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SPOTLIGHT

Venezuela:

What are the most effective US sanctions?

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What US sanctions would be most effective in maximizing pressure on President Maduro's government while minimizing repercussions for the Venezuelan people?

With the opening of a constituent assembly on August 4, Venezuela has entered a critical new period of upheaval. The July 30 vote to elect assembly members went forward despite the illegitimacy of the vote and massive protests; government-reported results were widely deemed to be inflated. This new 545-member body is set to eliminate the last remaining democratic checks that exist.

Prior to the July vote, President Donald Trump condemned Venezuelan President Nicolás Maduro as an aspiring "dictator" and threatened "strong and swift economic action" if constituent assembly elections moved forward. President Maduro was not fazed. On July 31, the United States imposed financial sanctions on President Maduro himself, who became the fourth sitting head of state currently under sanction, joining Syria's Bashar al-Assad, Zimbabwe's Robert Mugabe, and North Korea's Kim Jong-Un. These recent sanctions are likely to mark the start of an incremental enactment of harsher economic penalties aimed at compelling Maduro to change paths.

The Adrienne Arsht Latin America Center and Global Energy Center assess options for the United States in considering a ratcheting up of sanctions.

Additional Targeted US Sanctions

To date, US efforts to pressure President Maduro's government to respect civil and political rights have focused on individuals. In March 2015, President Barack Obama issued Executive Order 13692 (EO 13692)—renewed the following year—which adhered to and expanded on the Venezuela Defense of Human Rights and Civil Society Act of 2014. The order declared a national emergency based on the threat that the situation in Venezuela posed to the United States and imposed sanctions on seven government officials following the erosion of human rights and crackdown on the political opposition. Those sanctions were specific to individuals, blocking property held that was subject to US jurisdiction, and targeted neither the Venezuelan economy nor its people.

In February 2017, the US Department of the Treasury's Office of Foreign Assets Control (OFAC) sanctioned Venezuelan Vice President Tareck El Aissami and an associate based on evidence of their prominent role in international drug trafficking. In May 2017, the Trump administration used EO 13692 to impose individual sanctions on eight members of the Venezuelan Supreme Court for annulling the opposition-led and democratically-elected National Assembly, and in July, this executive order was used to sanction thirteen government officials accused of undermining democracy, corruption, and leading acts of violence against protestors.

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Given the deep rupture of the democratic order in Venezuela and the likelihood of further anti-democratic actions including government-supported acts of violence, what US sanctions would be most effective in maximizing pressure on President Maduro's government while minimizing repercussions for the Venezuelan people?

At least five options exist for new US sanctions—scaled from least to most severe:

1. Designation of Additional Officials and Related Entities

OFAC could use the existing EO 13692 to designate additional current or former officials of the Venezuelan government or to designate entities close to the administration that are providing support or acting on behalf of those officials. These sanctions would block all property belonging to those individuals and entities subject to US jurisdiction and prohibit US persons from engaging in transactions with them. The designations could be designed to put additional pressure on President Maduro and his inner circle, but like the existing sanctions on Maduro and his officials, these designations would have little immediate impact if the new individuals and entities do not have property in the United States or in a US bank. This is why it is critical that other countries follow suit by imposing the same individual sanctions as Panama, Mexico, and Colombia did recently.

It appears very likely that the Trump administration will continue adding individuals to the sanction list. Some of these individuals may be executives of Petróleos de Venezuela, S.A. (PDVSA), the state-owned oil company, as in the case of the current chief financial officer Simon Zerpa, who was recently sanctioned. This and similar measures could affect the regular functioning of the oil company, since there would be restrictions on these individuals' involvement in PDVSA transactions with US entities. In addition to individuals, some state entities like the Venezuelan armed forces or other non-oil state entities could be designated, affecting some of the regular operations of the Venezuelan government.

2. Limit Access to Financing for PDVSA

The United States, using a new executive order, could impose limitations on US persons dealing in new debt, including buying new bonds or providing credit to PDVSA and other major state-owned entities. Similar to the "sectoral" sanctions imposed on major Russian companies in 2014, these sanctions would limit PDVSA's access to financing and require US companies to collect on credit more quickly. The limits on financing could accelerate PDVSA's liquidity problems. Unlike the Russia sanctions, which were coordinated with the EU, however, unilateral US sanctions would not prevent PDVSA from seeking financing from European institutions. This highlights the importance of coordinating sanction decisions and gaining broad support from the international community.

Nonetheless, sanctions limiting new financing to PDVSA, even if enacted unilaterally by the US, would undoubtedly increase the likelihood of debt default by PDVSA (and possibly also the Venezuelan government). Even without any sanctions, the company is already facing severe cash-flow problems and needs to pay or refinance approximately $4 billion owed both by PDVSA and the Venezuelan Treasury before the end of 2017. Limiting access to US financial markets would increase the cost and decrease the availability of financing elsewhere, with the result that PDVSA is less likely to be able to make the payments. Still, the government has been avoiding default at all costs to prevent seizure of PDVSA's foreign assets by bondholders or any attempts to capture corporate revenue flows.

3. Ban US Exports to Venezuela

The Trump administration could issue a new executive order to prohibit the export of certain goods and services to Venezuela, although this would almost certainly have a severe and immediate impact on the Venezuelan people. The sanctions could be focused to more specifically target the oil and refined products exported from the United States, on which Venezuela currently relies.

Venezuela imports close to 200 thousand barrels per day (tbpd) of refined oil products and light crude, of which 110 to 120 tbpd come from the United States—an amount that has been increasing. About half of these imports are used for Venezuela's domestic market consumption, and the rest are used as a diluting agent for extra-heavy oil, which is then re-exported, primarily back to the United States. A US export ban would increase the cost of Venezuela's imports due to the resulting need to go to suppliers further away such as in Europe and Asia. The company would probably have to resort to increasing the use of swaps of heavy oil for refined products and light oil with Russian, Chinese, and Indian companies. This would reduce the margins of extra-heavy oil exports for Venezuela, possibly making the exports too costly with effects on up to 200 to 250 tbpd of PDVSA's extra-heavy crude exports.

President Trump could choose to phase-in the export ban so that the impact on Venezuela would not be immediate; however, this would give President Maduro time to change source countries during the phase-in period. President Trump could also choose to limit the export of oil field services from the United States. The prohibition on the export of services would gradually impact oil production and would threaten Venezuela's ability to maintain its fields for long-term production, making it harder to recover oil production in the future.

An oil export ban would have limited effects on the United States since the amount of light oil involved is minimal and the refined products can find other markets. The service ban could have a more significant impact on business activity and employment at a time when the sector has been in a downturn.

4. Ban US oil imports from Venezuela

The United States, through a new executive order, could prohibit the import of oil from Venezuela. The sanctions, prohibiting US refiners from importing and using Venezuelan crude, could be imposed either immediately or after a phase-in period to avoid sudden disruption to shipments. These sanctions would prevent PDVSA from selling its oil in the United States, but would not necessarily prevent PDVSA from accessing the US financial system or receiving payments for previous shipments.

A ban on US imports of Venezuelan crude would have a much more significant impact than the previous three options. The US imports around 750 tbpd of mostly heavy oil from Venezuela. CITGO, PDVSA's affiliate in the US, owns two refineries on the US Gulf Coast that process approximately 550 tbpd. About a third of that oil comes from Venezuela, but the amount has been declining due to the difficulties of PDVSA honoring supply contracts with other US refiners like Valero and Phillips 66. To operate under these sanctions, PDVSA would have to try to reroute those exports to deep conversion refineries in Asia, which can process heavy oil. But it would take time to find a market for the full amount, and it would require PDVSA to offer a significant discount, with the additional add-on of higher transportation costs. In fact, PDVSA does not have enough capacity in its terminals to export all that oil in the super-tankers that can efficiently transport crude to Asia. As a result, even if PDVSA can sell all the oil, PDVSA's margins would suffer significantly. Venezuela depends on oil exports for more than 92 percent of its foreign exchange and more than 50 percent of fiscal revenues, therefore a reduction in oil margins would have significant macroeconomic implications.

A Venezuelan oil import ban would be harder to manage for the US refining sector. Venezuela is the third largest crude supplier to the United States, largely of heavy oil. Some of this crude could be substituted by other sources in the Americas including from Canada, Mexico, and Colombia. However, due to the lack of infrastructure, limitations exist in getting more Canadian oil to the Gulf Coast. Some additional heavy oil would have to come from the Middle East at a higher cost. This would reduce refining margins and possibly increase US gasoline prices. Still, inventories are above average levels, and the Trump administration has announced that it is considering selling oil from the Strategic Petroleum Reserve, which would partially dampen the effects.

5. Designate PDVSA and Other State-Owned Enterprises

One of the most severe options for the United States would be to add PDVSA to the List of Specially Designated Nationals and Blocked Persons (SDN List). The United States could accomplish this through a new executive order or potentially through EO 13692, if there was a finding by OFAC that PDVSA was acting for or on behalf of designated Venezuelan officials. The designation of PDVSA would immediately block PDVSA's funds and property interests subject to US jurisdiction, including any funds owed to PDVSA by US companies. The sanction would prevent PDVSA from receiving financing from or engaging in any transaction with a US financial institution, or from engaging in transactions in dollars that would need to be cleared through a US financial institution. Moreover, the designation would likely limit PDVSA's access to the international financial system because many major international banks use OFAC's SDN List to screen transactions to limit legal and reputational risk.

The designation of PDVSA as an SDN List entity with full financial sanctions would have an effect equivalent or worse than the combined effect of all the other sanctions mentioned. Both an export and an import ban would surely cause PDVSA and Venezuela to default. The consequences of an SDN designation, however, could be devastating for the Venezuelan economy. Imports would significantly contract, compounding the already significant decline of nearly 75 percent since 2012; a similar reduction in the consumption of basic goods would likely follow. The economy could end up mired in the worst depression in Latin America's recorded economic history. The consequences would be dire for the citizens of Venezuela and would likely make the refugee and humanitarian crises even more profound. It is feasible that similar effects would occur at a slower pace, without the imposition of sanctions, if the regime continues to mismanage the economy. Similarly, the effects on the US economy would be more pronounced than with all the other sanctions combined.

Policy Recommendations:

What are the best or most effective options?

The following principles should be applied when assessing sanctions options:

- Impose or tighten sanctions gradually, from softer to harsher, with clear changes in behavior attached to the implementation or lifting of sanctions.
- Outline a clear narrative establishing why the Maduro regime is culpable and must comply with domestic and international demands to upheld democracy and the rule of law.
- Extend the use of individual sanctions, and potentially some entity-focused sanctions, to fracture the regime soft-liners from the hard-liners with nothing to lose.
- Strive for multilateralism at every stage as European and Latin American cooperation and support of any measures taken against the Venezuelan government would increase their potential efficacy.
- Offer an accompanying humanitarian aid package to try to mitigate the repercussions for the Venezuelan people.
- Limit the unintended consequences on US businesses and the US economy.

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