

# VENEZUELA AND CUBA DURING A PERFECT STORM OF SANCTIONS, CORPORATE POLITICS AND CHANGING ECONOMIC POLICIES

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## AN ASYMMETRIC DEPENDENCY

The dependency relationship between Cuba and Venezuela that emerged twenty years ago has been widely studied. Initially, it involved an exchange of Cuban medical services for cheap Venezuelan oil that Cuba consumed and re-exported. Many economists have tried to measure the volume of those transactions based on market indicators—oil prices and the cost of medical services.

It has been difficult to evaluate precisely the growing rate of Venezuela's dependency on Cuba's involvement in IT activities, immigration services, infrastructure, the financial sector and strategic state enterprises, frequently conducted below the radar of external observers.

The significance and density of interstate ties has quickly outgrown purely economic and social parameters to become a factor of mutual systemic and institutional support for the regimes in Havana and Caracas. The two countries have developed various dimensions of linkage beyond the socio-economic area: intergovernmental, technocratic, political, informational, security, and military. This important network has been reinforced by geographical proximity.

Left-wing researchers, as well as official propagandists of both countries, have emphasized the efficiency and synergy of Cuba-Venezuela cooperation, which has

supposedly helped reduce the pressure on both nations of Western sanctions, decreasing economic conditionality and weakening political opposition.

Mainstream western analysts have focused on the negative outcomes of such a relationship. These include the growing international isolation of both countries, their flawed elections, human rights abuses, and other violation of democratic norms—along with an unimaginable economic disaster in Venezuela, as many see it, directly connected to a transfer of Cuba's socio-political and economic template onto that South American country.<sup>1</sup>

There is no doubt that the existing asymmetric dependency has added uncertainties and vulnerabilities to both nations during the global pandemic crisis. By and large, availability of subsidized Venezuelan oil slowed down and postponed economic reforms in the island, undermining incentives for Cuba to diversify and modernize its economy, and expand the scope of the private sector.

Meanwhile, the very survival of the Maduro regime has become dependent on the military and security component of the government, which is strongly influenced, if not totally managed, by Havana. Cuba has contributed to strengthening Venezuela's internal security sector, shaping extensive intelligence networks, specialized police and paramilitary units, and

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1. Werlau, Maria (2019). *Cuba's Intervention in Venezuela: A Strategic Occupation with Global Implications*. Washington, D.C.: Cuba Archive, p.11.

keeping political control of the army. Such “friendly help” has constrained Caracas’ willingness and capacity to negotiate political solutions, and to begin discussions with the opposition regarding a peaceful transfer of power. Overall, Havana has incentivized Caracas’ evolution from a populist and competitive authoritarian system to a system of full authoritarianism—a regime in which no viable channels exist for an opposition to legally contest the executive power.<sup>2</sup>

The central nerve of this failing dual structure joining the two countries continues to be Venezuela’s oil output. Despite a dramatic plunge in oil production and a full-fledged political and economic crisis, Caracas has continued nurturing Havana by delivering its bartered crude (albeit in reduced volumes), and in so doing lessening Venezuela’s ability to implement crisis-mitigating measures. This destructive interaction has metamorphized into a self-devouring mechanism, deteriorating the positions of both countries, as they head into a perfect storm.

#### VENEZUELA AS A FAILED PETRO-STATE

We can probably better understand the consequences of ongoing events by looking at the domestic fabric of Venezuela’s political, socio-economic and humanitarian disasters, aggravated by a COVID-19 pandemic and a global economic recession. It’s an unprecedented drama of continental scale, clearly linked to the core of the Venezuela’s predatory system—a resource dependent state.

Whatever methodology we apply—a structural approach, a resource curse concept, an institutional equilibrium method (among others)—all have de-

icted Venezuela as a typical petro-state, heavily dependent on commodity sales—on export income rather than taxation—with the mismanaged and dysfunctional institutions that come through a non-diversified and deindustrialized economy.<sup>3</sup> According to well-known energy expert Daniel Yergin, Venezuela has become the very “embodiment of what is defined as a petro-state.”<sup>4</sup>

The beginning of the country’s oil dependency dates back to 1914, when its first commercial oil well, Zumaque, started production. Since then crude wealth has distorted the nation’s life, bringing on the symptoms of an “oil curse”—a Dutch disease, weak institutions, acute corruption, social polarization, rent-seeking behaviors, high levels of volatility and growing insecurity—that have flourished overtime and become important features of Venezuela’s reality.

Unavoidably, the purely socio-economic aspects of the spreading oil curse have spilled into the political domain, creating deep tensions and contradictions, and turned an escalation of civil conflicts into a permanent risk for Venezuelan society.<sup>5</sup> The current political regime has allowed the impact of the country’s negative aspects of a resource curse to increase dramatically, with harmful economic consequences. Suffice it to say that Venezuela’s average annual GDP growth rate over the last 10 years has been about minus nine percent.<sup>6</sup>

We’ll conduct here comparative data analysis with average regional indicators, and two another oil producing countries—Colombia and Mexico—with understanding of the significant differences between them and Venezuela. Unfortunately, Venezuela’s sta-

2. Levitsky, Steven and Lucan Way (2010). *Competitive Authoritarianism. Hybrid Regimes After the Cold War*. New York: Cambridge University Press, p.13.

3. Durnev, Art and Sergei Guriev (2007). *The Resource Curse: A Corporate Transparency Channel*. CERP DP 6547; Hausmann, Ricardo, and Roberto Rigobón (2003). “An Alternative Interpretation of the Resource Curse: Theory and Policy Implications.” In *Fiscal Policy Formulation and Implementation in Oil-Producing Countries*. Washington DC: IMF Press; Ross, Michael (2012). *How Petroleum Wealth Shapes the Development of Nations*. Princeton: Princeton University Press; Mayer, Jörg, Brian Chambers and Ayisha Farooq, editors (1999). *Development Policies in Natural Resource Economies*. Cheltenham: Edward Elgar Publishing.

4. Yergin, Daniel (2011). *The Quest: Energy, Security, and the Remaking of the Modern World*. New York, The Penguin Press, p.107.

5. Stronen, Iselin Åsedotter (2017). *Grassroots Politics and Oil Culture in Venezuela. The Revolutionary Petro-State*. London, Palgrave Macmillan.

6. IMF Data Set and author’s calculations.

**Table 1. LAC, Venezuela, Colombia & Mexico, Average Real GDP Growth, Percentage Change, 1980–2020**

	1980's	1990's	2000's	2010's	1980–2020
Venezuela	- 0.63	2.38	1.22	- 9.1	- 1.8
Colombia	3.43	2.86	3.86	3.14	3.32
Mexico	2.28	3.52	1.43	1.8	2.38
LAC	2.07	2.9	3.01	1.32	2.3

Source: IMF & author's calculations

tistics are not very reliable because of its huge informal sector, a black market that includes proceeds from narco-trafficking, illegal gold mining, and bartering trades of oil for goods and services. Such activities are not always tracked by data, but nevertheless accessible information reveals some important trends that have emerged. Table 1 indicates that Venezuela has lost more than forty years of development, with GDP growth averaging about minus two percent, according to IMF figures and the author's calculations.

As shown in Figure 1, from 1980 to 2020 the country endured economic downturns every 3–5 years, while since 2012 it has in fact been in a kind of free fall. This latest decline, the deepest in a peacetime crisis, started long before January 2019 when severe U.S. sanctions (an oil embargo) were imposed, at a time when oil prices were still high and national crude oil production was relatively stable. Such high economic volatility decoupled Venezuela's GDP growth from oil price cycles (Figure 2) and brought into the open a number of institutional and structural issues that prevented soaring oil prices to translate into rising crude production.

Over the last thirty years, the correlation coefficient between Venezuela's oil production and oil prices has been negative (-0.31), and regression analysis has shown a very low R square (0.09). There also have not existed any significant correlation between the

country's GDP growth rate and oil prices. This makes not very credible the rather popular thesis that Venezuela's economic crisis is an "imported product".<sup>7</sup>

As Figure 3 illustrates, it is not only the frequency of fluctuations in GDP growth that have exposed Venezuela's growth failures to attain economic growth, but also the depth of the declines in GDP, in a manner not even remotely similar to other Latin American countries.

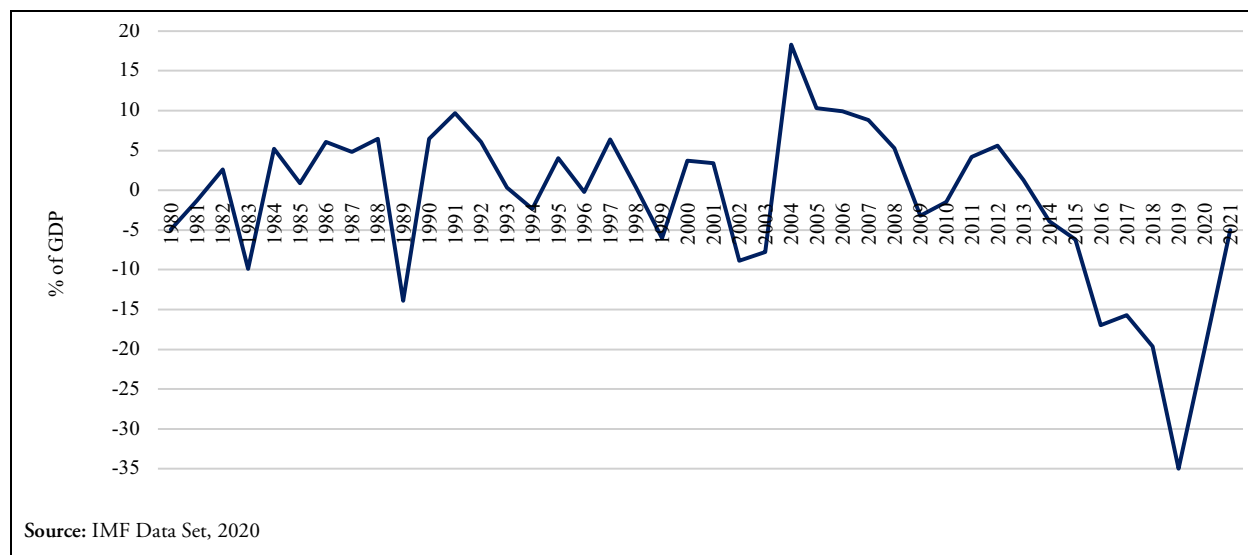
Figure 4 shows the dynamics of crude oil production vs. oil prices for Venezuela. What is surprising about the early 1990s, is the remarkable growth of oil output despite very low world oil price levels. Venezuela increased its production by almost one million barrels per day (mbpd) from 1993 to 1998 during what is now called the period of oil opening ("la apertura petrolera"). The government's goal was to turn the country into "the Saudi Arabia of Latin America." There were several factors behind that development, among them a rising demand for Venezuela's crude in the U.S. market, and a significant net inflow of foreign direct investment, mostly from the U.S. It is also important to bear in mind that in the 90s the Venezuelan economy was much more free market oriented and more attractive to foreign investors than any other economy in the region. In 1992–1997 Venezuela's state-owned oil and natural gas monopoly *Petróleos de Venezuela S.A. (PDVSA)* auctioned the rights to thirty-three oil fields, and struck major deals with Mobil, Philips, Chevron, and Amerada Hess, expanding production capacity by a third and targeting production to reach a level of 8 mbpd by 2010.<sup>8</sup> This Venezuelan oil boom was also fueled by national oil industry professionals who unified sector and increased its efficiency under the leadership of Luis Giusti López, president of PDVSA from 1994 to 1998.<sup>9</sup>

7. Weisbrot, Mark and Jeffery Sachs (2019). *Economic Sanctions as Collective Punishment: The Case of Venezuela*. Washington, D.C.: Center for Economic and Policy Research; <https://cepr.net/images/stories/reports/venezuela-sanctions-2019-04.pdf>

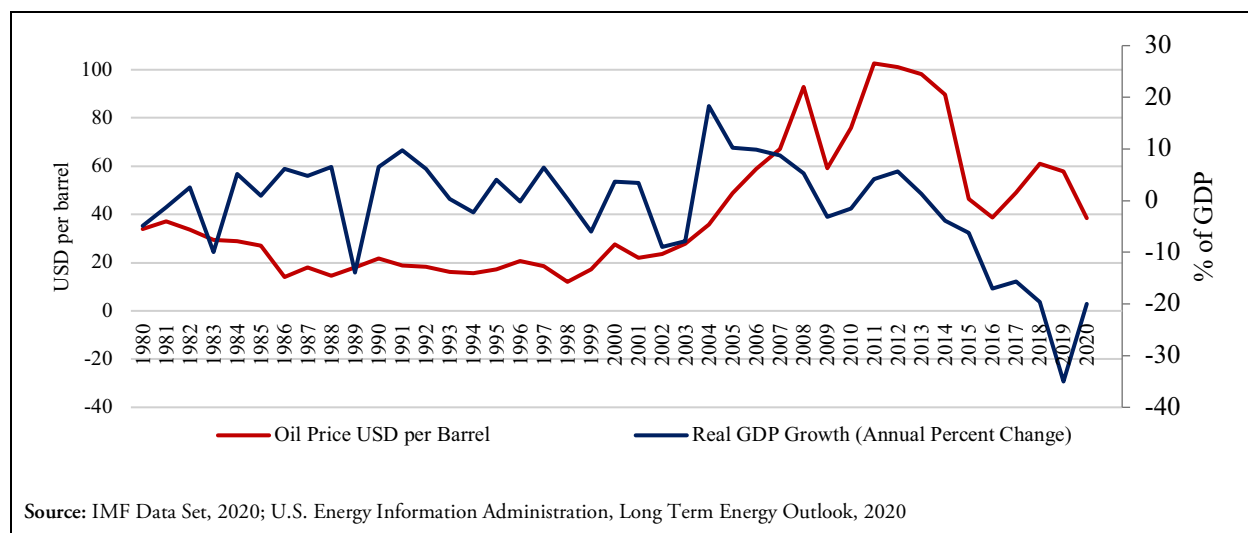
8. Molina, Carlos (2009). *Country Report: Venezuela and Petróleos de Venezuela S.A. (PDVSA)*. Austin: University of Texas. <https://www.mcombs.utexas.edu/~media/files/msb/centers/emc/events/conferences/c2es/country-report-venezuela-pdvsa.pdf>

9. <https://www.csis.org/people/luis-e-giusti>

**Figure 1. Venezuela: Real GDP Growth, Annual Percentage Change, 1980–2020**



**Figure 2. Venezuela: Real GDP Growth vs. Oil Price, 1980–2020**



A technological revolution in oil refining also started around the 90s with significant modernization of the U.S. refining industry, which included investments of about \$100 billion USD.<sup>10</sup> As result of that technological shift, many U.S. refineries adapted to process heavy crude, the most common quality of crude produced in Venezuela, and Venezuela solidified its positions among the leading oil-exporting countries to the U.S. Relatively speaking, Venezuela’s oil was

cheap, sold to the U.S. at a deep discount of up to 10 USD per barrel with respect to WTI. In the 2000s, when Hugo Chávez came to power, this heavy dependency on Venezuelan crude kept Washington from introducing tougher sanctions against the Chavez-led regime and his so-called Bolivarian revolution, even as Caracas began expropriating assets owned by ExxonMobil and Conoco Philips.

10. Yergin, Daniel (2020). *The New Map: Energy, Climate, and the Clash of Nations*. New York: Penguin Press, p.57.

Figure 3. LAC, Venezuela, Colombia and Mexico, GDP Growth, Annual Percentage Change, 1980–2020

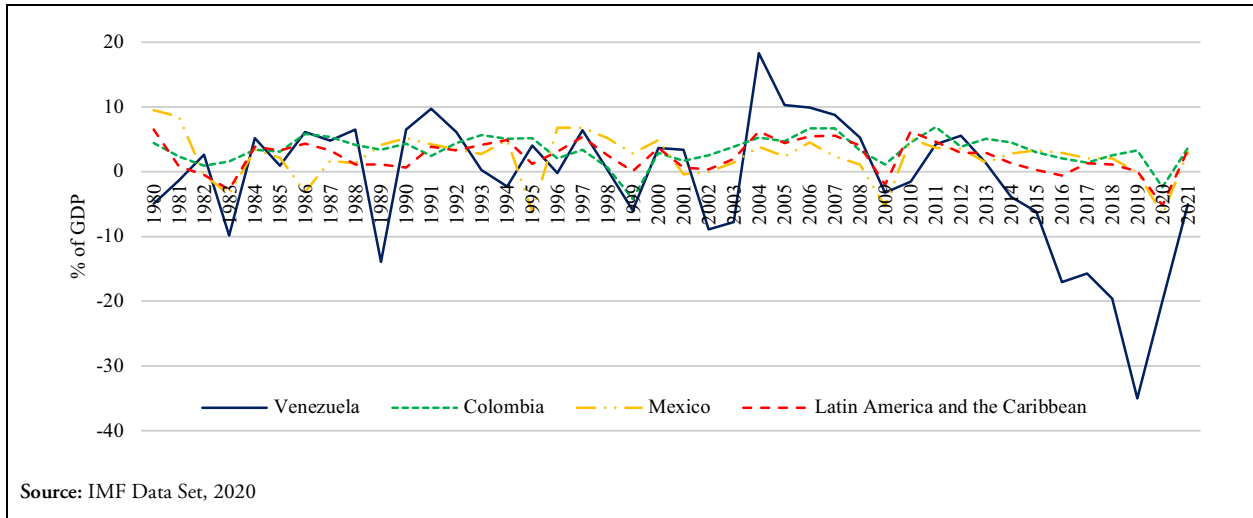
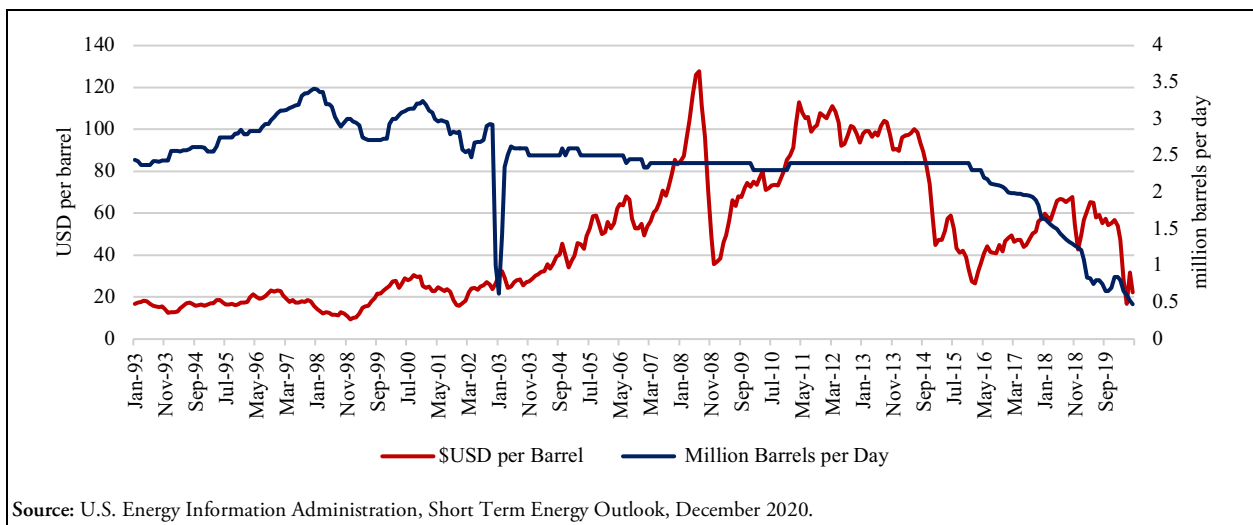


Figure 4. Monthly Venezuela Crude Oil Production vs. WTI Oil Price, 1980–2020



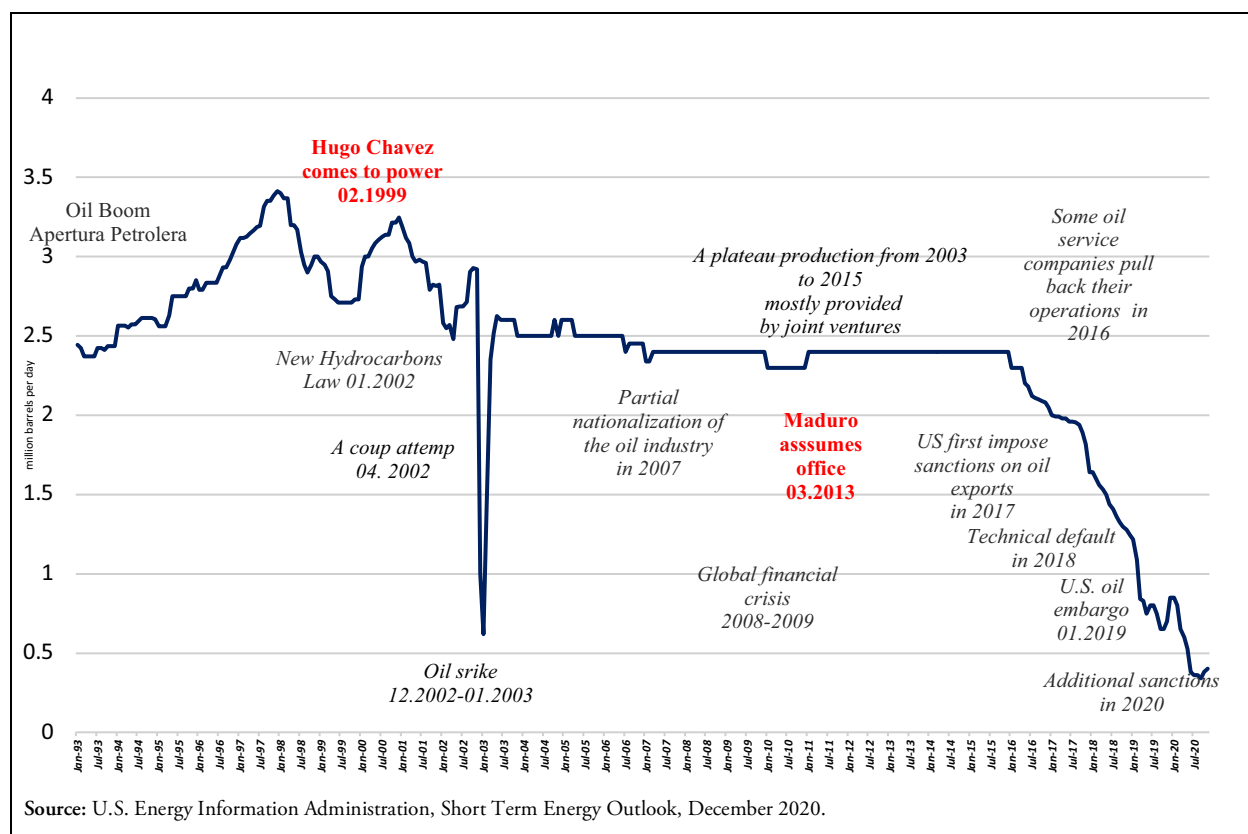
### A DISSAPOINTING GROWTH MOMENT

Economic and political cycles are often closely intertwined—in some cases reinforcing each other, in other cases significantly weakening one another. Figure 5 shows the behavior of oil output in Venezuela over the past 27 years, interspersing some important political events that transpired in that period.

It is now broadly recognized that the Chávez regime did not emerge from a vacuum. Development failures in Venezuela in the 80s and 90s were accompanied by an overall weakening of democratic and economic institutions that eventually allowed the rise of Chávez as a populist leader.<sup>11</sup> The volatility and decline in output of oil that followed Chávez’s ascent to power were due to a significant change in the owner-

11. Ricardo Hausmann and Francisco Rodriguez, editors, *Venezuela before Chávez. Anatomy of an Economic Collapse*, University Park, Pennsylvania: The Pennsylvania State University Press, 2014 is the fundamental work analyzing various aspects of the country’s socio-economic failure in the period from 1960 to 2000.

Figure 5. Monthly Venezuela crude oil output (mbpd) vs. political events, 1993 to 2020



ship structure of the oil industry, and the redistribution of financial flows in favor of the state.

This was driven by misguided macroeconomic policies, oil sector mismanagement, systemic corruption, labor and political instability and declining productivity. Very interesting is the oil production plateau from 2003 to 2015, even though it occurred during the partial nationalization of the oil industry, and during a global financial crisis, declining FDI as well as the departure of some old, and the entry of some new corporate players—particularly National Oil Companies (NOCs) from China and Russia.

Apparently, maintaining relatively stable oil production during such a challenging environment was possible because of soaring world oil prices that mitigated concerns about political risks and helped achieve a new fragile balance between geopolitical and com-

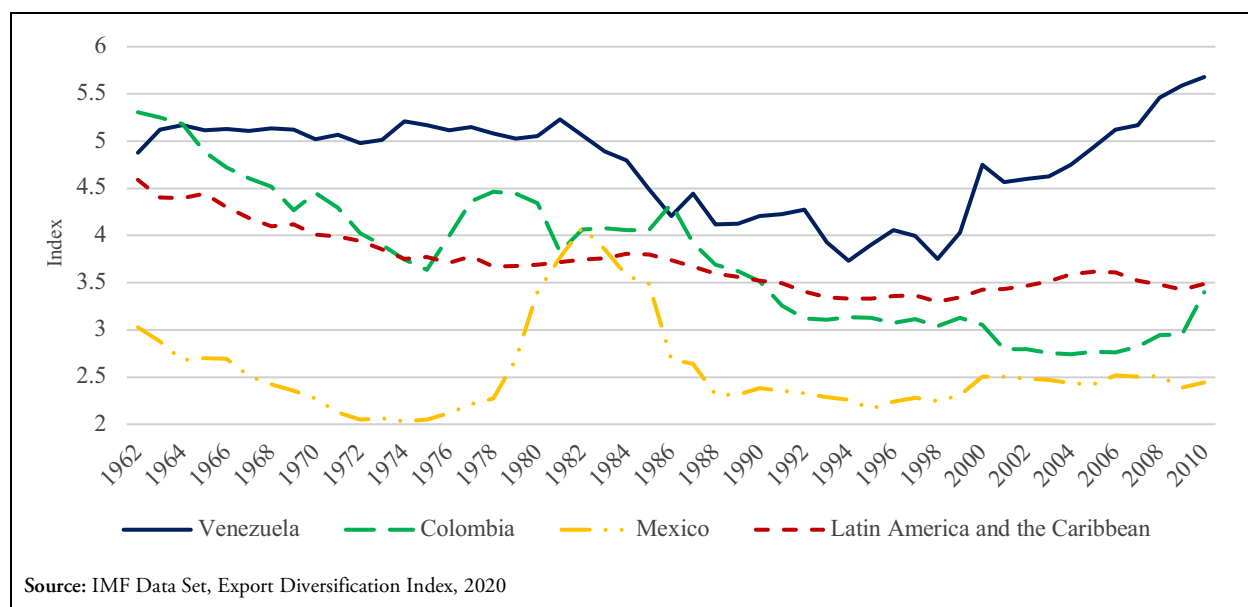
mercial goals. Chávez's regime was able to build, temporarily, a new partnership system of joint ventures with various foreign actors, in which PDVSA held at least 51 % ownership. In order to remain in the country, Chevron, Total, Statoil and BP accepted Chávez's demand to convert operating service agreements of the 90s into mixed enterprises ("empresas mixtas").

Over Venezuela's long history as an oil producer, some efforts have been made to diversify its economy. In general, its export diversification index has always been higher than that of other countries in the region.<sup>12</sup> However, starting in the early 2000's a widening gap emerged with other regional neighbors (see Figure 6).

If we analyze this trend overall, it is understandable why all attempts at diversification in the past twenty

12. The IMF Export Diversification Index contains different aggregation levels of export products. Higher values for index indicate lower export diversification and greater economic concentration.

Figure 6. LAC, Venezuela, Colombia and Mexico, Export Diversification Index, 1962–2010



years have failed. Venezuela fell into trap that categorizes petro-states—when oil prices are high, it is easier to import goods and services, especially when an unfavorable environment exists in the country for private initiative (as happened at the time when Venezuela ruined its own agriculture).

As oil prices begin to plunge, it becomes necessary to patch holes in budgets and correct fiscal imbalances. And in an authoritarian petro-state there are always “protected” budget items that cannot be touched – for example military or security spending, payments to bureaucracy or social subsidies—in order for the regime to maintain its political and social base.

Some have argued that Venezuela’s inability to develop an alternative export industry had to do with increasing global specialization.<sup>13</sup> We cannot exclude this exogenous factor affect the lack of economic diversification, but see it as an additional impediment to reaching positive results with regard to diversification, while the main causes of failure to develop an

alternative export sector were fruitless internal policies. As Figure 6 shows, Mexico and Colombia were able to more successfully overcome those oil dependency challenges.

Another enigmatic and difficult-to-explain reality concerns the inability of the Chávez and Maduro administrations to invest further in the country’s oil sector in the middle of a global commodity super cycle. To answer that we can look at PDVSA’s strategic plan outlined in 2005, projecting an increase of crude production to 5.4 mbpd by 2012, and 7.5 mbpd by 2020. Oil exports were expected to reach 3.8 mbpd by 2013 and oil refinery capacities were expected to increase to 4.1 mbpd by 2021. Higher levels of natural gas production (2.5 million cubic feet daily by 2012) was anticipated to convert Venezuela into a natural gas exporter.<sup>14</sup> However, those goals were never achieved.

The World Bank defined such forecast errors, which resulted in a huge divergence of performance from

13. Ricardo Hausmann and Francisco Rodriguez, “Why Did Venezuelan Growth Collapse.” In *Venezuela before Chávez. Anatomy of an Economic Collapse*.

14. *Planes Estratégicos de PDVSA para los próximos 25 años, periodo 2005–2030*. Caracas: Gobierno Bolivariano de Venezuela, 2005.

expectations, as a “growth disappointment effect”.<sup>15</sup> A remarkable feature about PDVSA’s miserable outcomes was a combination of declining production with stagnant or declining sales, even in the context of rising prices and expanding reserves, which is generally defined in literature as a “pre-source curse”. Such phenomenon is inversely related to the poor quality of political and economic institutions.<sup>16</sup>

Notably, the degradation of Venezuela’s human capital with mass purges of PDVSA professionals who were replaced by loyal followers of the regime, contributed to disastrous operational performance.<sup>17</sup> Despite enormous development opportunities in the Orinoco Belt, a negative growth multiplier emerged that could properly have been named the “Chávez coefficient” or the “Maduro moment.”

Ultimately, Venezuela’s regime, intentionally and unintentionally, ended up permanently underinvesting in the country’s oil sector, cutting PDVSA capital expenditures in favor of “more urgent needs”, and this way “killing the hen that laid the golden eggs.”

### ANATOMY OF A COLLAPSE

Undoubtedly the reasons behind such policies included short-term priorities of interest groups and chronic structural corruption. Since the early 2000s Venezuela has remained at the bottom of countries listed in the Corruption Perceptions Index (CPI) compiled by Transparency International.<sup>18</sup> A costly and confrontational foreign policy and massive capital flight have been among the more important causes of Venezuela’s wealth dissolution. Caracas paid a high price for promoting ambitious geopolitical goals as it subsidized oil exports to other countries sold at a discount to ALBA countries (Nicaragua, Cuba, and

some other Caribbean nations), as well as to Argentina and China.

In the 2000’s, as shown in Figure 7, incoming FDI declined. Despite tightening currency controls, the average balance of capital movement in the 2010’s has remained negative—net outflows were in a range of \$5 to \$35 billion USD annually (Figure 8). Consequently, and not surprisingly, oil output experienced a significant drop starting in 2015, that have accelerated the country’s drive toward a full-fledged economic crisis. Putting it in another way, the regime successfully sawed off the branch on which it was sitting.

Another question raised by the trends in Venezuela’s crude oil production described earlier, is pinpointing the driving forces of economic growth in the country for almost 12 years, from 2004 to 2015, when oil output stagnated around 2.4 mbpd. The answer is obvious: growth occurred because of activities in the non-oil sector, which was predominantly owned and operated by private capital. By and large it is clear that most non-oil-related activity in a petro-state is possible because of oil rents that finance imported goods.

When Chávez came to power the private sector’s share of GDP was about 65 percent, but a rapid decline started in 2012, and the private sector’s share has dropped to less than 40 percent of GDP (Figure 9).

Such a development is not a coincidence—state dirigisme and administrative pressure has been practiced for over 20 years, and among other things, authorities nationalized businesses, determined the multiple exchange rates and set the prices of basic goods. Ac-

15. Cust, James and David Mihalyi (2017). “Evidence for a Presource Curse? Oil Discoveries, Elevated Expectations, and Growth Disappointments,” World Bank Group, Africa Region Office of the Chief Economist, *Policy Research Working Paper 8140*. Washington, D.C.: World Bank Group.

16. Blanchard, O.J. and D. Leigh (2013). “Growth forecasts errors and fiscal multipliers,” *The American Economic Review* 103 (3), 117–120; Cust, J. and T. Harding (2014). “Institutions and the locations of oil exploration.” *OxCarre Research Paper 127*; Eastwood, R.K. and A.J. Venables (1982). “The macroeconomic implications of a resource discovery in an open economy,” *The Economic Journal* 92 (366), 285–299.

17. Hanke, Steve (2020). *Last Rites for Venezuela’s State-Owned Oil Company*. Washington, D.C.: Cato Institute; <https://www.cato.org/publications/commentary/last-rites-venezuelas-state-owned-oil-company>

18. <https://www.transparency.org/en/cpi/2019/results>.



Figure 7. Venezuela: Foreign Direct Investment, Net Inflows (% of GDP), 1970–2014

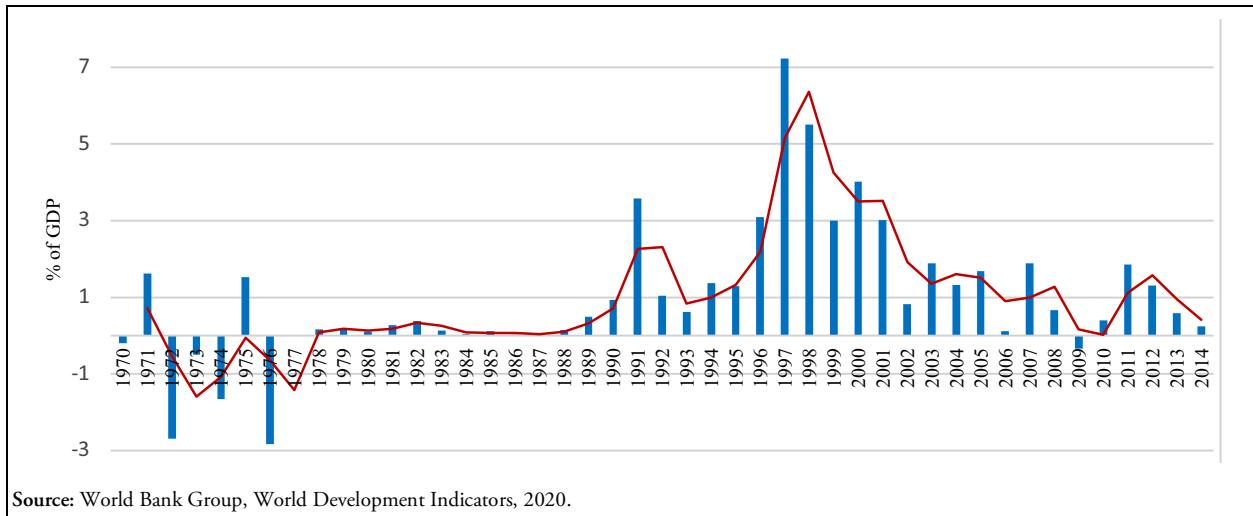


Figure 8. Venezuela: Private Inflows vs. Private Outflows, Million USD, 1995–2014

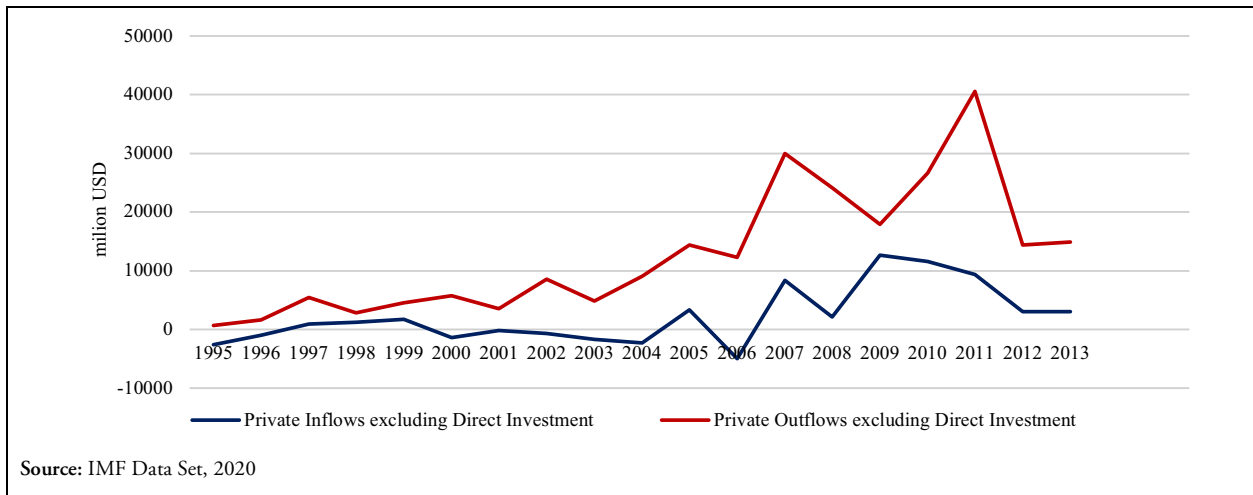
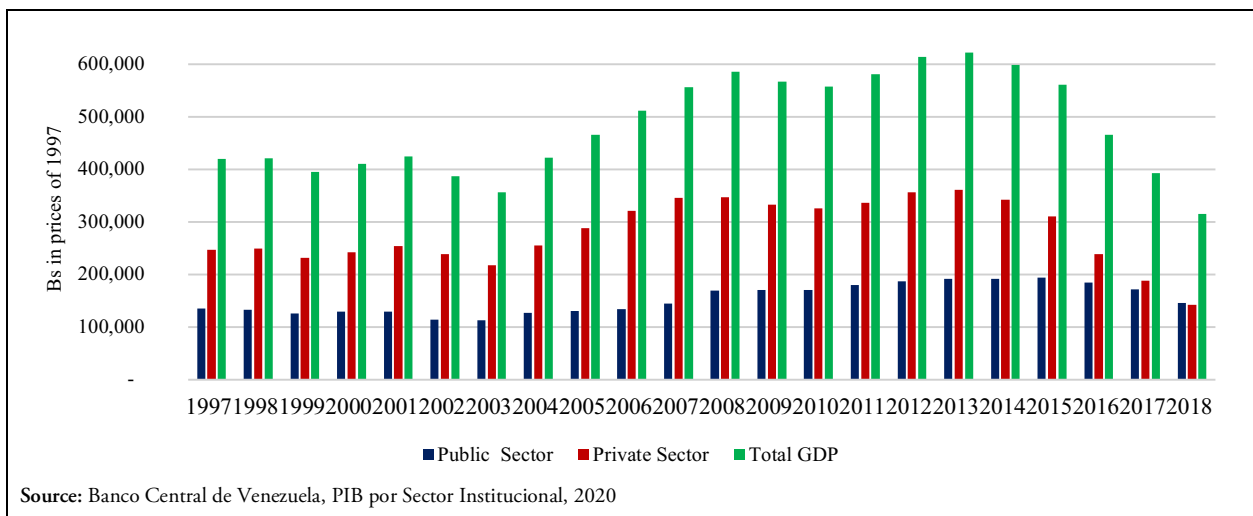


Figure 9. Venezuela: GDP, Public vs. Private Sector, Million Bs., 1997–2018



**Table 2. Doing Business in Venezuela, 2007–2020**

Year	Ease of Doing Business		Paying Taxes	Trading Across Borders	Dealing with Construction		Employing Workers
	Starting a Business	Permits			Getting Electricity		
2007	164	129	167	116	98	n/a	n/a
2010	177	142	182	166	94	n/a	181
2020	188	190	189	188	175	174	165

Source: World Bank Group, Doing Business, 2007, 2010, 2020.

According to a World Bank study (Table 2), it is almost impossible to legally launch a business in the country. Out of 190 states in the world, Venezuela ranks last in ease of starting a business, and its overall rating as a place to Do Business is third from the bottom, surpassing only Somalia and Eritrea.

The destruction of democratic liberties initiated by Chávez was eventually completed under the regime of Maduro, who has suffocated and corrupted further the country's economic and political institutions. The extremely dreadful state of these institutions explains why Venezuela continues to score very low in the Index of Economic Freedom, compiled by the Heritage Foundation, which evaluates rule of law, regulatory efficiency, government size and open markets around the world (Figures 10 and 11).

More broadly, several basic questions can be raised again here regarding the importance of democratic institutions, the crucial role of freedom for development, and the incompatibility of heavy populism and non-competitive authoritarianism with sustainable economic growth.<sup>19</sup> Venezuela's deplorable experience over the last 20 years confirms that lack of adequate institutional framework and instrumental freedoms, which include political freedom, economic facilities, social opportunities, transparency guarantees and protective security,<sup>20</sup> have severely constrained the nation's ability to develop.

Venezuela has become a textbook example in a number of other key areas of development, particularly re-

lated to a macroeconomic instability. There is an impression that Caracas hasn't learned any lessons from the regional economic crises of the 1980s and 1990s.

One reason for this is that under Chávez and Maduro, Venezuela has become an expositional playground for the most exotic leftist and ultra-leftist ideas. Some of them have been grown up locally, some have been imported by leftist immigrants from across the continent, and yet others have been brought to "the country of 21st century socialism" (as Chávez defined it) by new leftist groups from Europe, especially the Spanish far-left party Podemos.<sup>21</sup>

The most striking case of political irresponsibility and economic adventurism has been the regime's pro-inflationary policy that shocked the country and surprised the world. In 2015 Maduro appointed Luis Salas, a young socialist, who insisted that "inflation does not exist in real life," as economic czar.<sup>22</sup>

Reality turned out to prove him wrong: hyperinflation, economically disastrous and extremely painful for the population at large, has become endemic in Venezuela overtime. In 2018 the IMF reported that the country had reached an inflation rate of 1 million percent, even though it lasted a short period of time. Venezuela has had to deal not only with irresponsible management of monetary populism, but also with deliberate policies based on gross conceptual errors, among them presuming that inflation has been predominantly driven by non-monetary factors.

19. Acemoglu, Daron and James Robinson (2019). *The Narrow Corridor: States, Societies, and the Fate of Liberty*. Penguin Books.

20. Sen, Amartya (1999). *Development as Freedom*. New York: Anchor Books.

21. Vargas Llosa, Alvaro. "The Spanish Noose Around Chavez's Neck," *Washington Post*, 03.03.2010; Román, David. "How Hugo Chavez Helped Inspire Spain's Far-Left Podemos Movement." *The Wall Street Journal*, 02.26.2015; <https://www.wsj.com/articles/how-venezuelas-chavez-lives-on-in-spain-1425000737>.

22. Gallegos, Raúl (2016). *Crude Nation: How Oil Riches Ruined Venezuela*. University of Nebraska: Potomac Books, p.188.

Figure 10. Index of Economic Freedom: World, Americas and Venezuela, 1995–2020

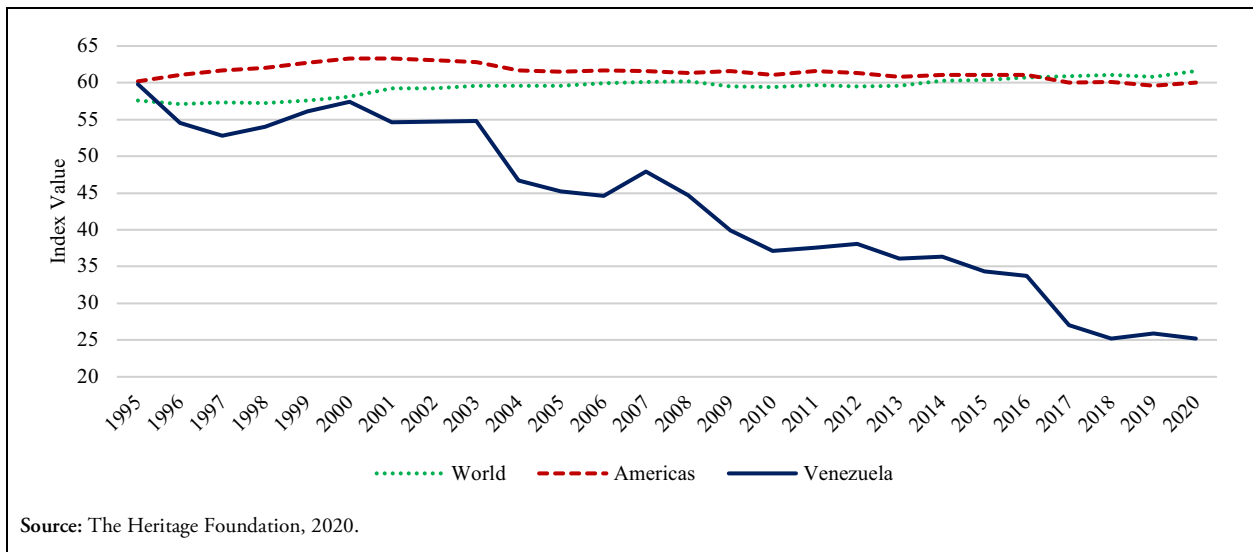
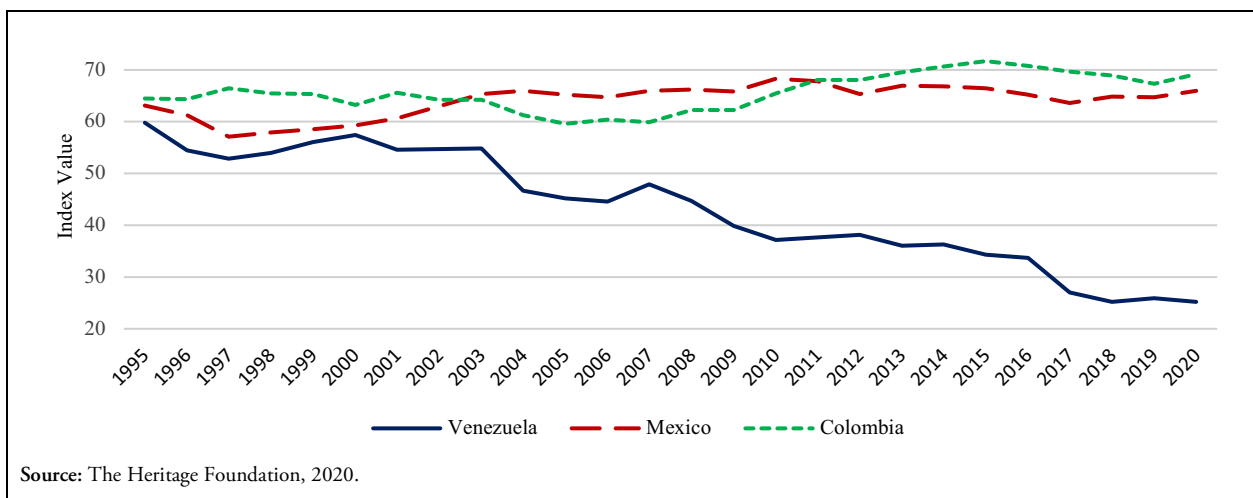


Figure 11. Index of Economic Freedom: Venezuela, Mexico and Colombia, 1995–2020

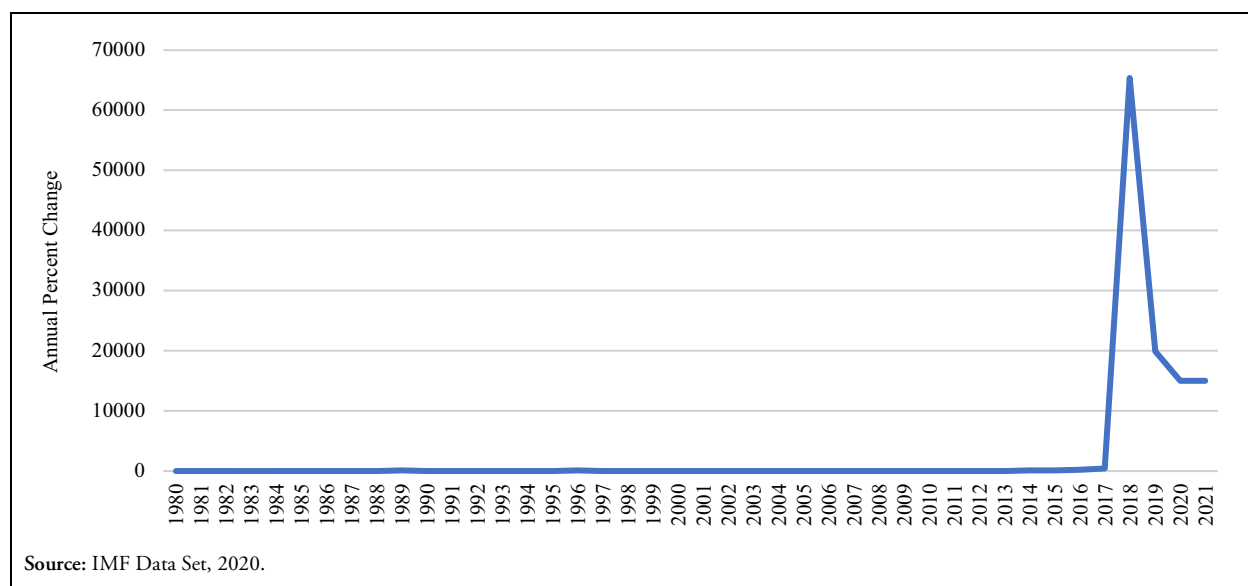


There has also been a long-held view that Caracas has permitted a decline in oil production to reduce the availability of foreign currency, and to foster a depreciation of the exchange rate that ultimately incentivizes high inflation. Those measures may have potentially triggered run-away inflation in the country, even though they were not the main cause. In any case, there is a well-known golden rule setting out that it is easy it is to spread high inflation by letting

the genie out of the bottle, but very difficult to get out of an inflationary spiral (Figure 12).

Another consequence of this leftist experimentation has been the largest migration and refugee crisis recorded in the modern history of the Americas, inspired by Cuban and Syrian events. There are numerous sources and literature on this ongoing Venezuelan humanitarian catastrophe,<sup>23</sup> but we can highlight some milestones of Maduro’s regime. Since

23. <https://www.worldbank.org/en/news/feature/2019/11/26/migracion-venezolana-4500-kilometros-entre-el-abandono-y-la-opor-tunidad>; <https://news.un.org/en/story/2020/12/1079782>; <https://www.unrefugees.org/emergencias/venezuela/>; <https://www.atlantic-council.org/blogs/new-atlanticist/boats-over-troubled-waters-caribbean-nations-struggle-with-response-to-venezuelan-migration-crisis/>.

**Figure 12. Venezuela: Inflation, Annual Percent Rate, 1980–2020**

2016 approximately 5.4 million Venezuelans—about 19% of the population—have fled their homes to escape political repression, extreme food and medical shortages, a lack of social services, and general economic failures.<sup>24</sup>

This migrant exodus includes all segments of the population, from the poorest to the very wealthy. At one end, pushing the poorest strata out of the country has allowed Maduro and his associates to ease pressures on the national system of social patronage; at the other, the flight of the middle class that has constituted the social basis of Venezuela’s opposition parties, has facilitated the destruction of political resistance pockets in the country and allowed for a complete demolition of electoral procedures.

At the same time, remittances back to Venezuela have become a significant source of hard currency in the country (in the amount of 4 billion USD in 2019)<sup>25</sup>, sorely needed because of a ruinous plunge of

the oil rents. Currently 35% of all Venezuelan households depend on financial support from family members working overseas. However, according to World Bank projections, remittances to Venezuela has declined sharply in 2020, by about 20%, due to a fall of the wages and employment amid the COVID-19 pandemic.<sup>26</sup>

In addition, by promoting the exit of large population groups, Caracas has put strong burdens on neighboring countries receiving the main flow of refugees (4.6 million of them now scattered throughout Latin America), warning in this way regional governments against further exacerbation of relations with Venezuela that might result in their absorbing larger migrant flows. These neighboring nations are now in fact paying Maduro’s bills.

#### A NEW ECONOMIC POLICY?

Venezuela’s economy has been in tatters since 2016, when Maduro declared an economic emergency.<sup>27</sup>

24. <https://www.unhcr.org/venezuela-emergency.html>.

25. Nice, Beatriz García. “Amid Venezuela’s Exodus, Remittances Boom.” Wilson Center, Latin American Program, Insight & Analysis, 02.12.2020; [https://www.wilsoncenter.org/article/amid-venezuelas-exodus-remittances-boom?gclid=Cj0KCQiA0fr\\_BRDaARI-sAABw4EuP5jzimMrazXbzL0jXbRjWB9uc9N-ZZWVmlu8hRvCsufLjJjEFzBacaAvZVEALw\\_wcB](https://www.wilsoncenter.org/article/amid-venezuelas-exodus-remittances-boom?gclid=Cj0KCQiA0fr_BRDaARI-sAABw4EuP5jzimMrazXbzL0jXbRjWB9uc9N-ZZWVmlu8hRvCsufLjJjEFzBacaAvZVEALw_wcB).

26. <https://www.worldbank.org/en/news/press-release/2020/04/22/world-bank-predicts-sharpest-decline-of-remittances-in-recent-history>.

27. Gallegos, Raúl (2016). *Crude Nation: How Oil Riches Ruined Venezuela*, p.190.

Pro-inflationary policies, oil price declines, tough U.S. sanctions and global pandemic stress have brought extreme pain to Venezuela's predatory system. In this crisis environment there was a marked increase in the country's informal sector and an expansion of criminal activities associated with gold mining, counterfeiting and drug trafficking.

To address the catastrophic trend Maduro's government, under pressure from Moscow and Beijing, was forced to seek palliative anti-crisis measures. In 2019 Maduro put forward a new economic program, which some of his loyalists likened to a "Tropical China" plan—limited business liberalization, with reduced state interference and declining regulations for addressing shortages of goods.

This unexpected shift, supported by Venezuela's business and political elite, brought a sense of temporary relief, especially to those who had relied on dollar remittances from abroad. On the one hand, it was a replica of Cuba's approach to the flow of remittances. On the other hand, the roots of Maduro's policy could be found in Bolshevik economic practices—the so called New Economic Policy (N.E.P.), introduced by Lenin in August 1921, after a bloody Russian Civil War almost 100 years ago. The N.E.P. was designed to bring capital into the state and support the Bolshevik regime through the expansion of market relations as a driving force for economic recovery.

Soviet Russia managed to stabilize the overall macroeconomic situation then and end hyperinflation with the introduction of so-called chervonets or a golden ruble; the substitution of forced requisitions of grain (a food appropriation system) with a fixed tax-in-kind or a "prodnalog"; the extended use of private entrepreneurs in industrial production, retail and services; and the attraction of foreign capital through concessions. However, it was a short-lived bridge

policy that helped to realize the transition from a market to a centralized planning economy, ended by Stalin 7 years later in 1928.<sup>28</sup>

Similar maneuvers in Venezuela currently are timid and non-sustainable—and essentially aimed at laundering the black-market proceeds of regime loyalists by using a fast dollarization of the financial system. Payments in U.S. dollars are practically legalized, as is also the obligation for law enforcement agencies and officials to invest money in local businesses, regardless of the origin of the money.

This new form of economic activity in Venezuela reminds one of a special type of public-private partnership, based on the formation of so-called "strategic alliances". The state has transferred some nationalized companies,<sup>29</sup> without ownership rights, to private operators. Private managers have provided investments, working capital and pay salaries. The "alliances" have to share with the state in-kind production or profits. In some cases, properties previously seized by the government are temporarily returned to their former owners.

Petrochemical enterprises, hotels, restaurants and other businesses are now functioning under these new conditions. But a major part of these business "alliances" have been created in the agricultural sector—from flourmills and grain elevator facilities to coffee-growing farms and dairy processing plants. The new arrangements work like medium-term concessions, limited for the time being to five to twenty years, with the key performance indicators (KPI) set by the government. In practice, those "alliance" formations have been going on since 2017, but officially they were legalized in October 2020 with the adoption of the "anti-blockade law", created to counter U.S. sanctions.<sup>30</sup>

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28. Kenetz, Peter (2006). *A History of the Soviet Union from the Beginning to the End*. Cambridge: Cambridge University Press, p.48; Richman, Sheldon (1981). "War Communism to NEP: the road from serfdom." *Journal of Libertarian Studies*:93–94; Siegelbaum, Lewis H. (1992). *Soviet State and Society Between Revolutions, 1918–1929*. Cambridge Russian Papers. Cambridge: Cambridge University Press, pp.97–116.

29. According to different sources the number of nationalized companies in Venezuela during the last 20 years has exceeded 1,300.

30. Zerpa, Fabiola and Nicolle Yapur. "Bankrupted by Socialism, Venezuela Cedes Control of Companies." *Bloomberg*, February 12, 2021; <https://www.bloomberg.com/news/articles/2021-02-12/bankrupt-by-socialism-venezuela-hands-over-control-of-companies>.

Maduro has significantly cut budget transfers to areas outside the capital, but has empowered local authorities to form new alliances. Some grassroots companies in “social” businesses have been allowed to pay no taxes, and have received licenses to export resources since the end of 2019. Several “alliances” exist in the form of joint ventures with different public and private partners from Cuba, Bolivia, Brazil, Argentina and Iran.<sup>31</sup>

This abrupt zigzag in Maduro’s economic policies has been extended mostly to agriculture, services and retail trade and has nothing to do with the primary pillar of the Venezuelan economy—the oil industry. There have been some announcements regarding possible privatization of PDVSA, but at present it is mostly wishful thinking on the part of Maduro’s bureaucrats who would like to enrich themselves by looting what is left of the national wealth.

Unfortunately, these pseudo-liberal economic steps have been accompanied by political repression and further dismantling of the country’s remaining democratic institutions. The coronavirus pandemic has also constrained implementation of new policies. It would seem evident that any substantial economic progress would be possible only with deep political and structural economic transformation. The current system is exhausted, and it can’t generate economic growth or reach a political settlement.

Over the past decade Venezuela has experienced a significant loss of accumulated national wealth, and GDP per capita has declined by more than half. In that regard, one hears arguments that the country has nowhere further to fall, and its predicament will eventually become a launching pad for a new revival, after the country goes through regime change. However, the experience of deep structural reforms, including those in post-communist Europe and Eur-

asia, demonstrate that a transformational recession will almost be inevitable, even if it proves to be short.<sup>32</sup> This prospect will apply to a future Cuban transition as well.

#### INTERNATIONAL OIL COMPANIES (IOCS) VS. NATIONAL OIL COMPANIES (NOCS)

The experience of many oil producing countries has confirmed that growth of more expropriation-sensitive industries, such as oil and gas extraction, depends on the level of a country’s predation.<sup>33</sup> Venezuela, as a highly predatory country, has suppressed its economic growth because of the negative impact of its resource endowment on development. Figure 5 showed that the country experienced a chronic decline in oil output starting from 2015.

Why 2015? The obvious answer is that the global commodities boom had ended, and oil prices had been plunging since 2014. Another reason for that decline could be related to a new balance of geopolitical risks and commercial interests that emerged in the country.

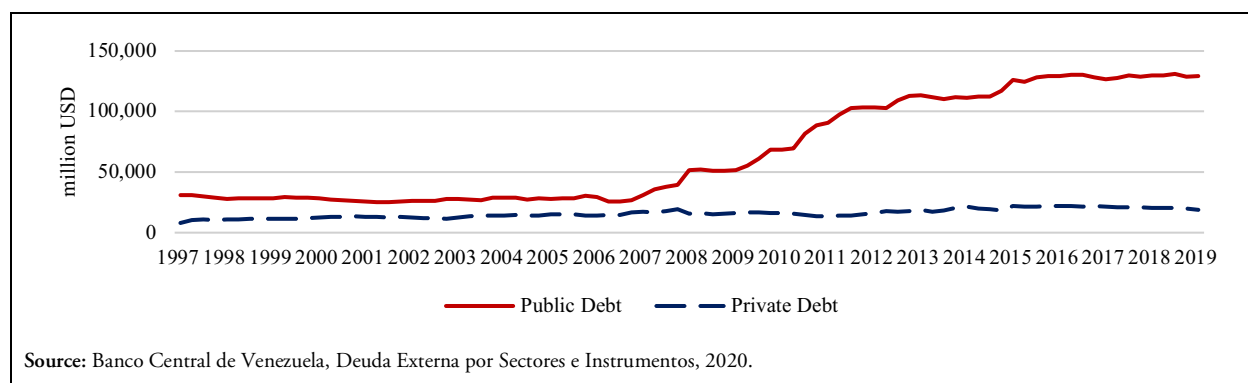
The equilibrium that existed from 2003 to 2015 ended due to rising instability and the unpredictability of future scenarios. What is surprising is that such delicate geopolitical and economic balance could survive over 12 years, resisting several shocks, such as the partial nationalization of the oil sector in 2007, when a number of foreign companies were pushed out from Venezuela by Chávez, including Exxon and ConocoPhillips; and the hardships of the global financial crisis of 2008–2009.

The companies that were expelled from Venezuela and had their assets confiscated sought to recover their losses in the international courts. As a result, the World Bank dispute settlement body, known as the International Center for Settlement of Investment

31. <https://orinocotribune.com/companies-agropatria-and-lacteos-los-andes-managed-by-private-operators-reports-bloomberg/>.

32. Kornai, János (1994). “Transformational Recession: The Main Causes,” *Journal of Comparative Economics*, 19 (1):39–63; Turley, Gerard and Peter J. Luke (2011). *Transition Economics: Two Decades On*. London and New York: Routledge, pp.239–245.

33. <https://voxeu.org/article/why-oil-bad-nation-s-long-run-growth>.

**Figure 13. Venezuela's Foreign Debt: Public vs. Private, Million USD, 1997–2019**

Disputes (ICSID), ordered Caracas in 2017 to pay Exxon 1.4 billion USD, and in 2019 it ruled that Venezuela should compensate ConocoPhillips more than 8 billion USD for the 2007 expropriations.<sup>34</sup>

Meanwhile, Chevron and some U.S. giant oil country service providers (Halliburton, Schlumberger, Baker Hughes and Weatherford International) have continued to do businesses in Venezuela. Thus, the American corporations split into two groups—those who departed from Venezuela and those who remained. It was a kind of compromise and informal risk hedging: all U.S. oil companies could not simultaneously leave the country with the largest untapped oil reserves in the world. Chevron argued that withdrawing would cede the company's market share and increase the influence of Russian and Chinese NOCs in Venezuela.

It is worth noting that the eventual growing role of Chinese and Russian national oil companies in the country was accompanied by a sharp increase in Caracas' foreign debt (Figure 13), a substantial part of which was loans from these two countries. Over the past decade, Caracas borrowed about 67 billion USD from Beijing alone.<sup>35</sup>

During the time of tumbling oil revenues, the Venezuelan government lost its ability to pay back lenders

and PDVSA had to declare a technical default in 2017. Paradoxically, until 2019, when Washington imposed an oil embargo, Caracas received a major part of its cash from the U.S. market, while its oil exports to China and Russia were used to repay Venezuela's debt to those two countries.

Another factor that significantly impacted on geopolitical and economic balances was the declining dependence of the U.S. refineries on Venezuelan oil, due to rising imports of heavy crude mostly from Canada and Russia (Figure 14).

To add some general points, the idea that nearly all oil output loss since 2017 can be attributed to the effects of Western sanctions against Venezuela, is an evident simplification—the self-destructive actions of the Maduro regime have only intensified under pressure of sanctions. That's why it is very difficult to define with mathematic precision the contribution of the external and internal components of this economic debacle.<sup>36</sup>

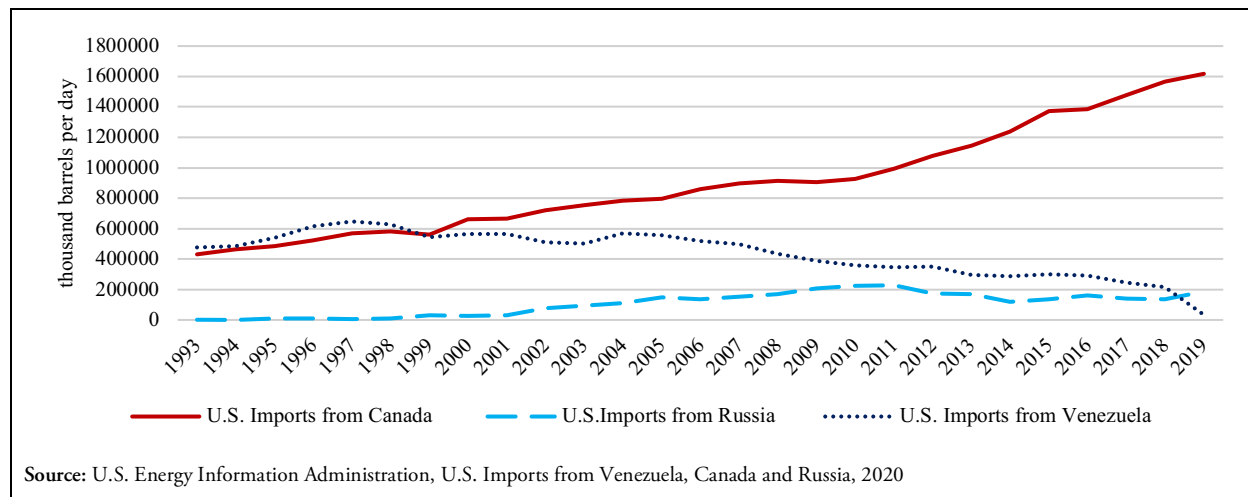
A sharp decline in direct investments, dramatic drops in oil prices, the flight of capital, debt burdens, extremely inefficient management, endemic rent seeking, demolition of institutions, constraints on private entrepreneurs, and the changing balances between geopolitical and economic factors—were all

34. <https://www.reuters.com/article/us-venezuela-exxon/order-for-venezuela-to-pay-exxon-1-4-billion-in-damages-overtuned-lawyer-idUSKBN16G38C>; <https://www.reuters.com/article/us-conocophillips-venezuela/venezuela-must-pay-conoco-over-8-billion-world-bank-idUSKCN1QP20V>.

35. <https://www.bloomberg.com/news/articles/2019-01-29/venezuela-s-choking-points-here-s-where-maduro-gets-his-revenue>.

36. <https://www.gao.gov/assets/720/712232.pdf>.

**Figure 14. U.S. Imports from Canada, Russia & Venezuela of Crude Oil and Petroleum Products, Thousand Barrels per Day, 1993–2019**



negative developments that inevitably undermined the country’s capacity to sustain its oil production, and plunged it into the depth of a severe contraction, with U.S. oil sector sanctions becoming the last straw in a homemade economic disaster.

The most serious attempt to “separate the wheat from the chaff”, and assess the impact of U.S. sanctions on Venezuela’s socio-economic life, is in a research paper by Francisco Rodríguez.<sup>37</sup> While recognizing the value of his analysis, we would like to include a few brief comments on some of the paper’s shortcomings: the research mostly used short-term data that did not allow us to see longer-term trends existing before sanctions; it underestimated the decoupling of oil output growth from oil prices, which had taken place in Venezuela since the 90s; it primarily attributed increasing difficulties in the financing of real production activity with a lack of access to credit because of sanctions, while downplaying the significance of changes (that were negative for PDVSA) on international capital markets, disregarding the existence of a debt bubble and the collapse of other investment instruments, including FDI. It also considered the growing output of Chinese and Russian joint ventures, less affected by the 2017–2018

sanctions, as proof that the country’s production could remain stable, and overlooked the fact that a special effort was required on the part of the joint ventures to increase oil output as credit payment for reducing Venezuela’s debt to China and Russia. Finally, it did not take into consideration “locally produced” macroeconomic imbalances, particularly hyperinflation, while evaluating the social costs of sanctions on the population and missing the causality between rapidly deteriorating living standards and a massive migration that started before the imposition of sanctions.

Having said that we agree with the main conclusion of Rodríguez’s research: that U.S. sanctions were indeed behind an acceleration in the rate of decline of Venezuela’s oil output. The paper also found, using a panel of countries covering 95% of the world’s oil production, that an average rate of reduction in Venezuela’s output in 2017–2019 was similar to that of countries undergoing armed conflict at the time.<sup>38</sup> Our reading of this sad outcome is the following: it was the result of accumulated structural and institutional issues over the last 20 years and extremely bad governance that produced Venezuela’s unusual peacetime economic happenings, which included record

37. <https://torinocap.com/wp-content/uploads/2019/06/Sanctions-and-Vzlan-Economy-June-2019.pdf>.

38. Ibid.



hyperinflation and massive migrant exodus, that usually afflicts countries at war.

Overall, sanctions integrate a mix of geopolitical, business and broader non-commercial interests, concerns, contradictions and aspirations. IOCs and NOCs could be instruments and subjects of sanction policies, but a combination of political and economic components are usually different in the two actors.

The biggest IOC and the last remaining major U.S. exploration company in Venezuela is Chevron, which started its operations there a century ago. Its Pascagoula refinery in Mississippi is engineered to process the heavy oil coming from the Orinoco Belt, underscoring the importance of Venezuela in its business model.<sup>39</sup>

Chevron has partnered with PDVSA in four joint-ventures, three of which are heavy or extra-heavy crude oil projects.<sup>40</sup> This American company managed to get a waiver for its joint-venture production in Venezuela after sanctions were imposed in January 2019, which has helped to keep the country's crude output afloat until recently (see Table 3).

The reasons for this inconsistency are understandable—Chevron not only fought to maintain its profits and privileged commercial goals, but also hedged against the potential risk of having Chinese and Russian oil companies seize its facilities. Thus, commercial corporate interests were entangled with U.S. geopolitical interests. Such situations are usual for IOCs owned by private capital. The commercial component of IOC activities is visible and palpable. In November 2020 the Treasury Department granted Chevron permission to remain in Venezuela until June 2021, effectively leaving further decisions on the company's future to the new U.S. administration.<sup>41</sup>

NOCs owned by the state are different and tend to be much more sensitive to non-commercial goals.

**Table 3. Venezuela: Crude Oil Production, Thousand Barrels per Day, March 2020**

Company	March 2020
Chevron (USA)	160
PDVSA (Venezuela)	130
Rosneft (Russia)	240
SINOPEC, CNPC (China)	130
Total	660

Source: AGPV Asesores Económicos, Informe Mensual, Abril 2020.

They are usually completely obedient to decisions made by the political leadership in countries as China and Russia. Nevertheless, in the case of Venezuela we can see different patterns of behavior on the part of Chinese and Russian NOCs.

Chinese companies are more cautious and try to avoid directly challenging U.S. sanctions; they want to preserve access to Venezuela's oil market and to be repaid for their outstanding loans of about 20 billion USD.<sup>42</sup> As we can see in Figure 15, Beijing has significantly reduced its oil imports from Venezuela in 2018 and 2019, while India, Malaysia and other countries (including Cuba) continued to be the key destination for Venezuela's heavy crude oil.

Chinese representatives have also held informal contacts with the country's opposition leadership, and personally with Guaidó. It is important to note that all political forces in Venezuela, both the government and the opposition, see China, not only as a current lender or joint-venture partner, but also a potential future strategic investor for rebuilding the country's infrastructure and oil industry.<sup>43</sup>

The role that Russia's NOC Rosneft played in Venezuela was remarkably different. Rosneft is not just an instrument in the hands of the Russian political leadership—it became a key actor in Venezuela that sometimes determined Russia's foreign policy decisions, because of the very special position of the com-

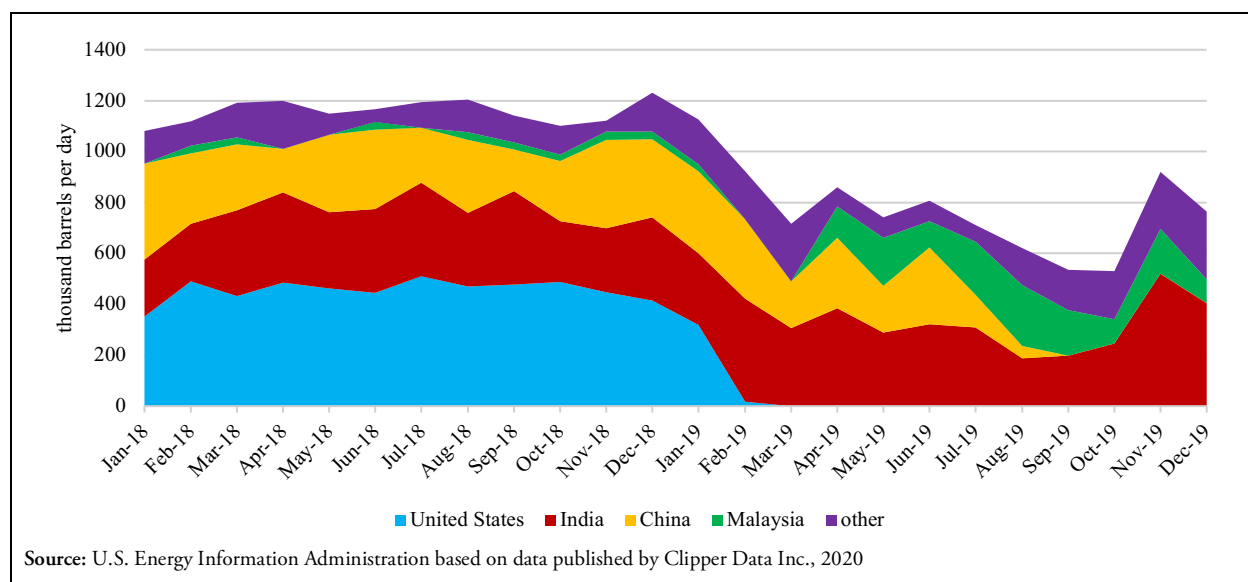
39. <https://www.bloomberg.com/news/articles/2020-11-17/chevron-wins-time-in-sanction-hit-venezuela-with-extended-waiver>.

40. <https://www.chevron.com/worldwide/venezuela>.

41. <https://www.argusmedia.com/en/news/2160677-us-gives-chevron-six-more-months-in-venezuela?backToResults=true>.

42. <https://www.cfr.org/in-brief/maduros-allies-who-backs-venezuelan-regime>.

43. <https://dialogochino.net/en/trade-investment/32971-china-remains-quiet-and-pragmatic-on-venezuela-crisis/>.

**Figure 15. Venezuela's Export of Crude Oil, Thousands Barrels per Day, 2018–2019**

pany's CEO, Mr. Igor Sechin, who also happens to be a part of the Russian political hierarchy.

Venezuela is a personal pet project of Sechin, whose power extends far beyond any institutional role he derives. His status is reinforced by his close association with Mr. Putin. He has been an influential member of Putin's inner circle over 30 years, and an informal leader of the hard line faction in the Kremlin. However, Rosneft's policy remains dependent on the will and whim of Russia's president.<sup>44</sup>

Rosneft's commercial activity has always been tangled with domestic political affairs and the ambitious geopolitical goals pursued by Moscow. At the same time, Rosneft cannot completely neglect its commercial goals. To avoid the extreme predicament of becoming cannibalized by Russian geopolitics, it frequently uses its lobbying power to obtain significant fiscal benefits, enjoys state protection from bankruptcy, gets opportunities to acquire other rival companies, and writes off losses at the expense of the state, as recently happened in Venezuela.

In 2020, when the United States sanctioned the company's subsidiaries—Rosneft Trading and TNK Trading—for working with PDVSA, Rosneft sold all its joint ventures, service companies and trading operations in Venezuela to another Russian state-owned entity. In return it received a 9.6% share of its own equity, currently worth \$3.8 billion USD, and converted the Russian government majority share into a minority stake.<sup>45</sup>

Rosneft has also profited from a reduction of Venezuela's production and the imposition of U.S. oil embargo against Caracas, replacing—together with Canadian companies—Venezuelan heavy crude blend exports to the U.S. (Figure 15). The U.S. market is important for Rosneft because Russia's monopoly receives cash from sales there, which is not the case when it trades with its largest consumer, China. Beijing financed several Rosneft's megaprojects and now is charging payments in the form of crude oil. As soon as Venezuela normalizes its relations with the U.S. and begins to restore its oil production, it will likely completely substitute Rosneft's heavy oil delivery to U.S. refineries.

44. <https://www.economist.com/leaders/2020/04/02/why-putins-favourite-oil-firm-dumped-its-venezuelan-assets>.

45. <https://www.reuters.com/article/us-russia-rosneft-venezuela/rosneft-sells-venezuelan-assets-to-russia-after-u-s-sanctions-ramp-up-idUSKBN21F0W2>.

## CUBA IN LIGHT OF VENEZUELA'S DOWNFALL

To summarize, key arguments regarding Venezuela's economic collapse and its impact on Cuba are as follows. There is a deep structural crisis in Venezuela, as its petro-state has crashed, while an authoritarian regime has flirted with untenable ideas of tropical socialism. The country's fundamental problems come from the oil-dependent nature of the Venezuelan state, whose extremely inefficient and corrupt forms of governance have become mixed with the destructive practices of authoritarian populism. In that regard the Cuban experience has been quite different. It continues to be an isolated island of socialism, still employing a system that collapsed in Europe more than 30 years ago.

The political transition to a post-Castro reality, the COVID-19 pandemic, and a global economic crisis, is pushing Cuba to make changes. According to available information, Cuba now seems to be drawn into the third reformist cycle. The first one in that country was triggered by the collapse of the Soviet Empire and was phased out in 1995. The second cycle, in 2008–2011, was initiated by a partial change in political leadership—the gradual departure of Fidel Castro from power, and the growing influence of his brother Raúl—as well as by pressure brought on during the global financial turmoil that took place at the time. The current cycle is linked to a further restructuring of the political hierarchy in Havana, to the implementation of some provisions of a new constitution, and to a deep economic crisis induced by the dramatic reduction of subsidies from Venezuela and the belated arrival of a coronavirus disease.

The pandemic has exposed the vulnerability of the Cuban economy, and Havana's attempt to compensate for the loss of Venezuelan assistance through the development of tourism has proven to be non-sustainable. Decreasing remittances and increased U.S. sanctions have also adversely affected the country's existing economic reality. Cuba finds itself between a rock and a hard place, and once again an on-

going crisis there has prompted a new round of reforms.

Paradoxically, after the 1959 revolution, Cuba turned out to be an oil-dependent country. During the Soviet period, an “oil in exchange for sugar” scheme was implemented that drew on subsidies from the Soviet Union that lasted for almost 30 years. In the early 2000s, reforms were pushed back by substantial subsidies from Venezuela. An involuntary parallel with the USSR occurred as well at the end of the 60s, when Kosygin's reforms were abandoned as a result of huge oil field discoveries in Western Siberia.<sup>46</sup>

Cuba, a country without significant oil reserves, turned into a kind of petro-state, critically dependent on oil delivery and distribution of oil revenues—first from the USSR, and then from Venezuela. That bonanza period now seems to have come to an end.

Reforms pose serious challenges to a socialist regime. Cuba is slowly moving toward high-risk and long-delayed exchange rate unification, with its government preparing to scrap the dollar-pegged convertible peso (CUC) and significantly devalue the ordinary Cuban peso (CUP).<sup>47</sup> Many experts believe that this step will be essential to advancing the island's reform agenda. The official goals of the currency reform include economic efficiency improvement, growth of productivity, imports substitution and stimulation of exports. It promises to be a delicate maneuver, putting pressure on inefficient state companies, generating open unemployment, threatening savings and creating inflation dynamics that will be difficult to control. According to widespread estimates the inflation rate will jump to triple digit numbers—above 100 percent—with the World Bank forecasts being three times higher (around 350 percent).

Timing the implementation of the currency unification with the arrival of a pandemic was not done by chance—it has allowed the government to reduce the risks of major social protests. There are always winners and losers in any reform program, but when

46. *The Economics of Russia Transition*. Edited by Yegor Gaidar. (2003). Cambridge (Massachusetts): The MIT Press, p.27.

47. <https://www.bloomberg.com/news/articles/2020-12-11/cuba-to-end-dual-currency-system-from-january-in-crisis-reform>.

it comes to currency unification, the major loser could be an incipient private sector, that has been weakened by the collapse of tourism in 2020 and 2021, while public companies will probably continue

to receive compensations from the government that has created a special fund.

Ultimately, the transitional agendas of Cuba and Venezuela have actually accelerated, even if their transitional pathways are likely to be different.