

Venezuela: Country Risk

Economic and Political Evaluation



Source: <https://flights.aeromexico.com/en-us/flights-to-venezuela>

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Author:

Alessandro Gagaridis

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Introduction

On the basis of its structural characteristics alone, Venezuela would have good opportunities for economic growth and for business. In fact, it possesses important natural resources (notably hydrocarbons and minerals), a young and highly urbanized population of around 30 million individuals, a Human Development Index in the “high” band¹ and a good geographic position between Latin and North America.

In the 2000s, Venezuela experienced a considerable economic growth thanks to the high price of oil on the international markets. As a matter of fact, petroleum is the main good it exports, accounting for more than 90% of the total trade revenue². However, due to the drop in the price of oil, the country has been affected since 2014 by a severe economic, social and political crisis; which has become more severe in recent months. This had a strong negative impact on the Venezuelan economy, thus deteriorating the country’s appeal as a destination for business.

Socio-Political Outlook

Since 1999, Venezuela has been ruled by the left-wing United Socialist Party (PSUV, *Partido Socialista Unido de Venezuela*), initially under the Presidency of H. Chavez and after 2013 of N. Maduro. Thanks to the substantial revenues originating from the state-held oil company (PDVSA), the government managed to implement a vast social care program that effectively resulted in a sensible reduction of poverty, unemployment and income inequality; and it was also able to provide sanitary assistance, education and other services to the population.

However, this socio-economic model presented considerable flaws: first, it was excessively reliant on the high price of oil on the international markets; second, it was based on state-owned companies, many of which were former private firms that had been nationalized. Due to this and



Source: https://www.tnp.no/newsimg/venezuela_protests.jpg

¹ United Nations Development Programme, Human Development Report 2016: http://hdr.undp.org/sites/default/files/2016_human_development_report.pdf

² Observatory of Economic Complexity: <http://atlas.media.mit.edu/en/profile/country/ven/> and Euler Hermes, Venezuela Country Report 2017: <http://www.eulerhermes.com/economic-research/blog/EconomicPublications/venezuela-country-report-jun17.pdf>

to a regulatory regime unfavorable to business, such framework did not favor private economic initiative and investment; and failed to foster innovation and raise productivity. These problems are at the basis of the current crisis and they continue to negatively affect Venezuela. *As they are the result of years of inadequate economic policies, such issues are unlikely to be solved soon; and business in the country will continue to be hampered by similar problems in the upcoming years, independently from the resolution of the ongoing socio-political unrest and from the future of Maduro's government.*

When the price of oil declined in 2014, Venezuela lost its main source of income and its whole socio-economic model entered into a deep crisis. As the state had no longer oil-derived wealth to spend, the economic situation started deteriorating rapidly and severe shortages of basic goods became regular as the country had no money to pay the imports upon which it relied to satisfy its domestic demand. At the same time, the state apparatus became unable to continue its distributive policies. The economic downturn and the difficulties of the welfare system resulted in a period of mounting social unrest in the country.

Starting from late March 2017, tension has reached a new level following a controversial ruling by the Venezuelan Supreme Court, which dissolved the Parliament (National Assembly) and took over its legislative powers. The opposition forces, united in the Democratic Unity Roundtable alliance (MUD, *Mesa de la Unidad Democrática*), claimed the decision was an attempt by Maduro to strengthen its position. Since then, protests and clashes have become regular, causing more than 120 dead. The election of a Constituent Assembly charged with writing a new Constitution has not appeased the opposition. In fact, the MUD contests its legitimacy and considers it as an attempt to tighten the executive's power. New episodes of violence followed, and the situation appears far from being solved. The pre-existing social divide between Maduro's supporters and opponents is widening. *Therefore, the risk of protracted violence is high; and events like uprisings, revolutions and even coups or civil war cannot be ruled out.*

Lastly, the international isolation of Maduro's government is also increasing. In particular, the US (which is Venezuela's top trade partner) has recently imposed sanctions on several top-level officials, including some linked with PDVSA. While such measures have a limited impact on the country's economy due to their targeted nature, *it cannot be excluded that in the future a new series of broader sanctions will be put in place by the US and other international entities;* thus increasing the risk associated with running business in Venezuela.



Source: <http://www.paolobarnard.info/images/Venez.jpg>

Economic Outlook

Since the start of the crisis in 2014, Venezuela's economic situation has severely deteriorated.

While the price of oil diminished, the state's revenues dropped dramatically. This is also due to a decline in Venezuelan petroleum production. In fact, while the

country possesses some of the largest oil reserves in the world, their chemical characteristics make it profitable to exploit only when the price of petroleum on the international markets is high. Following these events, the country became unable to continue importing many basic goods it needed and to continue its subsidies and social care policies. As a result, Venezuela experienced serious shortages of essential goods like food or medicines, as well as of water and electricity.

For the same reason, prices started soaring and inflation reached a three-digit growth, with some sources reporting a record high of 720% in 2016³. This also resulted in pressures on the national currency (the bolivar), which had been subject to a fixed exchange regime. In an attempt to solve the issue, in the first half of 2016 the government devaluated the official exchange rate and modified the currency exchange mechanism, but these measures were not sufficient. Moreover, the bolivar lost much of its value on the black market too, and these events alimeted the inflation even more. The existence of different exchange rates also resulted in more opportunities for arbitrage.

In this context of government deficit, mounting inflation and monetary devaluation, Venezuela's GDP contracted of more than 10% in 2016, with some estimates reporting a 18% reduction⁴; a drop that continues the sensibly negative trend of the last few years and which is expected to continue in the upcoming period. Accordingly, unemployment rose as well, rapidly surpassing 10% in 2016 against a level of less than 7% the previous year⁵. *In short, the country is experiencing a severe stagflation that will not be solved soon.*

This is also due to the debt problems that Venezuela is facing. While the debt / GDP ratio is not high, with figures ranging from 28% to 37% for 2016⁶, the country lacks the liquidity to pay it. The fall of oil-derived revenues and the rapid reduction of foreign currency reserves (which dropped to just 10 billion USD in 2016⁷) make it extremely difficult for the country to continue importing goods while paying the public debt at the same time, and *it is very likely that Venezuela will be forced to declare bankruptcy in the upcoming period, with the probability of default estimated at 95% over a five-year horizon*⁸.

The slight increase in the oil price is not enough to reverse Venezuela's economic downturn; and the measures taken by the government to counter the crisis have not been effective. On the contrary, they may have even worsened the situation, as the response by the Maduro administration was to take several initiatives to reinforce the control of the state over the economy, all while blaming the private sector and foreign interferences as the origin of the country's problems. This further deteriorated the business environment (already marked by poor regulatory conditions) by dissuading both domestic and foreign private investments; also because of the increased risk of arbitrary nationalization. Moreover, such policies have also fostered social unrest, thus contributing to a further deterioration of the situation. Not surprisingly,

³ CIA World Factbook: <https://www.cia.gov/library/publications/the-world-factbook/geos/ve.html>

⁴ Euler Hermes, Venezuela Country Report 2017: <http://www.eulerhermes.com/economic-research/blog/EconomicPublications/venezuela-country-report-jun17.pdf>

⁵ CIA World Factbook: <https://www.cia.gov/library/publications/the-world-factbook/geos/ve.html>

⁶ Euler Hermes, Venezuela Country Report 2017: <http://www.eulerhermes.com/economic-research/blog/EconomicPublications/venezuela-country-report-jun17.pdf> and CIA World Factbook: <https://www.cia.gov/library/publications/the-world-factbook/geos/ve.html>

⁷ Euler Hermes, Venezuela Country Report 2017: <http://www.eulerhermes.com/economic-research/blog/EconomicPublications/venezuela-country-report-jun17.pdf>

⁸ Euler Hermes, Venezuela Country Report 2017: <http://www.eulerhermes.com/economic-research/blog/EconomicPublications/venezuela-country-report-jun17.pdf>

many foreign firms have already ended their operations in Venezuela. *It is therefore clear that today and in the foreseeable future Venezuela will not be a suitable country for doing affairs*; as a matter of fact, it is ranked 187th out of 190 states in the World Bank's "Doing Business" index⁹.

Conclusive Remarks

Today, the social, political and economic condition of Venezuela is unsuitable for conducting economic operations. The situation is extremely unlikely to improve in the coming years; on the



Source: https://www.nbaa.org/ops/intl/sam/_images/venezuela.jpg

contrary, it is probable it will worsen both in economic and political terms. The policies the government is implementing have little or no positive effect. Initiatives like the redaction of a new Constitution or the organization of elections, while possibly being helpful to solve the immediate socio-political issues of the country, will not change the deeper problems affecting it. Moreover, if implemented wrongly, such measures may not only be ineffective, but may even worsen the social turmoil.

The central point is that Venezuela's crisis does not depend much on the policies and initiatives undertaken by Maduro's administration in recent years, but are the results of more than a decade of a poorly-driven socio-economic model that was excessively reliant on oil revenues and that failed to foster economic development in the form of private initiative, investment, productivity, innovation and so on. Therefore, independently from the ultimate outcome of the current political crisis, Venezuela will continue being effected by serious economic problems in the upcoming years, and it will take an extended period for its economy to stabilize and recover.

Anyone currently doing business in the country or willing to start new economic operations there should be aware of the high risk this country presents in both political and economic terms, which are likely to persist in the medium term.

⁹ World Bank: <http://www.doingbusiness.org/rankings>