Latin American and Caribbean Center
FLORIDA INTERNATIONAL UNIVERSITY

Assessing the Risks Associated with the Possible End of Petrocaribe Oil Subsidies

Harold Trinkunas, Ph.D.
Senior Fellow
Brookings Institute

Delivered as part of the LACC/ARC/U.S. Southern Command Policy Roundtable Series
June 16, 2014
Miami, Florida

Background

Petrocaribe provides subsidized financing for the purchase of Venezuelan oil by its 18 member states in Central America and the Caribbean. This agreement allows members states to defer payment for between 40 and 60% of their oil imports from Venezuela through 25-year loans at interest rates between 1-2% whenever the world price of oil exceeds $50/barrel. With the exception of a brief period in 2009, the price of oil has exceeded this level since 2005.[1] The member countries of Petrocaribe have among the lowest per capita GDPs in the Americas and the highest costs for energy. If we keep in mind that the price of oil has risen from $11.42 per barrel in December 1998 to nearly $100 per barrel in May 2014, Petrocaribe has had a significant impact on helping member countries address the rising costs of energy.

Yet this assistance has come at a cost. Member countries have accumulated growing levels of debt to PDVSA, which is as high as 50% of GDP in some cases.[2] By some estimates, one third of the foreign debt of Caribbean states will be owed to Venezuela by 2015. The countries most dependent on Venezuela for subsidized financing for oil imports include Cuba, Nicaragua, Haiti and Jamaica. In these cases, debt owed to Venezuela accounts for between 8 and 16 percent of GDP.[3] It has also had a political cost insofar as Petrocaribe member countries must be sensitive to Venezuela's political and ideological preferences, most recently revealed by their unanimous support in the April 2014 vote at the OAS addressing the political crisis in Venezuela.

The growing political and economic crisis in Venezuela highlights the economic, social, political and security risks for Petrocaribe countries of continued dependence on a single source of subsidized energy. Venezuela faces a serious shortfall in government revenues at a time when 42% of its oil production is sold at below-market prices, not only to Petrocaribe, but to members of the *Acuerdo de Cooperación Energética de Caracas* (Uruguay, Paraguay and Bolivia), and to Argentina and China. Reducing the amount of oil production sold at below-market rates by constraining supplies to Petrocaribe is a logical next step the Venezuelan government can take to remedy the revenue component of its domestic crisis. This is most likely to happen gradually, although there is a possibility that the crisis in Venezuela may become so severe as to produce dramatic economic reforms or regime transition.[4]

Economic Risks

The tapering or even collapse of the supply of oil provided by Petrocaribe would be economically serious, but not catastrophic, for member states. Alternative supplies of oil and refined products are readily available on world markets, and in particular, United States Gulf Coast refineries are exporting increasing amounts of the refined products most in demand among

---

[1] "Cushing, OK WTI Spot Price FOB," U.S. Energy Information Administration, last modified March 12, 2014, http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RWTC&f=D. Sistema Económico Latinoamérica y el Caribe, "Acuerdo de Cooperación Energética PETROCARIBE," SP/Di N° 3-13 , Caracas, Venezuela, Julio 2013.

[2] Francine Jácome, *Petrocaribe: The Current Phase of Venezuela's Oil Diplomacy in the Carribean*, Policy Paper, Programa de Cooperación En Seguridad Regional (Friedrich Ebert Stiftung, 2011), http://library.fes.de/pdf-files/bueros/la-seguridad/08723.pdf.

[3] RBC Financial (Caribbean) Limited, "PetroCaribe: A Handout, Not a Hand-Up, Which May Soon Run out" (presented at the 5th Biennial International Business, Banking and Finance Conference, UWI St. Augustine, Trinidad and Tobago, May 2013).

[4] Ted Piccone and Harold Trinkunas, "Cuba and Venezuela: The End of an Alliance?" Policy Brief, The Brookings Institution, June 2014.

the small island states in the Caribbean. While a sudden end would pose logistical challenges, the Caribbean island states and their partners in the region would be motivated to find some way to ensure that oil products continued to flow, even if at a higher cost. It is these higher costs that would have long-term impact on the countries reliant on Venezuelan subsidized oil. For example, it is estimated that Cuba, the most dependent of Venezuela's partners, would suffer an aggregate recession of 4.4 to 7% of GDP over several years if subsidized trade were to collapse.[5] The economic risks are not necessarily due to the short-term loss of supply but rather economic recession, reduced consumption, and lack of competitiveness among the Petrocaribe states.

The most serious economic risk is that the end of Petrocaribe would be accompanied by a Venezuelan demand for debt repayment in the near term. None of the Petrocaribe states would be able to adequately manage such a demand. For the highest risk states, the publicly acknowledged debt nearly equals or exceeds foreign currency reserves. According to RBC Caribbean calculations of cumulative deferred payments to Venezuela, the amounts might exceed foreign reserves by 6 times in the case of Jamaica and Dominican Republic.[6] Even though Petrocaribe makes a provision for in-kind repayment by member states, none of the members has exports valuable enough to seriously reduce the balance on the debt they have accumulated.

Social Risks

The social risks of a Petrocaribe collapse would mostly be related to the economic adjustment that would ensue. In many Petrocaribe states, protests over the cost of energy and over energy shortages would be expected in the short-term, particularly in those countries most dependent on refined oil products for electricity. In the long run, consequences are likely to include increased migration to North America by those in search of a better standard of living. Haiti is a special case in that reduced assistance from Venezuela would further delay recovery and reconstruction, as well as prompt additional migration across the already tense Haitian-Dominican border. In those countries where illicit economies are already present, such as Jamaica, Haiti and the Dominican Republic, the relative hold of criminal organizations on the population is likely to increase. Societal participation in the illicit economies of the region will become a more attractive alternative, especially if North American countries also impose further restrictions on migration.

Political Risks

Most, but not all, Petrocaribe states are consolidated democracies, so political risks to the region would be manageable. While the present ruling parties might suffer at the polls, democratic governance is unlikely to be seriously threatened. There would be more uncertainty associated with the fragile or less democratic members of Petrocaribe. The Haitian government already faces severe challenges to its effectiveness, and the loss of assistance from Venezuela would decrease its ability to address popular demands. In Nicaragua, President Daniel Ortega might see his ambitions for repeated re-election curtailed by the loss of substantial Venezuelan

---

[5] Pavel Vidal Alejandro, *Proyecciones Macroeconómicas de Una Cuba Sin Venezuela*, Desde La Isla (Cuba Study Group, 2014), www.desdelaisla.org.

[6] RBC Financial (Caribbean) Limited. "PetroCaribe: A Handout, Not a Hand-Up, Which May Soon Run Out." presented at the 5th Biennial International Business, Banking and Finance Conference, UWI St. Augustine, Trinidad and Tobago, May 2013.

support. In the particular case of Cuba, the political consequences depend largely on the speed at which Venezuelan assistance would be withdrawn. A gradual tapering of aid will likely strengthen the hand of economic reformers in Cuba, who already are planning to shift 1.5 million public employees to the private sector, either via self-employment (*cuentapropistas*) or cooperatives.[7] A sudden collapse of assistance might provoke a backlash by hardliners who fear threats to the regime and desire increased social control. However, even in Cuba the political risk is relatively low. The Cuban regime survived the collapse of Soviet assistance after 1991. By comparison with that period, Cuba's economy is now half as dependent on Venezuela, and its economy is considerably more diversified.[8]

Security Risks

The security risks associated with an end to Petrocaribe subsidies relate to the possible expansion of organized crime. As the legal economy weakens, the attractiveness of the illicit economy grows. The degree of risk is influenced by the degree of dependence on subsidized financing for oil imports but mitigated by the professionalism of local security forces in each particular member state. Some of the countries most dependent on Petrocaribe – Nicaragua and Cuba – have relatively professional security forces, strong police intelligence networks, and limited presence of illicit armed actors that could take advantage of economic weakness. However, other countries that are highly dependent on Petrocaribe, such as Haiti and Jamaica, have flourishing illicit economies and well established armed non-state actors that already pose a challenge to state security forces. There is also a long-term risk that, as an economic recession impacts government spending on security, some countries will become more attractive to transnational criminal organizations looking for new spaces in which to operate, both as markets and as way stations in the international illicit economy. This produces a long-term risk to the region of the proliferation of ungoverned spaces where armed non-state actors can conduct business and, by providing an alternative livelihood and form of governance, secure popular support.[9]

Mitigating Factors

The risks associated with Petrocaribe's collapse are substantially correlated with geography. Central America is better positioned to assure itself of energy supplies at a reasonable cost in the absence of Petrocaribe. Its economies are larger and more diversified, and therefore depend less on subsidies provided by Venezuela. They already use alternative sources of energy supply, particularly hydropower. With modest additional investment in interconnections to Mexico and Colombia, Central America would be able to integrate its regional electricity grid, known as SIEPAC, into South and North America. Central America's wider array of options is also revealed in the reluctance of many regional states to join Petrocaribe. The small Caribbean island nations have historically had fewer options when it comes to power generation. Alternatives, such as hydropower, have been in short supply and

---

[7] Richard Feinberg, "Soft Landing in Cuba? Emerging Entrepreneurs and Middles Classes," Report, The Brookings Institution, Washington D.C., November 2013.

[8] Ted Piccone and Harold Trinkunas, "The Cuba-Venezuela Alliance: The Beginning of the End?" (The Brookings Institution, June 2014).

[9] Peter Phillips, "The Security Threat in the Contemporary Caribbean: Challenges and Responses," *Caribbean Integration From Crisis to Transformation and Repositioning*, 2012, 351.

economies of scale are more difficult to achieve in these small countries.[10] However, Central America is not fully exempt from the risks associated with the end of Petrocaribe, as it sits astride major illicit trafficking routes.

Economic, social, political and security risks are also strongly tied to the speed at which Petrocaribe might come to an end. A sudden collapse would clearly have much more negative consequences for the member states. But there are strong reasons for Venezuela to delay the demise of Petrocaribe, and to ensure that it occurs gradually. The first is that Venezuela highly values the political support it receives from Petrocaribe nations in international forums such as the Organization of American States. It is likely to hold out the prospects of Petrocaribe's persistence as long as possible to ensure continued cooperation from its partners. Secondly, Petrocaribe's demise would be a highly visible signal of the weakness of Venezuela's Bolivarian Revolution, one that the regime would be loath to reveal. Instead, Venezuela is likely to gradually manage the level of subsidies downward, preserving support for favored allies such as Cuba and Nicaragua while allowing the quotas for other member states to drift lowers.

Policy Recommendations

In the long run, Venezuela's role in Petrocaribe is unsustainable.[11] Fortunately, there are numerous alternatives for power generation in Central America and the Caribbean – natural gas, hydro, geothermal, wind, and solar – that are increasingly cost competitive with oil-generated power.[12] However, the low credit worthiness of a number of Petrocaribe states is an obstacle to the financing needed for the necessary construction, and private sector energy producers are deterred by the great variation in regulations and laws across the 18 jurisdictions of the member states.

With this in mind, U.S. Vice-President Joe Biden recently announced a new U.S. initiative to transform the Caribbean's energy matrix with support from the U.S. Overseas Private Investment Corporation (OPIC). This effort is designed to promote new private investment in energy generation and regulatory reforms in the region, as well as foster collaboration among the private and non-governmental organizations dedicated to transforming the Caribbean's energy matrix.[13]

While this new initiative is undoubtedly a welcomed step in the right direction to further prepare for the possible consequences of Petrocaribe's end, the United States should:

1. Appoint a Presidential Special Envoy for Central America and the Caribbean. It will be important to have a point person in the U.S. government working with the member states

[10] Harold Trinkunas, *Changing Energy Dynamics in the Western Hemisphere: Impacts on Central America and the Caribbean*, Latin America Initiative Policy Brief (Washington DC: Brookings Institution, 2014), http://www.brookings.edu/~/media/research/files/papers/2014/04/04-energy-central-america-trinkunas/changing-energy-dynamics.pdf.

[11] Gabriel Di Bella, Rafael Romeu, and Andy Wolfe, "The Venezuela Risks for Petrocaribe and ALBA Countries," in *Cuba in Transition*, vol. 23 (presented at the Twenty-Third Annual Meeting of the Association for the Study of the Cuban Economy, Miami, FL, 2013), http://www.ascecuba.org/publications/proceedings/volume23/pdfs/romeuvene.pdf.

[12] Ibid.

[13] White House Office of the Vice President, "Fact Sheet: Promoting Energy Security in the Caribbean," June 19, 2014.

of Petrocaribe to maintain the momentum of the initiative announced by Vice-President Biden. He/she should also lead diplomatic efforts to bring together governments with multilateral organizations and private sector energy providers to prepare contingency plans for a smooth transition to a post-Petrocaribe environment. In addition, although Central America has made considerably more progress than the Caribbean on reforming its energy matrix, such an envoy could also explore the possibility of extending the recently announced initiative beyond the Caribbean to other interested countries in Central America.

2. Intensify collaboration with countries that have high levels of dependence on Petrocaribe and pre-existing presence of transnational criminal organizations and/or illicit economies. The U.S. Southern Command should discuss security risks associated with the end of subsidized oil supplies with regional partners, and as requested, make assistance available to regional security forces to improve their capacity to support the rule of law and prevent the formation of ungoverned spaces.