

Options for U.S. Policy in Venezuela

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Chairman Corker, Ranking Member Cardin, and Members of the Committee: Thank you for the invitation to testify today. I am grateful for the Committee’s interest in Latin America and am pleased to have this opportunity to discuss U.S. policy options in Venezuela. As always, I am eager to hear your advice and counsel.

Today Venezuela and its people face economic, political, and humanitarian crises. The economy has shrunk by nearly 30 percent over the last four years, declines often seen only in wartime. The value of the bolivar, the official currency, erodes daily, undercut by some of the highest inflation rates in the world. Poverty, which fell during the 2000s, has now surpassed pre-Chavez levels, with over three out of every four Venezuelans living in dire straits, and half of the nation suffering in extreme penury. A recent study by three prominent Venezuelan universities found that most Venezuelans can no longer meet the recommended

2,000 calories a day; 75 percent of the population reported significant weight loss in the last year alone.¹ Once South America's richest nation, the majority now live in conditions on par or worse than citizens in Bangladesh, the Democratic Republic of Congo, or Mozambique.

Every day there are too many stories of the sick going without care, of hospitals without basic medicines and equipment, of treatable diseases becoming death sentences. The few statistics and surveys available show that infant mortality, deaths during childbirth, and malnutrition have skyrocketed.

This economic devastation results from steep declines both in oil prices and in production, as world markets and local mismanagement have undermined Venezuela's traditional cash cow. With prices more than halving since 2014 and output down over one million barrels from 2000 production highs, government income has fallen precipitously.

It also reflects over a decade of broader economic interventions, undercutting the private sector through exchange rate and monetary controls, bureaucratic rules, and outright expropriations. Non-oil exports have fallen from roughly a quarter of products sold abroad in the 1990s to less than four percent today.

Venezuela increasingly no longer makes the basic products its citizens need to survive.

Added to these costs for economic growth and prosperity is widespread corruption. Independent estimates suggest over \$60 billion has been stolen since 2003. Whether arbitraging the official and unofficial exchange rates for personal gain, selling government purchased foodstuffs on the black market, or straightforward theft, this systemic graft has impoverished Venezuela's people and its economy.

Chances of Default

Many economists and investors don't believe the current economic status quo can last. The government owes \$140 billion in external debt—roughly equivalent to its dollar denominated GDP. 2017 interest and principal obligations of ten billion equal current reserves. Venezuela's state-controlled oil company

¹ National Survey of Living Conditions (ENCOVI), 2016

Petróleos de Venezuela, S.A. (PDVSA) was late last November making payments on \$404 million in coupons—signaling the extreme cash crunch it faces.

So far the government has been able to meet its external financial promises despite the dire financial circumstances. The government has consistently chosen debt repayment over other obligations, including the provision of basic goods. Imports of food and medicines have fallen by 50 percent and 67 percent respectively over the last year; total imports are now less than \$20 billion, roughly a third of the nation's 2012 bill. The government has resorted to a mix of blaming the private sector, lifting price controls on specific goods, and systematically repressing dissent to deal with the public desperation and outcry.

The government has also relied on asset sales and financial reengineering to stay on good terms with its creditors. It negotiated new and extended terms on oil payments due to the Chinese, its largest outside creditor. In the final quarter of 2016 it swapped nearly \$3 billion in PDVSA bonds for longer maturities, and raised an additional \$1.5 billion from Russia's oil company Rosneft. It also placed another \$5 billion in long term debt with undisclosed buyers. If oil prices rise in 2017—as most expect—the government's hard currency, and subsequent capacity to pay, will increase.

Taken together, while it will be quite difficult, there is a good chance the government can financially muddle through the coming year's payments, lessening this potential trigger for political change.

U.S. National Interests in Venezuela

Venezuela's fate matters for the United States as it affects economics, security, and democracy in the Western Hemisphere.

Economically, instability in Venezuela's oil production has risks for the U.S. refining industry and for global prices. For decades Venezuela's crude oil came north, mostly destined for Southeastern and Texan refineries. These flows have lessened in recent years as the nation's output has fallen and as more is sent to

China and India. Still, it represents some \$15 billion of business annually.² And Venezuela remains the third largest oil producer in the hemisphere; disruptions could hike prices.

In terms of security, Venezuela's willingness to permit drug traffickers, organized crime networks, potential terrorists, and other nefarious actors within its borders affects U.S. national security as well. Reports show that Colombia's *Bandas Criminales* (BACRIM), Revolutionary Armed Forces of Colombia (FARC), and National Liberation Army (ELN) all operate in the country, as do Mexico's Sinaloa and Zeta cartels. The nation has become a preferred drug smuggling route out of South America, with cocaine heading to the United States through Central America and the Eastern Caribbean, and to Europe through West Africa. The Venezuelan government effectively ended anti-narcotics cooperation a decade ago; since then Drug Enforcement Administration (DEA) and Department of Justice (DOJ) investigations point to active collusion and collaboration between prominent government officials and drug traffickers.

Venezuela matters importantly for regional stability. Its economic and authoritarian slide has the potential to undermine its neighbors. Both Brazil and Colombia are already dealing with escalating migrant and refugee flows, as tens of thousands of Venezuelans make their way across the borders in search of food, medicine, and a new start. Colombia in particular could face a quick escalation in displaced persons, given the roughly five million people of Colombian origin that reside in Venezuela. Most were refugees from Colombia's historic violence, now they may return to escape that permeating their new country. A flood of individuals could undermine one of the United States' strongest regional allies as it works to implement its historic peace process. And Venezuela is threatening the very sovereignty of its neighbor Guyana, reigniting long standing claims to its Essequibo region, roughly 40 percent of its current territory, and its newfound offshore oil.

Finally, Venezuela's authoritarian turn contradicts long held U.S. ideals and foreign policy goals. The crackdown on basic political and civil rights run directly counter to U.S. policy objectives to uphold and promote democracy, both a good in and of itself as well as for the salutary effects for stability, peace, and

² U.S. Trade Representative, 2015

development. It also flouts the will of the Venezuelan people, witnessed in the overwhelming support for the opposition in the December 2015 legislative elections.

Policy Options

Despite this worrisome state of democratic erosion and humanitarian trauma, and the negative ramifications for the United States and its regional partners, U.S. policy levers to change the current status quo are limited. A significant shift, if it occurs, will likely come from within. Nevertheless, the United States should continue to investigate and to reveal the criminal behavior of Venezuelan officials, work to increase pressure on and condemnation of the regime in multilateral venues, and prepare to constructively aid a receptive future government.

Targeted Sanctions. The United States has and should continue to use targeted sanctions against human rights abusers, drug traffickers, and corrupt officials. Over the last ten years the State Department has revoked the visa of over sixty officials for human rights abuses or support of terrorist and drug trafficking organizations; the Office of Foreign Assets Control (OFAC) has sanctioned seven Venezuelans, mostly military officers, for human rights abuses and undemocratic practices, and recently another fifteen individuals for drug trafficking and colluding with terrorists—among them Venezuela's Vice President Tareck El Aissami. These are important actions as they deny these individuals access to the United States and the benefits of its financial system. These sanctions also send an important message—reaffirming that the United States can and will uphold international norms and rules. Targeting individuals avoids the humanitarian costs of country sanctions, which intensify the hardships facing the broader population while leaving its leaders relatively unscathed.

Expanding the use of targeted sanctions, while the right thing to do in terms of justice, is unlikely to bring any real change to Venezuela's political or economic status quo. If anything, it will lead the individuals to refuse to negotiate or compromise, given that a change of government could affect their own personal freedom.

CFIUS review of recent financial transactions concerning CITGO. The late 2016 bond offering to Rosneft, giving them 49.9 percent of PDVSA subsidiary Citgo holdings in the case of default, coincides with ongoing speculation that Rosneft holds a material amount of other recently restructured PDVSA bonds also collateralized by Citgo assets. If the latter is true, then in the event of a comprehensive default, Rosneft looks in position to take over a majority controlling stake in the U.S. based subsidiary. The Committee on Foreign Investment in the United States (CFIUS) should begin a review concerning the potential acquisition (through a debt default) of these critical infrastructure assets by the state controlled Russian oil company.

Rally other nations to pressure the Nicolas Maduro regime. A second potentially fruitful policy approach is encouraging other nations to join together and take the lead in condemning Venezuela's authoritarianism. South America's democracies in particular—considered allies rather than “yankee” enemies—have more leverage, their criticisms harder to dismiss.

Electoral changes over the last eighteen months make such critiques more likely. Peru's Pedro Pablo Kuczynski, Argentina's Mauricio Macri, and Brazil's Michel Temer have all supported the recall referendum efforts to end Maduro's mandate. They have also publicly condemned the imprisonment of political opponents and limits on freedom of expression. Mercosur, the South American economic bloc, voted to suspend Venezuela for its human rights abuses and democratic failings. Add to this Venezuela's diminishing ability to “rent friends” by providing free and subsidized oil, as it has to many Caribbean and Central American nations in the past, and it opens up the possibility of a broader regional effort.

The United States has an opportunity, through careful and consistent diplomacy, to unite these individual expressions of concern and acts of censure into a more powerful opposition to the Maduro government and its authoritarian tactics.

One of the most fruitful avenues is the Organization of American States (OAS). Last May Secretary General Luis Almagro invoked the organization's Inter-American Democratic Charter, calling on its member states to review Venezuela's adherence to democracy and detailing its transgressions in a 132-page report. At the time the United States and others deferred in support of dialogue, including that led by the Vatican

sanctioned Jose Luis Rodriguez Zapatero and others. As these negotiations have now failed, largely due to the Venezuelan government's recalcitrance, the United States should adopt a harder line within the OAS, galvanizing support for a Democratic Charter review and building the two-thirds majority vote required for Venezuela's suspension from the multilateral body.

As the United States works to expand a coalition for change, China can and should play an important role. Having lent some \$60 billion over the last decade to keep the government afloat, it retains significant sway. There are signs that China's leadership is becoming increasingly concerned about Venezuela's stability; slowing the pace of new lending, of rollovers of existing government obligations, and even meeting with opposition leaders. The State and Treasury departments should begin preliminary conversations with their Chinese counterparts, who may become more willing to press the Venezuelan government in the case of a debt default.

Prepare for change. While change will likely come from the actions of Venezuelans themselves, the United States can and should prepare to help stave off the worst of a further deterioration and to help enable the nation to recover its economic footing. To address the humanitarian costs, the U.S. government should begin working with Colombia, Brazil, Guyana, and nearby Caribbean nations that may receive hundreds of thousands if not millions of Venezuelans fleeing repression or chaos. The United States can help protect and care for these refugees, sending funds, civilian personnel, and equipment to help Venezuela's neighboring governments, UN organizations, and U.S. and foreign nongovernmental organizations (NGOs) address the crisis.

The United States should also begin preparing to help a future receptive government deal with the economic and financial chaos. A new administration will quickly have to let the exchange rate float (given the exhaustion of international reserves), let domestic prices rise to reflect supply and demand, and rebuild an effective social safety net. It will also have to restructure the \$140 billion in sovereign and PDVSA debt. The U.S. government has an important role to play in bringing in and helping the International Monetary Fund (IMF) define the dimensions of a rescue package, and in helping coordinate with China, Russia, and other

interested parties. The faster and more comprehensive a deal is, the sooner Venezuela can bring back the economic growth necessary to alleviate the worst of its citizens' suffering.

Venezuela's economic, political, and social situation represents both a regional problem and a global affront to democratic values. As such it should be a priority for the current U.S. government, which should invest in the necessarily complex, time consuming, and fragile diplomatic processes to push for change, as well as to prepare for the day when it in fact may come.