

Venezuela

In search of a new transition path

Despite discussions about a revision of the US sanctions (e.g., Chevron) policy, the measures under consideration seem limited in scope and remain dependent on political negotiations. But it is possible that this could open a new window of opportunity in the ongoing effort to address Venezuela's political crisis.

CORE
#RussiaConflict

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- **Although Venezuela has been considered by some as potential alternative to the Russian oil supply, for now, it does not have the capacity to significantly increase production.** We estimate that the most that Venezuela could add in the short term would be about 200k b/d. This impact on the global oil market would be marginal and have little effect on oil prices.
- **The US maintains the strengthening of democratic institutions as a key pillar of its foreign policy towards Latin America.** We find it hard to see the US sacrificing its attempts to re-establish democracy in Venezuela – which have been the primary objective of the sanctions – for a marginal additional oil supply.
- **The main alternative under deliberation is allowing Chevron to take operating control of its joint ventures.** Financial sanctions are not part of the discussion, which leaves a potential debt restructuring process still far away and dependent of the resolution of the political situation.
- **The target in the ongoing negotiations remains having a free and fair 2024 presidential election.** Any resolution of the crisis and significant change in US policy before that seems to have a low chance of occurrence, in our view.¹
- **The Venezuelan economy could have an statistical rebound this year, but a rebound is not a recovery.** After losing 80% of its GDP, even growing at 10% annually, it would take 17 years to get GDP back to where it was at the beginning of the Maduro administration. In order to make growth sustainable, a solution to the protracted political crisis is needed.

A new window of opportunity opens up but still requires time

¹ EEUU y sus aliados dejan crisis en manos de Venezuela y apoyan elección en 2024, El Estímulo, February 16, 2022

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The escalation of global geopolitical tensions as a result of the Russian invasion of Ukraine has led the US government to engage in direct talks with the Maduro regime in Venezuela.² This has put on the table Venezuela as an alternative source of oil supply to Russia, leading some to consider the possibility of a revision of the sanctions policy towards the country.³ However, the measures under consideration are limited in scope and remain dependent on political negotiations.⁴ Meanwhile, the conditions on the ground in Venezuela suggest that any contribution in terms of oil supply from Venezuela in the short term is likely to be marginal. For now, Venezuela does not have the capacity to significantly increase oil production. Nonetheless, we think these events open a window of opportunity in the ongoing negotiations to try to solve the protracted political crisis in Venezuela and try to find a new political transition path, which is critical to advance in the debt restructuring process.

After falling to less than 0.5mn b/d in 2020 from nearly 3mn b/d in at the beginning of the Maduro government in 2013, Venezuela has been recovering its oil production in recent months standing now at about 800k b/d. Amid the lack of investment, sanctions, disruptions of basic services, lack of financing and loss of human capital, Venezuela's production remains highly unstable and difficult to sustain. Therefore, the recovery seen in recent months seems to be mainly resulting from the improvement in the capacity to commercialize the Venezuelan crude, rather than a recovery in production capacity.

With Iran's help, Venezuela has found some space to circumvent the sanctions.⁵ Although it has to sell the crude at a steep discount, the increase in oil prices makes those transactions commercially viable. Meanwhile, the underlying conditions, with the number of operating rigs close to zero (Figure 1), suggests that the production capacity has continued to decline and could probably be about 1mn b/d. Therefore, we think the most that Venezuela could add in the short term could be about 200k b/d, significantly lower than Russia's 7mn b/d of exports.

Considering this low amount, Venezuela does not seem to be an alternative to solving the energy supply issues in the near term. At most, it could replace part of the Russian production that used to go to the US market (c. 600k b/d), but it would not help to reduce prices at the gas pump. Moreover, Venezuela's capacity to divert exports currently placed in Asian markets to the US is also unclear given the financial obligations that Venezuela has with China, which requires the country to dedicate most its oil exports to service that debt.

The US maintains the strengthening of democratic institutions as a key pillar of its foreign policy towards Latin America.⁶ Therefore, it seems hard to see the US sacrificing its attempts to re-establish democracy in Venezuela – which were the primary objective of the sanctions – for a marginal additional oil supply. Moreover, Venezuela has become a domestic policy issue in a key swing state such as Florida, which may make it politically costly for the administration to make a unilateral lifting of sanctions.⁷

Finding a way to address to the complex Venezuelan political crisis requires a mix of carrots and sticks. For the US government its approach to Venezuela seems more likely be an attempt to find a new path for political negotiations regarding the Venezuelan crisis.⁸ The Maduro regime was in talks with the Venezuelan opposition in Mexico with the mediation of Norway and other countries last year. However, given the lack of incentives from the regime to concede in the improvement in electoral conditions, those negotiations were frozen in October. Within that

² "U.S. Officials Travel to Venezuela, a Russia Ally, as the West Isolates Putin," *The New York Times*, March 5, 2022

³ "U.S. officials travel to Venezuela, a Russian ally, for talks,"- *Reuters*, March 6, 2022

⁴ "U.S. ties easing of Venezuela sanctions to direct oil supply," *Reuters*, March 9, 2022

⁵ "Venezuela Doubles Crude Oil Exports Defying U.S. Sanctions," *Bloomberg*, January 3, 2022

⁶ "How Joe Biden is driving a complicated shift in US policy toward Latin America," *El Pais*, March 16, 2021

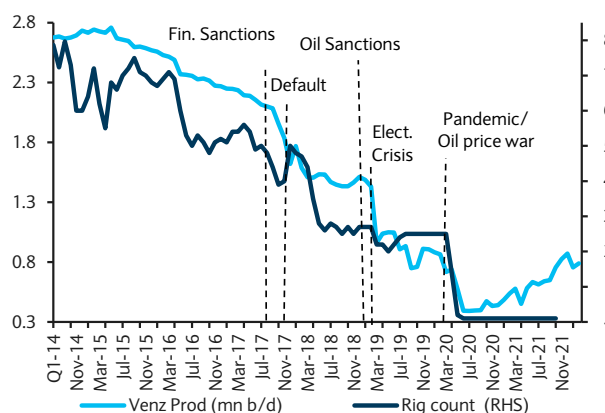
⁷ "Biden's diplomacy rattles Florida yet again," *Politico*, March 9, 2022

⁸ "Penfold: Guerra en Ucrania le da una relevancia a Venezuela 'que no hay que exagerar'," *Tal Cual*, March 12, 2022

context we think some flexibility in the oil sanctions on Venezuela could be a way to unlock the negotiations.⁹

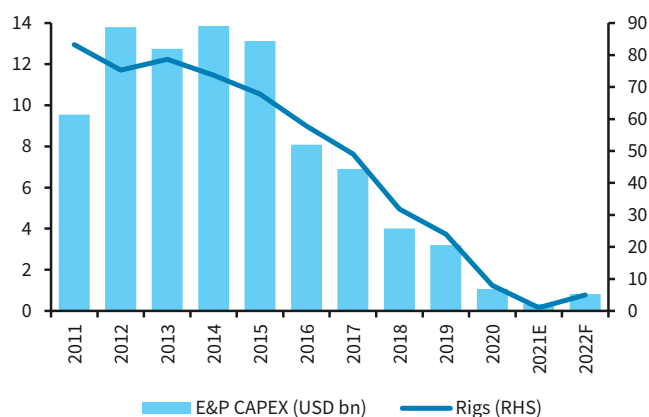
The main alternative under deliberation is allowing Chevron to take operating control of the joint ventures that it shares with the state-run company PDVSA and allow it to commercialize the Venezuelan crude coming from those projects. However, U.S. officials have made it clear that any new authorization will depend on whether Venezuelan President Nicolas Maduro takes further steps in political negotiations and Chevron spokesman Ray Fohr stated in a *Bloomberg* article that the company remains “in compliance with the current sanctions framework” and maintained that Chevron is “a constructive presence in Venezuela.”^{10 11} Chevron JVs in Venezuela, Petroboscan and Petropiar, used to produced around 150-200k b/d before the 2019, which is probably within the range of the production that could be recovered. For now, financial sanctions are not part of the discussion, which leaves a potential debt restructuring process still far away.

FIGURE 1. The recent recovery seems to be explained mainly by an improvement in commercialization, rather than production capacity



Source: OPEC, Bloomberg, Barclays Research

FIGURE 2. Without access to financing to increase Capex production recovery is capped and is difficult to sustained



Source: PDVSA, Bloomberg, Barclays Research

Although we think that in the short term Venezuela does not have the capacity to replace part of Russian oil supply and any additional supply is likely to be marginal for global markets, the country still has the potential to re-emerge as major oil producer in the long term. To realize Venezuela’s potential a re-institutionalization of the country would be critical. This remains a medium-term objective, with the 2024 presidential elections as a target. Any resolution of the crisis and significant change in US policy before that seems to have a low chance of occurrence.¹² However, if an agreement is reached to re-institutionalize the country and the political crisis is overcome, Venezuela could become a way to diversify the oil supply for the West and reduce energy security vulnerabilities.

In addition to the economic factors, the Venezuelan crisis has spillover effects – such as migration over neighboring countries in Latin America – which could be destabilizing for key regional US allies such as Colombia. Having a failed state in the western hemisphere also implies security issues.¹³ Therefore, there are still incentives in the international community to find a solution to the crisis. However, we believe a viable solution depends whether there is a fracture within the regime, which despite the high pressure has not happened; or if domestic stakeholders are willing to give mutual concessions and advance in a negotiation process.

⁹ Penfold, Michael (2021), *Democratization in Venezuela: Thoughts on a New Path*, Wilson Center.

¹⁰ Exclusive: Chevron set to trade Venezuelan oil if U.S. relaxes sanctions, sources say, Reuters, March 14, 2022

¹¹ “U.S. Weighs Easing Limits on Chevron Contacts With Venezuela,” *Bloomberg*, March 30, 2022

¹² EEUU y sus aliados dejan crisis en manos de Venezuela y apoyan elección en 2024, *El Estímulo*, February 16, 2022

¹³ “Armed Gangs and Warlords Are Taking Over Venezuela,” *World Politics Review*, April 29, 2021

As discussed in [Venezuela: From sanctions to negotiations?](#), November 6, 2020, the fatigue as a result of the extension of the stalemate could give incentives to negotiate a solution. Maduro has been able to stay in power but has not been able to provide a solution to the economic situation.¹⁴ The economy has dollarized and controls have been lifted, which has helped to alleviate the severe scarcity and inflation problems, but the economy has stabilized at a low income level. After having lost 80% of GDP since Maduro took office in 2013 (Figure 3), Venezuela has the lowest GDP per capita of the western hemisphere (Figure 4). The increase in oil prices provide some relief in the economy that could help it to recover; however, sanctions on Russia also complicate the situation for the Venezuelan government as it was using the Russian financial system to process its transactions.¹⁵ Therefore, some of its liquidity is now stuck in Russia and they now face new operational difficulties.

The economy could have a statistical rebound this year, but even growing at 10% annually, it would take 17 years to get GDP back to where it was at the beginning of the Maduro administration. Considering the low starting point, such high rates of growth could be achieved this year, the question is what needs to be done to make it sustainable. Venezuela has the potential to grow at very high rates. However, in order to have sustainable growth, the country would need to have access to capital, which would require a debt restructuring (that the sanctions block) and some minimum level of institutionality that today does not exist.

For Maduro the failure to resolve the economic crisis implies risks. So far the opposition and external threats have contributed to keep chavismo unified, but as those threats ease, Maduro's leadership could be questioned within the regime. While those at the top of the regime were able to benefit from the good time, the others in lower positions have not had their chance yet, which makes the current equilibrium unstable.¹⁶ The sanctions prohibit the issuance of debt, restricting fund raising. Therefore, in order to find a stable economic solution, the regime needs to address the main issue – Improvement in electoral conditions, which has been the main requirement from the international community in order to provide for sanction relief.^{17 18}

In our view, the weakening of the opposition may provide a situation in which the regime may improve the electoral conditions, with the view that it could win an election. It would be up to the opposition to turn that into a potential opportunity for a political transition, similar to what they recently did in the local elections in the state of Barinas.¹⁹ However, if the elections are conducted under minimum acceptable conditions for all parties involved, independently of who wins, it could provide a solution to the protracted political crisis and potentially pave the way for a debt restructuring. Although conditions suggests this is a possible scenario, political transition process are not linear. They have back and forth. Therefore, the process likely will require time to crystallize.²⁰

¹⁴ Pantoulas, Dimitris and McCoy, Jennifer (2019), Venezuela: An Unstable Equilibrium, Scielo

¹⁵ Sanctions on Russian banks could also hurt Moscow's Latin American allies, Miami Herald, April 12, 2022

¹⁶ Quiénes conforman la cúpula militar que sostiene a Nicolás Maduro en Venezuela, El Universo, February 19, 2019

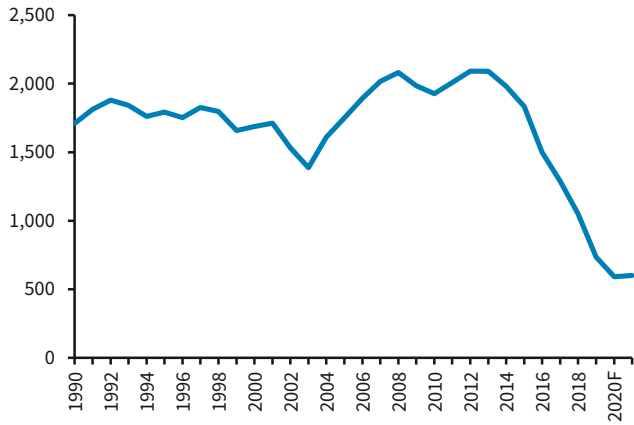
¹⁷ U.S., EU, Canada willing to review Venezuela sanctions based on negotiations, Reuters, June 25, 2021

¹⁸ Venezuela's Opposition Wins on Hugo Chávez's Home Turf, Foreign Policy, January 14, 2022

¹⁹ Venezuela's Opposition Wins on Hugo Chávez's Home Turf, Foreign Policy, January 14, 2022

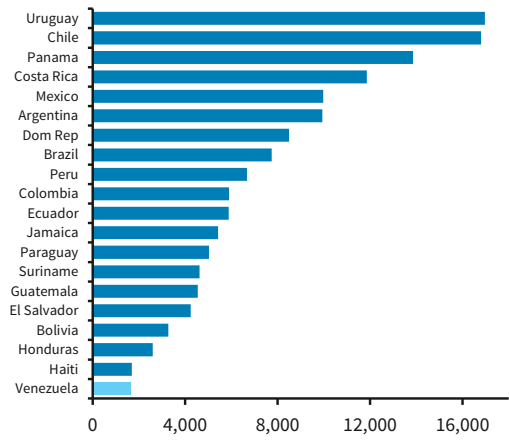
²⁰ EEUU y sus aliados dejan crisis en manos de Venezuela y apoyan elección en 2024, El Estímulo, February 16, 2022

FIGURE 3. After losing 80% of its GDP, even growing 10% annually (Per capita real GDP, VEB 1997)



Source: Haver Analytics, BCV, Barclays Research

FIGURE 4. Venezuela has stabilized at a low income level (GDP per capita, USD)



Source: IMF

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