

Venezuela foreseen economic path under fire

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ABSTRACT

The paper provides an analysis of one of the feeblest countries that were once one of the richest. The country is actually facing several economic and political crises. This crisis originated from the continuous communist economic system and its' heavy dependence on oil as a source of revenue. The dependence on oil and the absence of other sources put the country at high risk not for the country only but for the whole region. The paper provides an overview of the reasons for escalating the current situation and its implications on the neighbor countries and a conclusion reflecting the foreseen possible economic situations way out.

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Introduction

Venezuela is a country on the northern coast of South America with different natural fascinations. "Alongside its Caribbean coast are tropical islands such as Isla de Margarita and the Los Roques archipelago. On the northwest side are the Andes Mountains and the colonial town of Mérida, a base for visiting Sierra Nevada National Park". Centuries of political and economic variability in Venezuela has affected a huge population to flee to Latin America in the current years, according to the United Nations (U.N) migration organization that around 3.4 million Venezuelan citizens have left the country in quest of food, work, and health since 2014. Child malnutrition has an extended crisis levels in Venezuela, the U.N. children's agency recently reported that because of the distortion in Venezuela's health system, diseases such as diphtheria, malaria and measles that were once exterminated, are now spreading, and even dropping over national borders as Venezuelans migrate. Venezuela has the greatest recognized oil reserves in the world, superior to even those of Saudi Arabia.

This paper aims to highlight economic outlooks in Venezuela by assessing some particular economic trends and conditions. The International Monetary Fund forecasts that Venezuela's inflation rate reach 10 million percent in 2019 (Redi, 2019). Currently the country is facing several economic crises such as the dropping in oil prices and increasing government spending, increasing money supply, political instabilities, scarcity in food supply, shortage in medical services, and massive migration.

This paper, starts by giving hints and facts about Venezuela and its' crises a long with its timeline history, moving on to demonstrate its major causes such as the oil reduction, inflation, migration, health issues and violence. Moreover, the implications on the region and finally concluding with the type of help Venezuelans need and some possible solutions for the crisis.

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Literature Review

In the Literature Review section, theories about the economic growth will be discussed and explained but mainly emphasizing on the relation between energy resources and their impact on the economic growth, and the financial sector and the economic growth by explaining its impact.

The relation of energy resources and their impact on economic growth

In order to understand the role of energy in economic growth, we have to firstly understand the role of energy in production. Referring to David I. Stern (2010), Ecological economists usually ascribe to energy the central role in economic growth. Some economists believe that when energy resources are scarce, these resources will impose a strong constraint on the growth of the economy but when energy resources are abundant its effect on economic growth is much more reduced. Moreover, David I. Stern (2010), in order to examine the factors that could reduce or strengthen the relation between energy utilization and economic growth he used the production function approach. These important key factors are mainly presented in: (a) Substitution between energy and other inputs with an existing technology. (b) Technology change.

The relation between the financial sector and the economic growth

Many economists had arguments and debates on the impact of finance on growth. The relation between the financial sector and its impact on the economic growth has been a strong issue to make a debate. According to studies and discussions made by famous economists that are known as pioneers of development economics many opinions and beliefs had aroused whether to approve that finance has an impact on the economic growth or doesn't have an impact.

Referring to Robert Lucas (1988), who is a Nobel prize Laureate; he dismisses finance is a determinant of economic growth. Also, Joan Robinson (1952) strongly argued that enterprise leads first, then finance follows. This sheds a light on the idea that finance doesn't have a role in the economic growth; so when demand in real sector changes, finance directly responds. On the other hand, another Nobel Laureate named Merton Miller (1998) strongly argues that the contribution of the financial markets to the economic growth is an important and a serious case to discuss Demirguc-Kunt, A., & Levine, R. (2008). Theories explain the financial impact on the economic growth are various among three aspects: finance mechanism inside the country, endogenous growth, and the information collected. So, this theory explains in the short run, and how it will affect the economic growth in the long run, the more the financial efficiency which presented by providing insurance, screening entrepreneurs, and monitoring borrowers. The more the technological progress increases, the long run economic growth will be accomplished.

The theories explaining the process of economic growth

Referring to Alex William Trew (2007), a key element of the neo classical growth theory is the assumption that technical change is exogenous and that the same technical opportunities are available across countries. This assumption implies that steady state growth depends on exogenous population and exogenous technical progress. In order to achieve the economic growth there are main determinants that have to be achieved. Referring to Edwin Dewan and Shajehan Hussein (2001), the growth in any country is accomplished when meeting three factors. First factor depend on the making an efficient use of existing resources and growth, Second factor is the full utilization of productive resources as human capital. Third factor is technology development.

Scholars emphasizes on the importance impact of the financial sector on the economic growth. The overall evidence had expressed and emphasized on the important impact of finance on growth, that takes place by encouraging resource allocation and productivity growth (Beck, 2013). This sheds a light on the effectiveness of the financial sector as it permits the firms that have already existed to accomplish larger size of equilibrium by means of exploiting growth and investment opportunities. Later, Beck emphasis on the role of financial deepening in economic development, focusing on the role of government. The second part of the literature review is explaining other theories beliefs in the case of achieving economic growth.

Referring to the "Endogenous growth model explaining the internal forces and resources inside the economic system by making use of opportunities and incentives to maintain technological knowledge." But, when technological process takes place, the economic growth rate will expand in the long run, so when economic growth increases the output per person increases and the total productivity will increase. There is a big challenge between Endogenous growth theory and the neoclassical belief. According to the endogenous growth model view, technological process affects the long run economic growth rate as when technology is applied, innovations will emerge, new products will be produced, and markets will be emerged which will be result from active economic activities. On the contrary, neoclassical theory illustrates that long run economic growth can be accomplished exogenously outside the economic system. In the following section we will overview the impact of the structural imbalance in one of the riches countries that maximize its' risk by depending on one type of resource to achieve growth. An incident that turn down its' economic sustainability and pace them in high risk.

Current issue

The richest country in Latin America (Venezuela) is suffering from a growing malnutrition, a significant increase in the number of malaria infections, millions left the country due to the high level of unemployment and inflation is spiral. According to a study by

the parliament reports that the country's inflation rate is about 1.7 million percent in 2018, and the national currency has lost its value. Because of the crisis, hunger and poverty are increasing dramatically as more than 80% of the citizens are under poverty level, millions of people have migrated from the country over the past five years out of 30 million citizens according to the UN reports.

Venezuela is considered an economically poor country according to the growth domestic product (GDP), but it is also the worlds' lowest in terms of selling fuel prices, as it almost entirely subsidizes its prices to sell gallons of gasoline at \$ 0.04 per gallon, costing the state about \$ 15 billion a year. By the end of last year, commodity prices were doubling every 19 days on average, leaving many Venezuelans clinging to basics such as food and health items. Farmers suffers from seeds and fertilizers unavailability, a case that will reflect on a sign of agricultural sector collapse. And the government didn't import any seeds, fertilizers or pesticides. Consequently, farmers will be able to supply only 20 % of the domestic food demand then prices will continue rising. According to the US department of treasury 2019, the value of the local currency - the Bolivar - also collapsed against the US dollar. A country that depends heavily on borrowing since the early years of the second millennium and government spending has risen considerably especially after the drop in the oil prices then the incident that placed the country in a debt trap. The year 2019 witnessed a clear economic deterioration reflected on the political instability. The uncontrolled government spending led to catastrophic consequences that were reflected on food and medicine shortages. Adding to this, the irregular availability to public transport and the shortage in electricity and water is becoming more common. The power failure led to a severe damage to machines that can't be fixed, in many areas water services still aren't working normally because there isn't enough electricity to run the pumps.

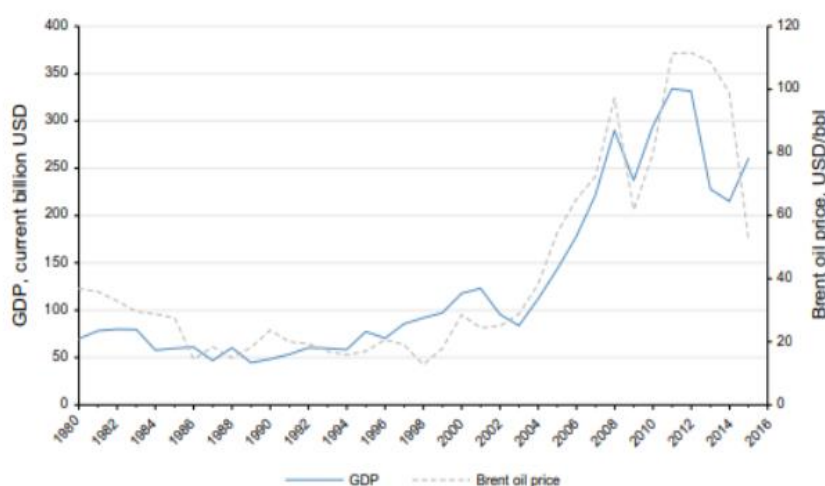


Figure 1: Brent crude oil price and Venezuela GDP; Source: IMF, BP Statistics 2016

Venezuela has many natural resources but since 1920 till 1970 oil is the main source for growth and development. Recently, it is recorded that crude oil reserves stand at 302,809 million barrels, the largest oil reserves in the world. Its oil revenues account for 98% of the total revenues of its exports. In addition to its enormous wealth of other natural resources, such as natural gas, iron, gold, diamonds and other precious metals. But despite all this, its oil production has fallen by half over the past 10 years to 1.4 million barrels in July. Which contributed to the creation of a severe economic crisis. The world's 10th largest oil exporter and the founding member of the Organization of Petroleum Exporting Countries (OPEC), suffered from the collapse in the price of Brent crude oil that has been hit by more than 55% since June, falling from \$ 115 a barrel to less than \$ 50 a barrel. Venezuela has been one of the main countries seeking to prevent OPEC from stabilizing production and has continued to criticize the resolution since it was issued in November to join countries such as Iran, Russia and Oman in attacking the decision not to reduce crude oil production. The imposed sanctions had escalated the crisis by stopping the flow of liquidity from the return for the nation's oil which was their main source of hard currency. Despite the current president's efforts to urge countries to cut production in order to support the falling in oil prices but marginal benefit was achieved. To summarize, the main reasons for the current crisis are: the main first reason for the fragile economic situation is the heavy dependence on oil that reflects on the increasing the country's risk level; where the level of exports reached to 96% and almost 60% of the government revenue depended on the industry of oil, see figure 1. In short, this action reflected on the economic performance of the country and declined the GDP more after the price fall of the oil in 2014 (Mu & Hu, 2018). The abundance of the black gold represents more than 90% of the country's exports; a situation that set the country to be a follower to their importing country. The second reason rooted to the adoption for the communism system that depend on the government activities, and the absent of market mechanism more all led to increase the country risk level. This reasons create a lack of confidence in markets and a dramatic decline to the GDP, as well the foreign companies shut down their businesses. Those who engage in government businesses will find it increasingly difficult to receive payment in a timely manner, and government debts accumulated over time (Gallegos & Quina, 2017).

Recently, Venezuela ranked first as the world's most miserable economy in 2018 for the fourth year in a row, while Thailand was at the bottom of the ranking as the least miserable economies, and Mexico experienced significant progress thanks to its control over inflation. Bloomberg related the index of poor economies at the expense of inflation and unemployment rates to gauge the

performance of the economy in general and what the citizens feel about it. The Venezuelan citizen is in a daily struggle to survive. Shopkeepers store goods because they are sure their prices will rise exponentially within days. Bartering has become the most popular method, so it is now not surprising that a person daily challenge is to find basic food requirement. This tough situation has forced hundreds of thousands of people to migrate from the country to Europe and number of migrant almost doubled, see figure 2. Also, Colombian authorities have recorded that around 870,000 Venezuelans are now in Colombia, see figure 2.

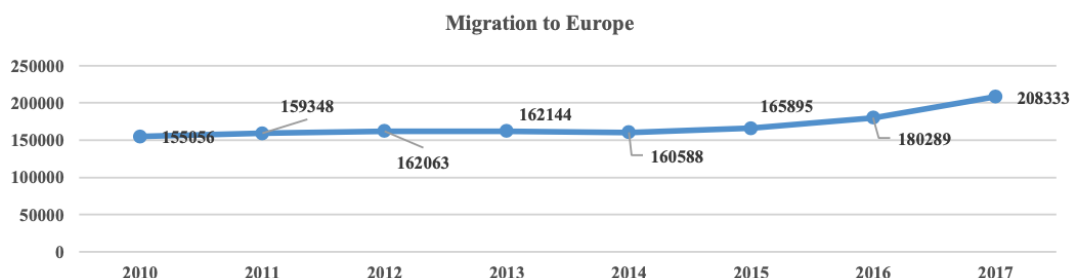


Figure 2: Migration to Europe; *Source:* The international office of migration 2018

Citizens' hopes are rising to solve the deterioration in the economic performance, thoughts believe that the political change will correct all imbalances and solve all the existing conflicts. Leaders aim to fight unemployment and retain migrants and robust the economy from the economic collapse. But an effective solution needs long term plans and a sustainable program based on diversifying the country's production which will require attracting direct foreign investments and open the markets and stop the nationalization that frightened the investments.

Reasons for the current crisis

The socialism Venezuelan economy during the period 1950 till 1980 depended heavily on the oil products and the economy was growing and it was considered to be one of the highest standards of living among the Latin countries. By the end of 1980 the situation shifted dramatically and inflation reached 84% by 1989 till 1996- despite it was the third oil producer and fourth exporter till 1998. The total trade accounted around 48% of the GDP also 95% of the exports were related to petroleum products during the same period. In 2000, the petroleum prices were in ups and downs, the government was still spending a massive amount of money. Besides, the country was selling the petroleum to the allied with exceedingly lowered rates. It is clear that the revenues received from the exported oil were not used to develop the infrastructure (Tarver, 2018). This situation reflects on decreasing the country competitiveness to attract investors and dropping the economic performance.

During 2002 till 2003, the nationalization to the oil companies led to a drop in the GDP by 27% and labour strikes accelerated the escape of the foreign direct investment. This deterioration forced the government to devalue the currency, this approach improved the situation of the Venezuelan people who relied on imported or domestically produced products which increases their dependency. The United States of America is the main importing countries to oil and it represents 41% of the country's exports of oil, followed by china by 25%, and India with 22% a record that reflects on these countries trade relation. During the 1990's the government was able to sign many oil deals with several governments, including Argentina, Bolivia and many countries in Central America and the Caribbean, and awarding lucrative but equally lucrative infrastructure contracts to Brazilian companies.

Venezuelan oil production has maintained its level since 2002 – till 2008, when the world oil prices peaked. According to statistics from the Organization of Petroleum Exporting Countries (OPEC), Venezuela spent about \$ 60 billion that year. But the collapse of oil prices in late 2014 - one year after their President's death - has dealt a devastating blow to the country's economy, which relies mainly on oil exports. As a result, the country suffered a serious crisis, with gross national product (GDP) falling by 6 percent and inflation rising sharply. Venezuelan oil production has receded since then. Consequently, many Venezuelans are abandoning the country; the United Nations recorded that around 3 million Venezuelans have fled their homes since 2014. Most of them fled to neighboring Colombia, some from Ecuador, Peru and Chile, while several went to Brazil. For Brazil, in particular, recent domestic political and economic crises have reduced their influence in Venezuela. Since 2013, successive Brazilian governments depleted by the economic recession and the massive exploitation that was spreading. The current government also increased wages in the public subdivisions thus infuriating inflation further. In summary, the reasons of hyperinflation in Venezuela spin around the dependency on oil production.

Economists conveyed that money supply increased by around 60 percent yearly till 2013 which increased more than 76 percent at the end of January 2014. Its investigation stated that this continuous increase was one of the prime reasons of high inflation levels, especially because the supply of national currency was more than the foreign currency reserves. All these factors have been able to reduce the impact of Brazil's foreign policy, leaving the region without leadership. Starting from 2016, the economy was in crisis, and the healthcare system lacked funding. Hunger and malnutrition, maternal and child mortality, infectious diseases, and unemployment were dramatically increasing. Yet in 2018 the currencies were again substituted from Bolívar Fuertes (strong) to Bolívar Soberano (sovereign). However, the new currency properly worth greater than 1 million from the main Bolívar (Tarver,

2018). The International Monetary Fund (IMF) announced that Venezuela's inflation rate could exceed one million percent by the end of 2018 as the country's crisis worsens. A senior IMF official, Alejandro Werner, said that the economic turmoil in Venezuela was similar to that in Germany after World War I and Zimbabwe at the beginning of the last decade. August 2018, the country faced hyperinflation pushing the government to cancel five zeroes from the face value of its old currency and ties the new "sovereign bolivar" to a cryptocurrency that can't be traded. The country's risky situation reflected on the devastating situation and it is likely to be worsening. The Venezuelan citizens inability to have the required food supply due to the high inflation urge the government to subsidize food as well they stand in queue for long hours to get necessities such as oil (Tarver, 2018). Also medical supplies are rare and this created a black market with very high prices. In 2016, the infant mortality raised to 30% and malaria cases have been reported with 76%. This led to a weaker medical situation. People who undergo chemotherapy, need emergency surgeries, or even have a sinus infection are at risk due to the crisis of not receiving acceptable health-care (Acosta, 2019).

Implications on the neighboring countries

Neighboring countries affected differently for Brazil, in particular, recent domestic political and economic crises have reduced their influence in Venezuela. Since 2013, the year in which Maduro assumed the Venezuelan presidency after Chogo Chavez passed away, successive Brazilian governments, depleted by the economic recession and then massive corruption in the country, have been able to reduce the impact of Brazil's foreign policy, leaving the region without leadership. A situation that allow the crisis in Venezuela to worsen.

Today, South America is paying the price for its terrible failure in Venezuela. After two decades in which the continent's governments tried to reduce the influence of outside players, the four most shape influential countries in Venezuela now, respectively, are the United States, China, Russia and Cuba. Other countries in the region have only limited capacity to events in Caracas. This is a particular concern because migration from Venezuela already places a burden on its neighbors such as Brazil and Colombia. The continuation or intensification of the crisis will have indirect effects for years to come. Despite recent political changes - evidenced by the election of President Jair Paulsonaro in Brazil - and renewed determination in most parts of the region to address the Venezuelan crisis, South American governments will have little say in resolving this crisis.

Security experts in Colombia are concerned with required resources to face the continuous massive refugees movement. Colombia agrees to host US forces, but no countries in the region are willing to accept direct intervention. For example, it seems that Paulsonaro is keen to support the United States rhetorically, but this is unlikely to amount to practical assistance. The Brazilian military will not agree to put its forces on the ground in Venezuela, even those pro-US forces in the region, will see this as a dangerous precedent. In fact, it is unlikely that governments will go beyond diplomatic measures, such as recognition of Khan Guaido, which he has already adopted. In case Maduro's government collapses, subsequent events in Caracas will be formed in Washington and Beijing, thanks to Venezuela's recent economic importance. The relations between Moscow and Havana with Venezuela are largely political and shrinking if Maduro left office. Maduro's successor will need to sign huge deals with both Western and Chinese development banks to begin rebuilding the country - a painful process that is likely to take decades. Indeed, many of Venezuela's problems, including the lack of social equality and dependence on oil revenues, are ahead of Chávez's rise, and no future government will be able to solve them easily. Recovery is likely to take anything similar to pre-crisis levels for years, requiring constant attention and assistance from US and Chinese leaders.

Argentina, Brazil, Chile and other countries in the region should use the collapse of Maduro as an opportunity to deepen cooperation between their armed forces. This can be done through existing institutions such as the South American Defense Council, which should include, among other initiatives, joint military exercises, joint missions to deal with natural disasters and joint participation in United Nations peacekeeping operations. The goal must be to increase peer pressure on the Venezuelan army - which will lose the transition to democracy, given the privileges it has accumulated under Maduro - to stay inside its barracks under any future leader.

Although this cooperation will have only limited and indirect impact on the Venezuelan army, in future crises of this kind, neighboring countries will be offered an additional channel of dialogue and coordination - a necessity if South American governments want to influence what is happening in the yard.

Conclusion

The crisis in Venezuela is escalating day after day tailoring a tragedy with severe implications. A tragedy that many thought it is because of the dependence of oil but I think it is referred to the communist economic system that didn't change itself and relaxed on a rich resource creating more revenue. I thought that in the coming future there are many possible scenarios that can may exist depending on the complexity of the situation. These scenarios can range in the following five situations. First, the probability for Maduro will continue standing upfront in the international pressure is very weak. Because he is suffering from a siege, where he will pretend that he wants to negotiate and find a compromising solution with Guaido, and will work above all to gain time. Especially as he founded about 50,000 armed groups throughout the country with the task of "defending the Bolivarian revolution", and without Maduro these groups will not exist. "

Second, the Venezuelan army could lead a coup against Maduro and take over by power. Third, the military can organize a military coup in favor of the opposition. Fourth, it could open the door to negotiations between Maduro, the Venezuelan opposition and the

United States, on the other hand, with the possibility of Cuba being lost as a result of this crisis, which means that if Maduro falls, it could also collapse Cuba. Fifthly, we can also see an American military intervention in Venezuela, where Washington can be supported by Colombia and Brazil, if it does so and this option is widely accepted by the researcher. While other opposes it because the history of the previous United States intervention in the Latin American countries lead to catastrophic consequences. Also the opposition will lose in this case the citizen acceptance. Only American troops can intervene in case of attack on the United States embassies. But the best scenario is to allow for political negotiation and accept that Guido could be a temporary president till an early election finalizes the situation. By this situation they can overcome any foreign intervention and the civil war. If this doesn't work out then the country will face huge uncontrollable conflicts especially if the army divided between supporting to the current president and opponent to him. The possibility of civil war will push for huge migration more than the Syrian war. The collapse of Venezuela's stability will reflect on catastrophic consequences on the whole continent, for example the number of migrants to the United States will increase and one wall will not be enough to stop migrants to the United States. The delay in overcoming the political instability situation will open the door for an external intervention. This situation historically led to catastrophic economic consequences in Latin America. Nevertheless, the best scenario is to allow political negotiations to overcome any foreign interventions and the civil war. If this doesn't work out then the country will face huge uncontrollable conflicts. The collapse of Venezuela's stability will reflect on catastrophic consequences on the whole continent, for example the number of migrants will increase and one wall will not be enough to stop migrants from moving and the worst of the crisis is yet to come.

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Institutional Review Board Statement: Ethical review and approval were waived for this study, due to that the research does not deal with vulnerable groups or sensitive issues.

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