occurred in 2003 when 18,000 managers and workers were summarily fired for striking. PDVSA has never

really recovered from this state intrusion; all future employees would be hired after having passed a loyalty test committing themselves to Chavez, later Maduro, and the PSUV.

Other indignities to the corporate welfare of PDVSA included: more than 50% of oil production was sold below market prices, with retail gas subsidies the highest in the world. Massive loan repayments were traded in oil for consumption items. There is even a bizarre international give-away program, called PetroCaribe, colloquially referred to as “oil-for-jeans,” which amounts to billions in subsidies aimed at Caribbean and Central American nations. Recipient nations can “purchase” oil at low interest rates (1%) and/or re-pay with food products, consumer goods or medical doctors, from Cuba for example.<sup>6</sup> Moreover, 42% of oil exports have been “commercialized under non-market arrangements; ... lots of oil is sent to China to cover off more than \$40 billion in loans.”<sup>7</sup>

Production problems at PDVSA are ubiquitous; in the first two quarters of 2016 crude production has fallen off 5.4% and 5.0% year-over-year. Production is down to 2.37 million barrel/day in May, a 14.4% decline over the last year.<sup>8</sup>

Operational problems are manifold; there are daily accidents and stoppages. “Project deadlines and production goals are rarely met.” And the employment rolls are regularly ginned up: the latest number is “150,000 ... despite production falling.”<sup>9</sup> PDVSA is used by the state as a massive source of employment -- whether workers are needed or not.

Exports “fell by more than 300,000 b/d in June, compared with the 2015 average.”<sup>10</sup> Venezuela holds the world’s largest reserves in crude oil, but the country poses “a growing supply risk for international oil markets [going into] 2017.”<sup>11</sup> Venezuela is prospectively losing its share of markets, particularly with the U.S., in favour of Canadian, Mexican and Saudi oil. In an odd turn of fate, Venezuela is actually becoming a net importer of light crude. It has to mix light oil with heavy oil, and that is giving U.S. gulf coast refineries a leg up.

PDVSA cannot get ahead of the game because for years it has suffered under-investment; cash has been siphoned for all manner of social programs, and so refineries have been left rust in the hot sun.

Not only refineries have suffered under-investment but so has exploration. Starting in 2014, the rig count declined to an average 68 from 72 in 2013, and 61 in mid 2015, and dropped precipitously from March 2016 down to 50 in September.<sup>12</sup>

Two bright spots have emerged: heavy oil development and joint ventures. The only area where production is increasing is in Orinoco Oil Belt where heavy and extra heavy oil is produced. This oil, which “requires upgrading or blending with lighter oils” is a growing business. The volume of increase was 1.3 million b/d in 2015.

Joint ventures with international energy companies have been a blessing to the Venezuelan economy; they have produced more than one million b/d in oil in 2015, which is about one-third of the country’s output. Venezuela has cut deals with CNPC, Eni, Chevron, Repsol and Rosneft. These “foreign partners own up to 40% of these projects.”<sup>13</sup>

With the world price of oil rising, in Venezuela's case to \$40 a barrel in June 2016, \$10 higher than at the start of the year, you'd think the pressure on Venezuela would have dissipated. Unfortunately, lags in the system prevented an early turnaround, and, of course, other things were catching up. For example, in July 2016 reports, PDVSA was "showing a 40% annual decline in revenues, and a 79% collapse in profits," coming from an "operational loss of \$3 billion on its global operations."<sup>14</sup>

But the real vulnerability lay in PDVSA's debt position. Projected gross export revenues – of which PDVSA comprises 95% -- are in the neighbourhood of \$30 billion if 2016. Of that amount PDVSA must cover \$10 billion in debt service charges, allowing about \$20 billion for imports of good and services, including the cost of its oil imports, which were about \$6 billion in the first three quarter of 2015.<sup>15</sup> So financing is tight. In an unprecedented move, Maduro raised the retail price of gas 6000% from 10 centavos – less than one penny U.S. -- per litre to 6 bolivars or 60 U.S. cents per litre. For PSUV this was like slaughtering a sacred cow; low gas prices were sacrosanct.

Recently, PDVSA's debt situation got a little worse. Fearing a default, the government entered into a debt swap trading \$5.325 billion in bonds coming due in 2017 for \$2.8 billion due in 2020. The big news and the thing that put the deal over the top was the offer "to sell off the lucrative Citgo Petroleum, PDVSA's U.S. downstream operation." But PDVSA is not out of woods; several investors say there is a "51% probability that the company will still default in the next 12 months."<sup>16</sup>

The economy as whole is no better off. According to the International Monetary Fund, the economy is shrinking by 10% per year. That's because inflation is at a hyper-inflation state, 720%.<sup>17</sup> And because the currency has been trashed by the governing socialists, now worth less than a U.S. penny. "A year ago, one dollar equaled 175 bolivars. Now a dollar is worth 865 bolivars (Jan. 2016) i.e. one bolivar is with worth \$0.0011." Confusion is added because Venezuela has three exchange rates: one for ordinary folks and two for exports.<sup>18</sup>

Driven to take at least some modest action, President Maduro announced a series of emergency measures in January 2016 – through his usual medium, a 5-hr. address on television. "The economic initiatives include changes to the country's multi-tiered exchange rates, as noted the increase to retail gasoline prices, the implementation of a new tax system, and the expansion of community control over food distribution."<sup>19</sup>

In addition, the president is cracking down on state corruption, charging 55 officials at a state supermarket chain with wrongdoing. He also, as part of his economic initiative plans, wants to spend 190 billion bolivars on public infrastructure.<sup>20</sup>

The world of opposition politics in Venezuela took a turn to the positive in December 2015; the National Assembly was taken over by MUD (Democratic Unity alliance), a coalition of opposition parties. This was the first time in 17 years that a non-socialist faction had control of the Assembly.

In March, they decided to oust Maduro from the presidency. Since mass protests and street violence alone had not worked for them before, they decided that things would be different

this time. They settled on a tripled-pronged strategy: to initiate a recall referendum, a constitutional amendment to reduce the president's term of office, and mass protests.<sup>21</sup>

The recall referendum would be tricky. The collection of signatures with all the judicial and bureaucratic impediments would have to be wrapped up by the end the year or else they would only be replacing an autocratic, socialist president with an autocratic, socialist vice-president. Moreover, as a final stage "at least 20% of registered voters would have to sign a petition asking for a referendum." And the collection of signatures could only start once the president had served half his term, which meant a start date of April 19, 2016.<sup>22</sup> The next item was the constitutional amendment to shorten the president's term from 6 to 4 years. That way a new election could be held as early as December 2016. Since MUD had a super-majority of two-thirds of the National Assembly seats, this option seemed reasonable. The third option, mass protests -- which the future would dictate would be their only option -- the MUD coalition was determined would remain non-violent to avoid the 43 deaths that occurred across the country in 2014.<sup>23</sup>

As expected a series of delays and obstructionist tactics were invoked by the National Election Board (CNE) during the spring of 2016 -- all Maduro appointees.

Vice President Aristobulo Isturiz stated flatly that the recall referendum was a no-go, because "signatures collected by the opposition were [bound to be] fraudulent." Indeed, Maduro took to the airwaves on May 17<sup>th</sup> in "a belligerent condemnation of the opposition discounting the referendum."<sup>24</sup>

In June, CNE said it would begin the process of validating first stage signatures. The next step -- a bizarre procedure -- would be to allow citizens to withdraw their names from the lists. And those who wanted to leave their names on the lists would have to have their finger-prints doubled-checked -- an outright intimidation tactic if there ever was one. Ultimately, the CNE invalidated 605,000 signatures. Even the former presidential candidate in 2013, Henrique Capriles, had his signature invalidated.<sup>25</sup>

In the midst of all the wrangling, the National Assembly introduced a new oil and mining law. It proposed opening up the oil servicing sector to private and mixed firms, as well as make compensation payments to private corporations who had been expropriated.<sup>26</sup>

At this juncture, mid-July, 64% of Venezuelans said they would vote for Maduro's ouster.<sup>27</sup>

When the first stage of the referendum was completed, when 1% of voters had signed a petition in every state, CNE gave its go-ahead. The next step was to collect 20% of the nation's voters about 4 million signatures.<sup>28</sup>

In the meantime, the country's Supreme Court was insisting that three opposition members had registered fraudulently and therefore sat illegitimately in the National Assembly. Conveniently, a reduction of three of the MUD coalition would wipe out their 2/3's super-majority.<sup>29</sup>

In August, given the obstacles presented, the opposition was starting to run out of time to have all the requirements in place for the referendum. And the constitutional provision for a 4 year presidential term was going nowhere.

In September, the CNE ruled that even if signatures were gathered by December, the referendum would not occur until 2017, which meant under the constitution the opposition would be stuck with Maduro's second-in-command. Opposition leader Maria Corina Machado voiced a call for "civil disobedience."<sup>30</sup>

A poll of Venezuelans in support of Maduro's ouster was topping out at 84% by late September.

Also in late September, CNE pulled out all the stops in terms of obstructions:

- CNE ruled that 20% of nation signatures must take place in 3 days;
- Polling places would be open for 7 hours each day and closed for lunch;
- Less a third of voting machines will be made available;
- Voters would have no more than 90 seconds to cast their vote, and best of all
- The 20% threshold would have to be met in all 24 states.

At the end of October, CNE suspended the signature drive as several regional courts had set aside the stage one petition drive. The opposition reacted angrily at the latest offence. The crisis continues.

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