COMMENTS ON CUBA'S OIL SWAPS FOR DOCTORS AND CUTBACKS ON VENEZUELAN OIL DELIVERIES

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Ernesto Hernández-Catá's paper[1] presents an excellent analysis of Cuba's economic and social environment in a context of major changes in its relationship with Venezuela. I agree with his assessment that the reduction of Venezuela's oil sales to Cuba and of exported services and oil products from Cuba to Venezuela will have huge economic consequences for the island.

According to Hernández-Catá's estimates, the lower level of Venezuela's oil sales to Cuba in 2019 would represent a drop of 2.0 percent of Cuba's absorption—defined as consumption plus investment by the state and household sectors—and the decreased exported services and oil products would have an impact of 7.0 percent of GDP. As he mentions, the absorption and exports/GDP ratio may be underestimated because of the overvalued currency.

These impacts seem small to me. In a dynamic framework, the total impact of the cut-offs of the economic relationship between Venezuela and Cuba could be much larger than calculated by Hernández-Catá. In Venezuela, the interconnection of oil with other economic sectors is important. The oil sector has close ties to several sectors, such as services, transportation, construction, electricity and manufacturing. Every US$1.0 spent in the oil sector, represents, at least, US$2.0 in the total economy (based on Venezuela's input-output tables).

With respect to the external sector, Hernández-Catá estimated that Cuba's external flows will reduce in more than half in 2019. Cuba's 2019 trade surplus may drop to US$2.9 billion from an estimated US$5.5 billion surplus (without supply shock).

This major supply shock anticipates negative Cuban GDP growth with high inflation in 2019. Lower per capita income and real wages with balance of payment problems will likely occur.[2]

The ways to deal with this new environment may bring conflicts between economic reality and ideology. In my opinion, the central planning model (collective ownership of the means of production, centralized decision-making process, progressive redistribution, among others) may have no way to deal with external shocks such as total cut-offs of oil imports, commodities market volatility, and international sanctions, among others, in order to reduce economic and social deterioration.

Cuba's current economic model—like Venezuela's economic model—seems to be financially unsustainable. In my view, Cuba now has two extreme policy options: One, to implement quantity-only adjust-

1. Ernesto Hernández-Catá, "Cuba's Swaps of Petroleum for Doctors and the Impact of Cutbacks in Venezuelan Oil Deliveries," in this volume.

2. These considerations may also be relevant for the 14 countries which are included in the 2005 "Acuerdo de Cooperación Energética PetroCaribe", namely Antigua and Barbuda, Bahamas, Belize, Cuba, Dominica, Grenada, Guyana, Jamaica, Dominican Republic, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Suriname.

ment (without the price system) via rationing, as it has done in the past. Or two, to implement a market-friendly strategy, with price and quantity adjustments, where the private sector leads the economic processes. The former will generate lower per capita income and depressed social indicators. The latter may represent a less socially costly scheme.

It seems that managed market-oriented policy and appropriate incentive structures should be the way to move forward. The new strategy will have to consider the openness of Cuba to the world economy in order to be able to finance its external gap (exports alone may not be enough).

The current situation may require major economic policy changes, including foreign financing.[3] Cuba needs, at least, US$1.8 billion to fully substitute Venezuela's oil exports to the island, estimated on the basis of 90,000 barrels/day (BD) at US$55 per barrel. Based on my own estimates, Venezuela's oil sales to Cuba could have dropped to 32,000 BD in June 2019 from 95,000 BD in 2017. It is important to keep in mind that this is not a hypothetical scenario: the collapse of Venezuela's oil production is happening right now and will go on until a political solution is reached.

DETERIORATION OF THE VENEZUELAN OIL INDUSTRY

Venezuela's oil production plunged 50% in the last six years, from 2.8 MBD in 2013 to 1.4 MBD in 2018. This downward trend continues in 2019. Currently, Venezuela's oil production is probably around 740,000 BD, close to the level of national oil production in 1946.

The deterioration of the Venezuela's oil industry has been caused mainly by reduced capital expenditures. Capital expenditures in the industry were US$ 4.0 billion in 2018, 30% of the $13.0 billion invested in 2013. Adding to the deteriorating situation were massive corruption, social expenditures paid by revenues from the oil industry and general mismanagement.

It should also be noted that U.S. oil sanctions have also affected Venezuela's oil production. New U.S. sanctions could make the situation worse. Sanctions announced in January 2019 will prohibit U.S. oil companies to operate in Venezuela after July 27, 2019 (the date was subsequently extended until October 25, 2019). If that were to happen, only Chinese and Russian oil companies will continue to operate in Venezuela, producing some 373,000 BD (China's CNPC and Sinopec, combining for 132,000 BD; Russia's Rosneft and Gazprom combining for 241,000 BD).[4]

Venezuela's oil industry got to the very serious situation in which it finds itself today because the Maduro administration, in an environment of relative low international oil prices (during 2013–2018, Venezuela's average oil price fell by 24.6% to US$61.3 per barrel from US$81.3 per barrel in 2007–2012), implemented a strategy based on reduced oil investment and loose fiscal and monetary policy in an environment of political uncertainty, anti-democratic behavior and institutional weakness.

THE VENEZUELAN ECONOMY: RECENT DEVELOPMENTS

During 2013–2018, Venezuela's annual GDP dropped 10.1% and inflation went as high as 21,917.1% per year. The Central Bank's international financial reserves fell to US$8.8 billion in 2018 from US$29.9 billion at the end of 2012.[5] Total imports diminished to US$14.9 billion in 2018, compared to US$66.0 billion in 2012. The open unemployment rate has been estimated at 30% or higher, and the informal sector may be over 50% of the economy.

This economic downward spin happened without a natural disaster or a war. The poor performance of Venezuela's economy started in 2007–2012 under

3. Multilateral, bilateral and private financing, FDI, remittances, donations, among others.

4. It should be noted that CNPC has decided to stop participating in Venezuela's oil industry because of the U.S. sanctions.

5. Currently, Venezuela's cash-generating oil exports are nil after deducting domestic consumption and pre-paid oil exports to China and Russia.

the second Chávez administration, when the oil price jumped 165.7% (to US$81.3 per barrel in 2017 from US$30.6 per barrel in 1999–2006), while the economy grew 3.2% and inflation by 25.6% (they were 2.9% and 19.3%, respectively, in 1999–2006). In addition, 2012 imports increased 100% (to US$66.0 billion from US$ 33.6 billion in 2006) and the Central Bank's international reserves fell by US$7.5 billion (to US$29.9 billion).

RELATIONS WITH RUSSIA

Russia's important participation in the Venezuelan political process started with Hugo Chávez's coming to power. The Russia-Venezuela relationship was created in order for Chávez to counteract U.S. influence. In addition, Venezuela wanted to have another option to buy military equipment. For Russia, the new ties with Venezuela were significant for its planned future regional presence.

Based on Chavez's view that the Venezuelan oil sector should be developed by state-owned oil companies (instead of private oil companies), Venezuela opened its oil sector to countries with national oil companies, such as China, India, and Russia. Thus, Russian state companies like Rosneft and Gazprom entered into joint ventures with PDVSA. Their current oil production is around 241,000 BD. In addition, financial ties were established in 2011 between Venezuelan and Russian oil companies, with a US$4 billion loan from Rosneft to PDVSA and a US$1.5 billion loan in 2016 (secured with 49% of Citgo shares[6]). The joint ventures and these financial arrangements have brought Russia into Venezuela's political process.

6. Established in 1910, the Cities Service Company has been an independent oil producer and refiner for over a century. In 1965, the company changed it name to Citgo. Venezuela's PDVSA acquired 50% of Citgo in 1986, and 100% in 1990.