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Caracas

View of Caracas, Venezuela. Source: Stephen Downes (CC), Flickr.com.

Chinese Finance in Venezuela: A Non-Interventionist Lender's Trap

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Focusing on Venezuela, China's largest borrower, this essay explores how Beijing's non-interventionist principles create important limitations on its foreign lending practices. In the case of Venezuela, the governance of commodity-backed loans has ingrained mechanisms that allowed mismanagement and corruption to grow, undermining the development goals that inspired them. China's non-interventionism has limited its ability to successfully implement the projects it financed. Rather than a 'debt trap', Chinese engagements in Venezuela proved to be a lender's trap for China and a rent trap for Venezuela, in which neither party achieved what it wanted.

From the outbreak of the Covid-19 pandemic to the Russian invasion of Ukraine in February 2022, the global economy is currently facing a multifaceted crisis and countries in the Global South are experiencing economic contractions and the inability to pay foreign debts. Unlike in previous debt crises, after years of providing loans at levels on par with traditional financial institutions and governments from the Global North, China is now a major global lender. In this role, China has privileged bilateral negotiations, rather than favouring multilateral negotiations, to solve repayment crises (Carmody et al. 2022: 204, 209). While the Chinese authorities have often followed the practices initiated by major lenders of the Paris Club, they have also emphasised resolving debt crises on a case-by-case basis (Acker et al. 2020). Moreover, they have adhered to the principle of non-interventionism in their dealings with sovereign partners (Bräutigam 2020)—that is, they have never imposed political conditions, especially those that involve changes to the governing principles or policymaking of loan recipients.

In economic terms, China has chosen to write off interest-free loans for highly indebted countries, mostly in sub-Saharan Africa. In many cases, the Chinese Government has preferred to lengthen repayment time frames through maturity and grace period extensions or reduced interest rates than through reducing principal amounts (Acker et al. 2020; Bon and Cheng 2021). The literature on China's lending suggests that if Chinese banks and state officials believe in the repayment capacity of the debtor, they are more likely to allow payment delays than write-offs and interest rate changes.

But in cases like Venezuela, where trust in the economy has been eroded due to almost a decade of political and social strife, Chinese state officials are likely to withdraw from partnerships and signal caution to private investors and banks.

China–Venezuela financial relations are paradigmatic of how China deals with countries in crisis. Venezuela is China's largest debtor globally (Gallagher and Myers 2022). However, after years of strategic relations marked by loans, dynamic investments, and increasing trade, a deep economic and political crisis in Venezuela starting in 2014 severely limited the country's repayment capacity (Bull and Rosales 2020; Puente and Rodríguez 2020). At the core of the China–Venezuela relationship are commodity-backed loans, which linked Venezuela's oil exports to China's development finance and infrastructure investment. This arrangement initially allowed Venezuela to diversify its oil exports away from an overreliance on the United States, while obtaining crucial development finance that was increasingly hard to find as the Venezuelan Government became critical of traditional lending institutions and antagonistic to US-led initiatives (Rosales 2018a). For China, Venezuela was an entry point to South American markets and a way to secure oil from the country with the largest crude deposits in the world.

Amid Venezuela's economic turmoil, China's practices were initially typical of its approach to countries in crisis. In response to the Covid-19 pandemic, Chinese authorities first extended the grace periods of loans. Moreover, China continued to allow reduced oil shipments as international sanctions significantly affected the capacity of Venezuela's oil industry to keep its production afloat. However, as the United States threatened to impose sanctions on third parties purchasing Venezuelan oil (and did sanction Russian state-owned enterprises for investing in Venezuelan oilfields), China became wary of US secondary sanctions. In 2015, China stopped new lending to Venezuela, withdrawing its commitment to a socialist country in crisis. At the time of writing in December 2022, the Chinese Government still actively discourages outward investment in Venezuela (Ferchen 2020; Kaplan and Penfold 2019; Rosales 2018a).

Due to the significance of Venezuela in China's overall lending portfolio, it is important to understand the unique conditions of this bilateral relationship and how they can shape, limit, and enhance China's future lending in the developing world. In part because of the amount of China's lending to Venezuela—which totalled more than 60 billion USD and was 43 per cent higher than that of the second-largest borrower, Angola, between 2000 and 2020 (Boston University Global Development Policy Center 2022)—some in the Venezuelan Government and media expected China to do more to help solve the country's crisis. However, China did not play the expected role as a lender of last resort for Venezuela, and withdrew its lending commitment. In addition, while Chinese authorities did not impose any political conditions, in keeping with their principle of non-interventionism, they continued to expect repayment of outstanding loans.

We contend that China's non-interventionist principles and practices have important limitations and that the governance of the commodity-backed loans will require substantive reform if China wants to secure repayment. For Venezuela, long-term

practices of rentierism and an authoritarian leadership that eroded oversight and accountability meant that the development goals that inspired its deals with China could not be achieved. Meanwhile, China's non-interventionism limits its ability to successfully implement the projects it finances. In this case, rather than a 'debt trap', the China–Venezuela Development Fund proved to be a lender's trap for China and a rent trap for Venezuela, in which neither party achieved what it wanted.

A Clash between Authoritarian Developmentalism and Socialist Rentierism

Venezuela is a long-time oil exporter and is often labelled a petro-state (Karl 1997). In essence, the country is heavily reliant on rents derived from the sale of oil on the international market. Petro-states dependent on resource rents generally have the capacity to 'decouple' from social constituencies, building linkages of patronage and clientelism with powerful cronies, which lead to poor democratic performance and low levels of development. Venezuela historically developed mechanisms to maximise rent appropriation by imposing royalties and taxes on international oil companies and its own national oil company, Petróleos de Venezuela (PDVSA). With the Bolivarian Revolution since President Hugo Chávez's rise to power in 1999, new mechanisms of rent appropriation have been established, mainly through the dramatic overvaluation of the currency (Dachevsky and Kornblihtt 2017; Purcell 2017). Between 2003 and 2012—a period of high oil prices—the Venezuelan State used the higher revenues from oil rents to import goods, which allowed it to contain social unrest in an otherwise conflict-prone political environment (Rosales 2016). However, from 2013, this model faced important challenges as the distortions provoked by price and exchange controls triggered inflation, scarcity, and large differentials between the legal exchange rate and the market rate (Rosales 2019). The Venezuelan Government increasingly resorted to monetisation of its fiscal deficit, while maintaining price and profit controls in most productive sectors, triggering hyperinflation that lasted until 2021. According to the Observatorio Venezolano de Finanzas (OVF), in 2018, Venezuelan inflation peaked at nearly 1.7 million per cent. By the end of 2021, inflation remained high (660 per cent), but price growth was en route to stabilisation and for 12 consecutive months price growth was below 50 per cent (OVF 2022).

China's commodity-backed loans were instrumental to Venezuela's radical rentier model of development. They allowed the Venezuelan Government to discretionarily spend resources outside traditional institutions of oversight and, more importantly, to use rents before oil extraction even occurred, as these were prepaid oil sales. Ideally, the government expected to use China's loans for development purposes and carry out large infrastructure projects that would support its industrial policies; however, due to

the way this cooperation mechanism was managed, as we will explain below, these goals were not met. Some infrastructure projects were built, especially those related to the housing program Misión Vivienda, which was a key promise of Chávez's re-election bid in 2012. Also, many Chinese imports were purchased to equip homes with new appliances. This was, however, a watered-down version of the more ambitious original plan to set up subsidiaries of the Chinese appliance company Haier in Venezuela to help satisfy the country's demand for these products. After years of investment, mostly by the Venezuelan Government, only one subsidiary was built, and it has produced a meagre output (Herrera 2021). Oil investment flowed into oil camps, especially joint ventures, but mismanagement and corruption led to widespread misuse of funds.

Among the most well-known infrastructure projects that have not been implemented is the 468-kilometre railway between Tinaco and Anaco in Venezuela's central plains, which had a total projected investment of more than 7 billion USD. Construction started in 2009 and was expected to last three years, but only one-third was completed (El Cooperante 2018; Segovia 2021b). According to several interviewees and as corroborated by media reports, agricultural projects commonly fell prey to bribery and corruption networks. For example, in 2010, the Venezuelan Government signed an agreement with Chinese state-owned CAMC Engineering Limited to develop rice-fields in Delta Amacuro, one of the poorest Venezuelan states (Berwirck 2019). CAMC agreed to develop several agricultural projects for about 3 billion USD, but none was completed. The company charged at least 100 million USD for one project, much of which ended up in the hands of contractors and intermediaries (who purportedly helped CAMC secure the contract) (Berwirck 2019). Importantly for the discussion that follows, these problems affected projects to be developed not only in Venezuela but also in China. The China–Venezuela Guangdong Petrochemical complex is a significant example. A plan to develop a 10-billion-USD refinery and petrochemical complex in southern China capable of refining 400,000 barrels a day of Venezuelan crude was agreed on in 2012 (CNPC would have a 60 per cent stake and PDVSA 40 per cent). It was to be inaugurated in 2014 but this was later rescheduled. PDVSA proved incapable of paying the 40 per cent equity investment in the operation and the partnership was dropped in 2018 (Chen 2019).

The Venezuelan example is also often brought up in discussions of China's lending practices as an example of Beijing's supposed 'debt-trap diplomacy'. However, while the popular discourse often accuses China of engaging in this activity—especially because of coverage in the media from the Global North—there is no evidence that China purposefully lent to Venezuela or other high-risk countries in the Global South with the intention of seizing their assets or managing their economies from Beijing. Several scholars have argued that, if anything, the Venezuelan case illustrates a 'lender's trap' that China has created for itself, in so far as lending to a poorly managed and increasingly corrupt economy means that the prospects of its loans being repaid are increasingly slim (Bräutigam 2020; Ferchen 2020).

The China–Venezuela relationship highlights important limitations on the principle of non-intervention, some of which are intrinsic. Power should not be understood as purely material forms of control, or the power of one actor to make another actor do something it would otherwise not do (Barnett and Duvall 2005). There are *structural* conditions in the relationships between actors in international politics that shape their interactions and behaviour. In this case, the constitution of a relationship based on the crucial exchange of commodities for finance—between a rentier socialist state (Rosales 2016) and a developmentalist authoritarian one (Gonzalez-Vicente 2022)—largely determined relations beyond the declared intention and principles espoused by state officials. As we shall see, in fact, Venezuelan officials created governance conditions that effectively turned Chinese loans from development financing to oil rent for discretionary use. In turn, China's trust in Venezuela's authoritarian leadership, and commitment to non-interventionism more broadly, influenced the outcome of these loans.

Senior Venezuelan officials involved in the crafting and management of Chinese loans highlighted in interviews with the authors the importance for both parties of negotiating a price formula for the oil used to repay the loans. This means conditions were already built into the loans through the terms of repayment. Similarly, all were explicit in the negotiations about China's non-interventionism in political terms: there were no conditions beyond prepaid oil deals. Rodrigo Cabezas, former Minister of Finance (in office 2007–08), recalled that there were some conditions regarding the use of loans to purchase goods from China. In an interview we conducted with him in June 2022, he said: 'China wrote conditions whereby it became the main supplier of certain goods—for example, vehicle parts, electronic devices, and other technology associated with the satellites that the government launched with Chinese support.' This arrangement was formalised in a 2010 agreement that led to the creation of the 'Grand Volume' fund, worth the equivalent of 20 billion USD. Half of this fund was denominated in US dollars and the other half in renminbi, which would be used to import massive amounts of Chinese goods, including home appliances for Venezuelan households, as explained above. Other financial conditions were related to the institutions in charge of disbursing the funds, including the use of Chinese banks. Both parties wanted to avoid using third countries and financial institutions to channel the deals and hence encourage the building of a financial infrastructure between the two partners. Another senior official, from the Venezuelan Economic and Social Development Bank (Banco de Desarrollo Económico y Social de Venezuela, BANDES), stated that China built in its financial conditions through other means, such as the promise of increased investments (or threat of their withdrawal), interest rates, and other associated commercial conditions that could improve the standing of Chinese companies in the long term.

More importantly, Venezuelan officials devised mechanisms to overcome institutional oversight of the use of Chinese funds. As former BANDES president Temir Porras Ponceleón said in an interview with the authors in 2020: 'The cooperation fund established a relationship that allowed the resources from oil sales to be used for

development projects without ever being recorded in PDVSA's budget.' With the China–Venezuela Development Fund, Venezuelan state officials managed to bypass the traditional budget and use Chinese loans as discretionary funds outside the purview of institutional accountability (Mora Contreras 2009, 2017). Moreover, these resources were directly linked to oil sales and treated as oil rents, which were obtained and spent before oil extraction occurred, thus undermining the rentier state's ability to reinvest in its own industry (Rosales 2016, 2019).

Recent interviews we conducted with former top state officials reveal that government ministers and policymakers in Venezuela saw the China–Venezuela Development Fund as a slush fund and leveraged the urgency of purported developmental projects to obtain approvals from institutions such as BANDES and the Venezuelan presidency with little regard for technical and economic feasibility. In many cases, the fund was used as a pool for private embezzlement (Guerrero 2021; Segovia 2021a).

These practices—derived from long-standing rentier tropes and new political dynamics of increasing authoritarianism—collided with Chinese authoritarian developmentalism. This collision brings about another, more practical limitation to non-interventionism. As Gonzalez-Vicente (2022: 5) has argued: '[T]he idea of modernization in the PRC [People's Republic of China] has become closely associated to measurable or legible outcomes at a national scale, [which also] favours specific forms of development intervention overseas.' This idea of modernisation was impossible to achieve, as it clashed with the political views of Venezuelan socialist leaders who saw national development as a feature more of rentier redistribution than of national modernisation. This conflict led to what Kaplan and Penfold (2019) have explained as China walking a tightrope between adhering to its foreign policy framework of non-intervention and attempting to collaborate in policymaking with the goal of suggesting reforms that would secure repayment and generate greater success in development projects. Several senior policymakers explained in interviews with the authors that, when consulted, Chinese officials offered extensive policy advice. They blamed intragovernmental disagreements and lack of trust between officials in Venezuela for not following up meaningfully on policy suggestions.

Faced with this dilemma, China progressively withdrew its support to Venezuela. Former senior Venezuelan officials and workers in the oil industry argue that Chinese partners were disappointed with the lack of consistency and continuity in Venezuela's bureaucracy, which are crucial for the state to carry out modernisation projects (Clark and Rosales 2022). Under Chávez's personalised political system, turnover in technical teams was high. A former senior official of BANDES explained how Chinese officials would attempt to follow up on projects for years only to witness the countless personnel changes among their Venezuelan counterparts. Chinese technical teams were disappointed with the 'day-to-day management disaster' in Venezuela's bureaucracy. This emphasis on management and state capacity in China's authoritarian developmentalism clashed with Venezuela's socialist rentierism.

The concern about management problems perceived by Venezuelan officials is reflected in Chinese government documents such as the country guide for investments in Venezuela of the Ministry of Commerce (MOFCOM 2021: 55), which underscores the 'frequent changes in Venezuelan decision-making levels'. MOFCOM's guide recognises that 'Chinese-funded enterprises carrying out economic and trade cooperation in Venezuela are facing the situation that the debts of the Venezuelan side cannot be repaid'. The guide also highlights the malaise of the country's economic mismanagement:

> The local inflation rate is very high, and as the currency depreciates rapidly, contractors' expenditure increases significantly, but it is difficult to obtain compensation from the price adjustment; supply of steel, cement, sand and gravel is insufficient while prices keep rising; projects often are forced to be suspended while waiting for supplies of materials. (MOFCOM 2021: 55)

Development Implications

China's non-interventionism is focused on political principles of state sovereignty and is narrowly concerned with a logic of economic results. It is much less concerned with institutional processes of democratic governance, even when these are part of the partner's constitutional mandate. These principles are squarely based on measurable outcomes rooted in a legacy of national modernisation. In Venezuela, non-interventionism translated into inaction that led to non-results for both countries' goals. At the outset of the expanding relationship, Venezuela was meant to become a platform for launching China's investments in South America and securing an abundant supply of energy—mostly crude oil—and other natural resources. For Venezuela, the relationship with China was expected to leverage its immense oil reserves for the benefit of its infrastructure and developmental projects, while diversifying the markets for its oil (Briceño-Ruiz and Molina Medina 2020; Rosales 2016). Yet, the design of the China–Venezuela Development Fund undermined oversight, accountability, and democracy. Even if neither country shows any affinity with liberal democracy, the lack of oversight and accountability undermined the prospect of achieving the goals of the strategic relationship. Furthermore, China's non-interventionism prevented it from taking the actions necessary to ensure the success of the projects it funded.

While oil remains an important link between the two countries, the inability to build refineries in China to process Venezuela's heavy crude and the collapse of Venezuela's oil industry have challenged the original ambitions of both. As mentioned above, PDVSA was unable to commit sufficient resources and expertise to the joint petrochemical and refinery complex in Guangdong Province. Other planned refineries also never materialised. With the imposition of US sanctions on Venezuelan oil starting in 2019,

the country sells its crude at a discount to Chinese companies, which in turn use Malaysian and other intermediaries to resell the oil on international markets (Bloomberg News 2022; Bradstock 2022). Inadvertently, Venezuelan government officials deepened some of the ills they wanted to solve by turning to China for support. Venezuelan resource nationalists long complained about the dynamics of an enclave economy, in which oil was used merely to satisfy global markets, providing little development for the country. In fact, back in the 1980s, the policy of internationalisation led by PDVSA had the goal of creating a network of refineries in the buyers' markets. The aim was to create a vertically integrated industry with upstream and downstream productive linkages (Rosales 2018b). A similar logic sought to build refineries in China and acquire large transport vessels to avoid oil companies suppressing prices and the resale of Venezuela's oil to other markets in the absence of refining capacity within China. The failure to realise the infrastructure and oil projects agreed on by the two countries entrenched Venezuela's disadvantaged position in relation to its partners. Venezuela sells oil at greater discounts and uses intermediaries with hefty fees for transport not only because of US-imposed sanctions, but also because of the lack of refining capacity in China for Venezuela's heavy crude. By selling its oil at a lower price, PDVSA is required to ship more crude oil to China because the total price has already been paid.

The Future of China's Lending in the Global South

Recent scholarship on China's presence in the Global South has highlighted a gradual shift in its engagement, with declining numbers of bilateral loans but increasing partnerships with traditional lenders (Carmody et al. 2022). A move to 'donorship' is also evident in the context of the Covid-19 pandemic and its aftermath, with China increasingly pledging grants as a donor to developing countries to help solve problems, instead of issuing intergovernmental loans. Similarly, China could be encouraging more loans from commercial banks, such as the Industrial and Commercial Bank of China and private outward investment (Gallagher and Myers 2022), rather than massive public loans from state-owned banks to national governments. These changes could help diversify the exposure of state institutions and contribute to sharing the responsibility for foreign lending with other actors and states. Yet, these changes are framed within continued support for development financing and encouragement of a different form of leadership on the world stage.

As Banik and Bull (2022) underscore, China's support for multilateralism strengthened during the Covid-19 pandemic, as well as a discursive rejection of unilateral action, sanctions, and bullying by traditional powers. Banik and Bull (2022) argue that this defence of multilateralism seeks to highlight the existing crisis of legitimacy encouraged in part by the actions of the United States and other traditional powers, while elevating

China's respect for state sovereignty and handling of strategic interests directly with state leaders. This is 'a form of multilateralism that places China in the lead while seeking to deepen bilateral alliances' (Banik and Bull 2022: 226). In a nutshell, while Chinese practices seem to fall into line with those of other lending institutions, China continues to favour dealing with debt restructuring on a case-by-case basis.

The dynamic engagement with Venezuela in the past two decades offers some key lessons for China's development financing. It is incumbent on the Chinese leadership and scholars of development to recognise that engagement in development financing is already a form of structural power that helps define and constrain global politics even without imposing explicit conditions. Crucially, acknowledging the structural power of large development lenders embedded in deeply rooted productive dynamics is fundamental for a more responsible lending outlook. While non-interventionism may be an important principle in China's foreign policy, it has limitations in the face of structural economic conditions, such as resource-dependent economies, and the very nature of 'win-win' cooperation agreements that are based on continuing and deepening such dependence. Non-interventionism does not necessarily lead to neutrality or cooperation; it can also be damning if it strengthens existing rentier practices that undermine accountability and oversight.

In fact, non-interventionism in the Venezuelan case allowed a predatory elite to use Chinese commodity-backed loans with little to no oversight, which undermined the rentier state by diverting funds that could have been reinvested in oilfields and infrastructure. For this reason, linking infrastructure and development projects to financing schemes dependent on volatile commodity markets should be done with caution, especially in countries with poor institutions and governance. The structural power of the lender in this case can lead to deepening of unsustainable rentier practices, even if unintentionally, by conditioning the relationship on commodity-backed loans. ●

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