Venezuela's Relationship with China:

Implications for the Chavez Regime and the Region

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As the People's Republic of China has expanded and deepened its relationship with Latin America in the last decade, Venezuela has emerged as one of its key allies in the region. China recognizes Venezuela as one of its four "Strategic Partners" in Latin America. With the help of a high-level bilateral working group and frequent trips by senior officials to include six trips by Venezuelan president Hugo Chavez to China, the relationship has produced over 300 bilateral agreements and more than 80 major projects,[1] including over $28 billion in loans and $16 billion in investment commitments. China-Venezuela bilateral trade exceeded $10 billion in 2009, and is likely to expand even more rapidly as Chinese petroleum companies ramp-up their operations extracting oil from Venezuela's Orinoco river basin, while simultaneously realizing major new projects to sell their consumer goods in the country.

This paper analyzes Venezuela's relationship with China and their implications from a strategic perspective. It begins with an analysis of the interests within both countries shaping the expanding two-way engagement. It finds strong, complimentary interests in both countries in expanding the relationship, accompanied by risks that each side must manage. Chinese benefits center around access to Venezuela's resources and markets, with the risk that ties to Venezuela will create problems with its more strategically important relationship with the United States. For Venezuela, the support of China prolongs the ability of the Chavez regime to fund revolutionary activities both domestically and in the region, yet creates a fundamentally unsustainable cycle of indebtedness and dependency. Moreover, should the Venezuelan regime of Hugo Chavez disintegrate into the future due to political and economic contradictions, the involvement of China and other Venezuelan allies such as Russia and China will make the accompanying crisis more complex, and more dangerous.

PRC Interests in Venezuela. It is difficult to conclude with confidence the true motivations of Chinese government officials and businessmen as they expand the web of bilateral agreements and projects with Venezuela. Nonetheless, an analysis of the pattern of these activities suggests three types of underlying interests: (1) Secure access to primary products, (2) expanded sales of Chinese products in strategically important higher value-added sectors, and (3) maintaining strategic political and economic spaces in the Americas in which China con operate. While the specific initiatives by the PRC toward Venezuela and its style of engagement is distinct from its relationship with other individual countries, the underlying motivations involved in that engagement are a specific expression of China's broader global interests.

In the resource domain, the PRC has principally focused on Venezuelan oil, although it has also demonstrated an interest in iron and other metals and minerals. According to an estimate by the U.S. Geological Survey, the tar sands of the Orinoco river basin of Venezuela may contain 1.5 trillion barrels of oil, of which some 513 billion barrels may be recoverable, making total Venezuela reserves larger than those of Saudi Arabia and several other nations of the Persian Gulf combined.[2] While the oil in Orinoco is expensive to extract and requires specialized refineries to process, the sheer quantities involved make it of interest to China, as that nation seeks to satisfy ever expanding demands for oil imports.

Although Chinese oil companies have been operating in the Maracaibo region of Venezuela since 1997 in the Caracoles and Intercampo oil fields,[3] and in the mature Zumano oilfield in Anzoategui since 2004,[4] the focus of Chinese activity in the future will be the Orinoco region. Bids by Chinese companies in the Orinoco belt, including interest in the Boyaca-3 block and commitment to develop the Junin-4 block represent a significant leap forward in the quantity of Chinese investment in the country, and the quantity of oil that the Chinese expect to extract. The Junin-4 block, in which Chinese companies have committed to invest

$16.3 billion,[5] is expected to produce 400,000 barrels of oil per day when it comes on line by 2016.[6] The Venezuelan oil company PdVSA expects to expand its exports to the PRC from 39,000 barrels per day in 2005, to 1 million barrels per day by 2012.[7]

As a compliment to direct Chinese investments in extracting Venezuelan oil for export to China, each of the three large loans that China has made to Venezuela since 2007 has been tied to future deliveries of Venezuelan oil. As of June 2010, the $8 billion that the PRC has contributed to the Venezuelan "Heavy Investment Fund" through China Development Bank was being repaid in oil shipments averaging 100,000 barrels per day.[8] Similarly, the $20 billion loan agreed upon in April 2010 is to be repaid over a period of 10 years with oil deliveries of an additional 100,000 barrels per day.[9]

While much attention is given to Chinese interest in Venezuelan oil, the PRC is also interested in the mineral deposits contained in the south of the country. In May 2010, for example, a Chinese fact-finding commission traveled to the south of the country to investigate iron and other mineral deposits there, evaluating the prospect of partnering with *Corporación Venezuela de Guayana* (CVG) to extract the minerals for export to China.[10]

In addition to secure access to primary products, the PRC also has an interest in the role of Venezuela in helping it to expand its position in Latin American markets in strategically important high value added sectors. The collapse of the Venezuelan manufacturing base due to the policies of the Chavez regime, in combination with Venezuela's suspension of imports from Colombia, has created an opportunity for Chinese companies to export products to fill the void. Due to the favorable political orientation of the Chavez regime toward commerce with the PRC, Chinese companies enjoy a relatively privileged position in the Venezuelan market, including promotion of their goods by the Venezuelan president, and the opportunity to form joint ventures to serve the Venezuelan market and ultimately export their goods to surrounding countries with the support of the Venezuelan government and access to currency at favorable exchange rates.

One example of the privileged access to the Venezuelan market that Chinese companies enjoy is the May 2010 agreement by which Venezuela will purchase 300,000 consumer appliances from the Chinese manufacturer Haier to be sold through Venezuelan state stores.[11] As part of the accord, Haier will also establish a production facility in Venezuela, in the Valley of Tuiy. The partnership with the Venezuelan government in this venture is likely to benefit Haier through access to currency at favorable exchange rates, and a position as a preferred supplier as Venezuela attempts to expand its non-oil exports and trade between countries of the Bolivarian Alliance of the Americas (ALBA).

In addition to Haier, both of the principal Chinese telecommunications firms, Huawei and ZTE, have set up similar joint ventures with the Venezuelan government, for manufacturing cell phones in the country. The first such phone, the "Vergatario," based on the ZTE model A933,[12] was introduced in May 2009 with promotion by Venezuelan president Hugo Chavez on his national radio show "Alo Presidente." Chavez, who used the phone to call his mother during the live program, proclaimed it to be "The best cell phone in the world."[13] Huawei and ZTE collectively plan to assemble up to four million units per year in their Venezuelan factories, selling the cell phones not only in Venezuela, but also in nearby countries.[14] In addition to high-level promotion, Chinese cell phones manufactured in Venezuela may also receive special tax benefits, to include import duties on foreign-manufactured competitors.[15] In introducing the Vergatario, Chavez indicated that one goal of the sales would be to fill domestic demand in order to limit the importation of cell phones.[16]

In the domain of military goods, as with commercial products, China's relationship with Venezuela helps Chinese companies to penetrate the region with higher value added products in strategically important sectors. Venezuela has committed to purchase 18 Chinese K-8 light-attack aircraft. The first flight of six K-8s was delivered in January 2010. Five months later, the Venezuelan government approved $82 million in funding for the second six aircraft.[17] The possibility of Venezuelan purchases of the more sophisticated Chinese L-15 fighter has also been discussed.[18]

Beyond aircraft, China has also sold Venezuela air defense radars,[19] and has constructed and launched a satellite for the country, including support for ground stations and the training of Venezuelan personnel in the PRC.[20] Venezuela's purchases of such military goods and technology are particularly important for China as it seeks to penetrate the Latin American market with its military goods. As China attempts to move beyond selling simple, low-value added items such as military clothing, it must overcome the lack of a track record that its goods have in Latin America. Venezuela's purchases of Chinese goods give the PRC the opportunity to prove the reliability of its goods and support infrastructures. The purchases also set an important precedent for Venezuela's allies. In 2009, for example, the Ecuadorian army began evaluating two Chinese radars of the type sold to Venezuela, and subsequently committed to purchase four.[21] Similarly following Venezuela's lead, Bolivia purchased 6 K-8 aircraft from the PRC,[22] and contracted with the Chinese company Great Wall Industries to develop and launch a communications satellite.[23]

Another strategic sector, the Chinese aircraft industry, has also benefited from the Venezuela-PRC relationship. In an agreement announced in May 2010, China will loan Venezuela $300 million to establish a new regional airline, "Línea Aérea Bolivariana Socialista." Under the terms of the joint venture between China International Holding Corporation (AVIC) and two Venezuelan companies (Sireca and Fundagrial), the aircraft and helicopters for the new airline will be purchased from Chinese companies using the loaned funds.[24]

Beyond consumer appliances, telecommunications, military goods, and aircraft, China and Venezuela continue to actively look for other sectors in which the PRC can sell its products into the Venezuelan market with the facilitation of the Venezuelan government. As of May 2010, for example, the China-Venezuela "Mixed Commission" was studying options for expanding sales of Chinese cars and other technology-intensive manufactured products Venezuela.[25]

In the service sector, Chinese firms have also been able to secure a number of lucrative work projects, including a $7 billion contract for China Railway Engineering for the construction of 1159 kilometers of railroad infrastructure,[26] and the award of contracts for 2,000 kilometers of new fiberoptic lines to the Chinese firm Huawei, out of 5,000 kilometers of such infrastructure contracted in the country.[27]

Apart from China's strategic economic interests in Venezuela's primary products and markets, the PRC also has an interest in the survival of Venezuela as a populist regime, to the extent that China's relationship with Venezuela does not undermine its more strategically important relationship with the United States. Although Chinese diplomacy actively seeks to avoid actions that appear to confront the United States, the anti-US Bolivarian project of the Chavez regime nonetheless benefits the PRC strategically. Politically, the efforts of Chavez to challenge the dominance of the US, neoliberal capitalism, and western companies in the region creates spaces in which the PRC can do business and build relationships. The inability of the US to consolidate a "Free-Trade Area of the Americas," for example, was arguably a permissive condition for China's pursuit of bilateral free trade agreements with Chile, Peru, and Costa Rica. Similarly nationalizations and the restructuring of the legal framework for businesses in Venezuela, as well as among its allies Ecuador and Bolivia, created important opportunities for Chinese companies in countries and sectors previously dominated by Western multinationals. The role of the PRC in multilateral institutions in the Americas such as the OAS and IADB has arguably also benefited from the ideological divides within these entities in the face of the Venezuela-led Bolivarian movement. But in addition to its effect on the US, Venezuelan radicalism also inhibits the consolidation of a Brazil-led "social democratic alternative" to the US in the region—an alternative consensus which could similarly preclude opportunities for the PRC.

While the PRC benefits from the impact of Venezuelan anti-US initiatives in the region, it is important to point out that China's relationship with the United States is vastly more important for it strategically than is its relationship with Venezuela. This is because the re-emergence of China as a great power in the current era of globalization depends on sustained access by the PRCs to Western markets and technology. It is reasonable to take Chinese leaders at their word when they declare that US is China's most important bilateral partner.[28] Such declarations to not imply that China views its interests as consistent with those of the United States, but rather, recognizes that the re-emergence of China in the current global context, is inextricably tied to its ability to cooperate with the US in matters of trade and technology, and avoid being perceived by the US as a significant near-term threat in the domain of security. In short, the PRC benefits from Venezuela's anti-US radicalism only insofar as it can avoid being associated with it, and thus being associated with the threat presented by Venezuela to US interests in the hemisphere.

As a final note from Chinas perspective, Venezuela represents a future source of leverage for the PRC with respect to its attempt to change the posture of those nations that currently recognize Taiwan. For the PRC, the issue of Taiwan is a critical internal security issue and a constant in its public diplomacy in the Americas. Eleven of the 23 nations in the world which continue to recognize Taiwan are found in Central America and the Caribbean. Many of these nations depend on Venezuela for their oil, which they receive under the favorable payment terms of Petrocaribe. Currently, an informal "truce" is in place between China and Taiwan, under which each nation has agreed to refrain from attempting to change the diplomatic posture of nations recognizing its opponent. Consistent with this truce, to date, the PRC has not publicly sought to use Venezuela's economic leverage to change the diplomatic posture of nations recognizing Taiwan. Nonetheless, the dependence on Venezuelan oil and credit by nations which recognize Taiwan represents an additional way in which Venezuela may be of value for the PRC in the future.

Venezuela's Interest in China. Venezuela's interest in the PRC compliments yet is distinct from, China's interest in Venezuela. At its core, trade, investment and technical support from China helps the Chavez regime to preserve its economic and political viability as it pursues a strategy in the region that defies the US and western economic institutions. Although the interest of Chavez in China is clearly is colored by ideology,[29] it is not driven by it.[30] The contribution of China to the viability of the Chavez regime has five elements: as a source of short-term funds, assistance in extracting Venezuela's commodities, in diversifying Venezuela's export markets, in generating symbolic projects for domestic consumption, and serving as an alternative supplier of second-tier military goods.

First, China has been an important source of liquidity for the Chavez regime as it has turned away from traditional partners and financial institutions, while elevating spending on programs both at home, and among its allies within the region. During the period from 2007-2009, for example, China Development Bank (CDB) contributed a total of $8 billion of capital into the Venezuelan Heavy Investment Fund. In April 2010, the two nations agreed upon a new loan of $20 billion, half of which would be paid in dollars, and half in Yuan.[31] According to the Venezuelan government, the fund would be used, in part, to support Venezuelan social programs. Part of the $10 billion portion of the loan to be paid in Yuan would be used by the Venezuelan government to purchase Chinese consumer goods, to include 300,000 consumer appliances from the Chinese company Haier, for sale in government stores *Corporación de Mercados Socialistas* (Comersos)[32] at low prices to help counteract inflationary pressures from the currency devaluation.[33]

Chinese companies are also playing an increasingly important role for Venezuela in extracting its commodities in order to generate a continuing source of export revenue. As the policies of the Venezuelan government have made traditional companies increasingly wary of doing business in the country, Venezuela has turned to the state companies of China and other allies for the physical investment and technical expertise that it requires to develop strategic sectors, such as the heavy oil in the Orinoco tar belt. In the oil industry, the diversion of resources of the Venezuelan national oil company PdVSA to support social spending has made the Chinese contributions ever more important.[34] In April 2010, the Venezuelan government awarded a contract to develop the Junin-4 block in Orinoco to China National Offshore Development Company (CNODC), in exchange for $900 million in upfront payments, and a commitment to invest $16.3 billion in developing the field, in conjunction with PdVSA.[35] Although the deal is the largest single investment commitment by a Chinese company in Venezuela to date, Chinese companies have been an important contributor to Venezuelan oil production since entering the Intercampo and Caracol fields in Maracaibo in 1997, to include operations by CNPC of 15 mature oil fields in the province of Anzoategui.[36]

Beyond the activities of the major companies, Chinese oil service firms have also played an important role in supporting the activities of PdVSA…particularly as the regime has increasingly come into conflict and began nationalizing western oil service companies. Chinese support to the Venezuelan oil industry also includes other forms of assistance as well. Since 2007 Chinese firms have sold oil drilling rigs to Venezuela, and have helped Venezuela to establish a production facility in Venezuela for assembling these rigs from Chinese components, with the first six such drills to be manufactured in Venezuela during 2010.[37] China is also engaged in joint ventures to build new tankers for the transport of Venezuelan crude, and the refinement of that petroleum in China. In January 2010, the Chinese government approved the initiation of construction on a $6 billion refinery for processing the special heavy Venezuelan crude in the Guangdong province of China, with construction expected to begin in November 2010.[38] Two other refineries have also been discussed.[39]

Chinese support in extracting Venezuelan resources not limited to the oil sector, however. As noted previously, as of May 2010, China was evaluating an investment in the extraction of Venezuelan iron ore in the south of the country, in conjunction with the *Corporación Venelozana de Guyana* (CVG).[40]

In addition to short term liquidity and assistance for extracting commodities, the PRC provides an alternative market for Venezuela's exports as the nation seeks to diversify away from sales to the United States. In the oil industry, for example, Venezuela's exports to the PRC have gone from almost zero in 2004 to 460,000 barrels per day currently, and are projected to reach one million barrels per day by 2012.[41] Sales to China, in combination with other emerging customers for Venezuelan crude such as India, represent important steps for Venezuela in lowering its dependence on the U.S. as the principal customer and refiner of the majority of its oil products.

The relationship with China also benefits Venezuela through a range of high-visibility manufacturing joint ventures that allow the Chavez regime to demonstrate progress to its people, even as its policies are eroding the country's manufacturing and business base. Such projects include cell phone manufacturing plants on Venezuelan soil by both of China's principal telecommunication firms: Huawei and ZTE. The first of these factories, representing a joint venture with the Chinese firm ZTE, was inaugurated in May 2009 in the state of Falcon, with much fanfare by President Chavez in his television show "Álo Presidente."[42] In May 2010, a second cell phone manufacturing factory was inaugurated in the state of Miranda, representing a joint vulture between Venezuela and the Chinese firm Huawei.[43] Beyond cell phones, the May 2010 agreement between Venezuela and the Chinese appliance manufacturer Haier included a commitment by Haier to establish a factory and training facility in Venezuela, near the coast in the Valley of Tuiy, for the production of appliances.[44] In another case, the Venezuelan Ministry of Mining and Basic Industries (MIBAM) announced discussions underway with China to create a national aluminum facility in Venezuela.[45] Finally, in April 2010, China and Venezuela signed a deal in which Chinese banks would loan Venezuela $300 million for the establishment of a new national airline "Línea Área Bolivariana Socialista," utilizing aircraft to be purchased from the PRC.[46] In each case, apart from the specifics, the agreement allowed the Chavez regime to announce a project in which Venezuela's relationship with the PRC, and the socialist policies of the Chavez regime, were bringing jobs, technology, and manufacturing capability to the country.

Beyond resources and symbolic projects, a lesser but important benefit accruing to Venezuela is that the PRC serves as an alternative supplier for the purchase of second-tier goods by the nation's armed forces. The Venezuelan military continues to purchase its most sophisticated hardware from Russia, such as Su-30 fighter aircraft[47] and Mi-17 transport helicopters.[48] Nonetheless, at a time in which traditional suppliers such as the United States have suspended military sales to Venezuela, the PRC represents an important source of a range of goods at competitive prices. Recent examples include Venezuela's previously mentioned purchase of 18 K-8 light attack aircraft from the PRC, and interest in purchasing the more sophisticated Chinese L-15 fighter. Similarly, th radars sold by China to the Venezuelan government have been put under the control of the military and deployed in a north-facing orientation toward the Caribbean and the United States. China's development and sale of the "Simon Bolivar" satellite, beyond its civilian uses, has the secondary benefit of providing additional, reliable communications capabilities to the military in time of crisis. Beyond such sophisticated hardware, Chinese companies also continue to supply military clothing and logistics supplies to the Venezuelan military.

Consequences of the Growing Venezuela-China Relationship. The implications of the growing China-Venezuela relationship for the country, for the region, and for the US are significant, regardless of the intentions imputed to actions by the PRC. On the one hand, the relationship is generating growing PRC influence within the country, and ultimately, a growing stake in its political and economic course. It also contributes to the short-term ability of the Chavez regime to maintain its domestic support and project its influence in the region in a fashion that could complicate and make more severe the likely eventual crisis of the Chavez government.

As China and Venezuela deepen their commercial, political and other ties, Chinese influence in the country is growing, at the same time that China's interest in policies and stability of the Chavez regime is growing. With respect to influence, Venezuela is increasingly relying on Chinese companies to extract Venezuelan oil and other commodities, producing revenue streams critical to the Chavez regime. As noted previously, Chinese companies not only play a significant role in current Venezuelan oil production in the mature fields of Maracaibo and Anzoategui, but are an increasingly important part of plans to produce oil in the Orinoco belt in the future. Nor is this dependence limited to the role of the major Chinese oil companies. Beyond national oil companies such as CNPC and CNODC, Chinese service companies play an increasingly important role in the sector.

In addition to resource extraction, Chinese companies play an increasingly important role in critical infrastructure projects, such as the previously-mentioned construction of railways and the new fiber-optic backbone. Chinese companies are also constructing the three new coke-fired power generating facilities that PdVSA will depend on in the future to supplement its hydroelectric generating capability.[49]
Furthermore, as the Venezuelan manufacturing sector collapses, Chinese companies such as Huawei, ZTE, and Haier will play an increasingly visible role in the manufacturing and technical base of the country. At the same time, as evidenced by the deal with Haier to purchase home appliances, as the Chavez government blocks traditional sources for consumer goods, such as Colombia, while welcoming products from the PRC, the presence of those products and associated retail networks in the country will continue to grow.

Over the short term, by supplying resources and expertise to Venezuela, China will help the Chavez regime to postpone difficult decisions regarding cuts in domestic spending and the curtailment of regional projects. Although it is not clear how the $8 billion injected by the PRC into the Heavy Investment Fund was used, press accounts suggest that the money has been spent, and by implication, without the money, less spending would have been possible. The Chavez regime has indicated that a significant part of the $20 billion of new Chinese loans has been earmarked for social programs, allowing the regime to continue its spending patterns, to include the purchase of the 300,000 Haier appliances, which will allow the regime to offer inexpensive goods for sale to its support base. Similarly, the three thermoelectric plants to be built by the Chinese will help avoid the types of power cuts which undermined the popularity of President Chavez among his core supporters in the summer of 2010.

While Chinese assistance helps to sustain the Chavez regime in the short term, it contributes to a fundamentally unsustainable cycle of spending and mismanagement by the Chavez regime, while sewing the seeds for a complex and potentially dangerous situation when the internal contradictions of the regime bring it to its crisis point. Although Venezuela's external debt is still relatively low, it is expanding rapidly, increasing 32% over 2009 alone to $61.6 billion.[50] On one hand, very little of the Chinese funding appears to be creating productive capacity within Venezuela that could be used to repay that debt. On the other hand, the loans appear to be structured to ensure that the Chinese debt will be repaid, even if Venezuela is forced to default on its other obligations. The latest $20 billion loan package, for example, is to be repaid in deliveries of Venezuelan oil from areas in which Chinese companies are performing the production. In short, whereas in the past countries could default on loans to the IMF or World Bank by refusing to send the money, for Venezuela to default on its loan from China, it would have to actively prevent China from extracting oil from Venezuela.

It is important to point out that China will compete with other powers such as Russia in its bid for influence in key sectors, including petroleum and military goods, and with Brazil for serving Venezuelan markets. The growing Chinese presence in Venezuela, in conjunction with these other actors, including Iranian oil and banking interests, may complicate any future succession crisis in the country. Control over the revenue stream that could determine the survival of a new regime in such a situation may be in the hands of a combination of Chinese, Russian, Iranian, and other companies that produce and ship Venezuela's petroleum. Making matters even more complicated, beyond greater Caracas, the Venezuelan countryside will be characterized by a combination of regular military and police units, militias, foreign companies, guerrillas and organized crime groups, the actions of each of which will be unpredictable.

Conclusion. For both Venezuela and China, the rapid deepening and expansion of the relationship with the other is characterized by both significant incentives and risks. As Chinese firms quietly enrich themselves and obtain secure access to petroleum and other goods important for China's continuing economic growth, China itself must avoid being too closely associated with the anti-US crusade of the Chavez regime, or inadvertently involved a crisis of the regime through its sunken investments and the presence of its companies on the ground. Reciprocally, as Venezuela relies increasingly on China to extract its oil and loan it money for current spending, it must avoid being trapped in a cycle of dependency on the PRC, particularly given that Chinese interests in Venezuelan commodities and markets may not fully coincide with the objectives of the Chavez regime.

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