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Economic Bulletin

VENEZUELA: NO ROOM FOR APOLOGISTS



Image Credit: iStock/camacho9999

- Over President Chavez's term (1998 to 2013), Venezuela's economic freedom score went from average to one of the most repressive.
- President Chavez apologists – including Jeremy Corbyn – argue that the reforms were a success as poverty fell from 1998 to 2013.
- But that was cosmetic. It only occurred as there was a 600% increase in oil export revenue, which arose from oil price increases, not gains in output or productivity.



- Price controls were already causing food shortages in 2006, by disincentivising domestic food production. Oil revenues had to be used to pay for a fourfold increase in imports to fill the gap.
- President Chavez's unrestrained spending was astonishing. The country went from a budget surplus in 1999 to a deficit of over 14% of GDP when Chavez left office – despite booming oil export revenue.
- Widespread nationalisation was associated with collapsing productivity in industries including oil, steel and sugar, as well as widespread corruption.
- Regional competitor Chile, which has implemented free market reforms, is now the wealthiest country in the region, seeing absolute poverty plummet in the last decade.
- Price controls, mass nationalisation, profligate fiscal policy, and ever-growing corruption have sown the seeds of the current economic and political calamity in Venezuela. It is not simply about oil prices.
- It is therefore deeply troubling that the leader of the UK's official opposition described President Chavez's reforms as "a better way of doing things".

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1. INTRODUCTION

Some on the British Left put the blame of Venezuela's crisis squarely on "US meddling". Others argue that the disintegration of Venezuela is the fault of President Maduro, not his predecessor President Chavez. If either of these narratives is accepted, those that supported the Chavez reforms feel free not to apologise or re-think their position. One such person is Jeremy Corbyn, who once [commented](#) that President Chavez "*showed us a better way of doing things*". In reality, as we will show, Chavez's reform agenda was always doomed to disaster – and so, by extension, would Corbynism.

There is no doubt that Venezuela has the potential to be one of the wealthiest countries on the globe, having the world's largest oil reserves. US International Energy Agency [statistics](#) show that Venezuela has 300 billion barrels of proven oil reserves, exceeding Saudi Arabia's reserves by 33 billion barrels. And in the early part of the 2000s Venezuela was, indeed, the richest country in Latin America, with its GDP per capita even exceeding Argentina's, [according to data](#) from the World Bank.

Under Hugo Chavez's term in office (1998-2013), its growth in GDP per capita mirrored many other Latin American countries and poverty rates saw a marked fall until 2013. This led many socialists to view President Chavez's reforms as a blueprint for change.

However, this growth in wealth along with seemingly improving living standards – which effectively arose from high oil prices and the resulting large export revenues – concealed a catastrophic set of interventions in the national economy. Years of price controls and aggressive nationalisations have disincentivised the production of essential items. Poor financial management, heavy subsidies and currency controls have also exacerbated corruption, sapping the government's finances.

Now oil prices have dropped, the legacy of the Chavez era is clear for all to see. Inflation is at over 700%, there are chronic shortages of basic goods, 60 people are being murdered every day and the country is in the grip of political upheaval. However, there were clear signs – even during the oil boom years – that the socialist policies of President Chavez were leading to disaster.

Venezuela has, of course, had a chequered history, suffering from bouts of inflation and political turmoil. Yet this cannot excuse the policies of the last 20 years, which have led to the current crisis.

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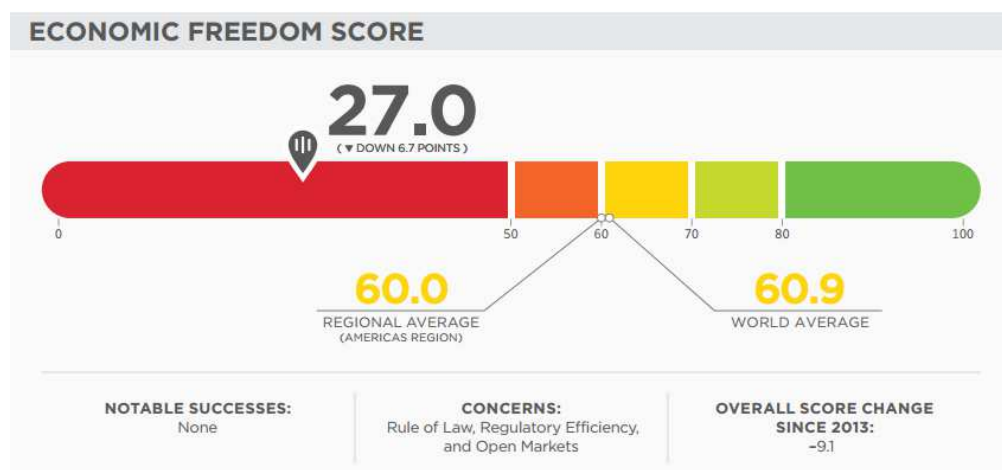
2. THE CHAVEZ ERA – IMPLEMENTATION OF SOCIALISM

Amid disenchantment with the political establishment, Hugo Chavez was elected President of Venezuela in 1998, bringing in a new constitution along with a series of economic and social reforms. This included the State-sponsored Bolivarian Missions, which boosted Chavez's popularity by offering housing subsidies, adult-education campaigns and discounted food to poorer parts of the population.

During his time in office, President Chavez [nationalised a wide range of industries](#) in sectors including oil, agriculture, finance, industry, gold, steel, telecommunications, power, transport and tourism. For example, in 2001 [a new law](#) was passed requiring the PDVSA – the State controlled oil company – to hold a majority stake in all upstream oil projects. He also went on to [expropriate](#) millions of acres of land and nationalised hundreds of private businesses and foreign owned assets, including oil projects run by ExxonMobil and ConocoPhillips. This was accompanied by price controls, which [fixed prices](#) on basic foodstuffs, and [controls on foreign exchange](#) in an attempt to prevent capital flight.

As a result of this revolution, Venezuela has dropped out of the [Global Innovation Index](#) rankings and is now 189th out of 190 countries in terms of the ease of starting a business, according to the [World Bank Group](#). Moreover, its economic freedom score using the Heritage Foundation's analysis has declined from nearly 60, the current average for the region, in 1998 to just 27 (see Figures 1 and 2).

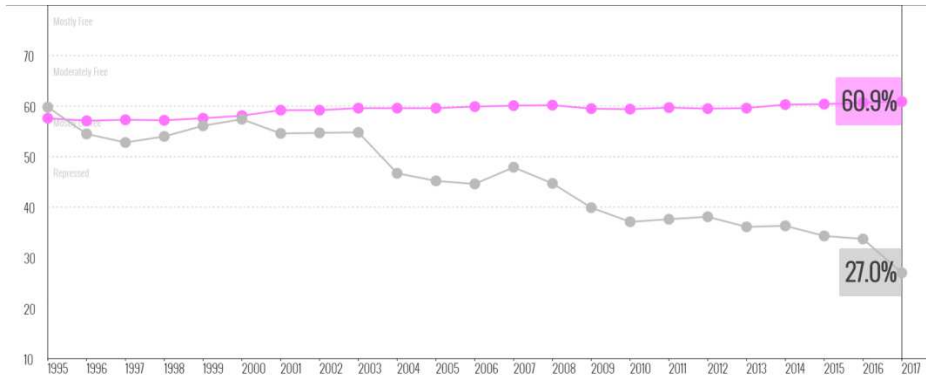
Figure 1: Venezuela's Economic Freedom Score



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Figure 2: Economic Freedom over time [Venezuela vs World average]



Note: World average line is pink, Venezuela is grey.

Source: Heritage Foundation [link](#) [link](#)

3. THE IMPACT OF CHAVEZ'S REFORMS

DID CHAVEZ REDUCE POVERTY?

Chavez's supporters often pointed to his record on poverty alleviation with, for example, Jeremy Corbyn [saying](#): "Thank you Hugo Chavez" in 2013. Indeed, World Bank [figures](#) suggest that absolute poverty rates did fall over the Chavez's tenure, dropping from 50% in 1998 to 30% in 2013¹. The expanding social service programmes of food, housing subsidies and health care programmes undoubtedly contributed to this. However, this drop in poverty masked a series of structural problems that were being created by the Chavez regime.

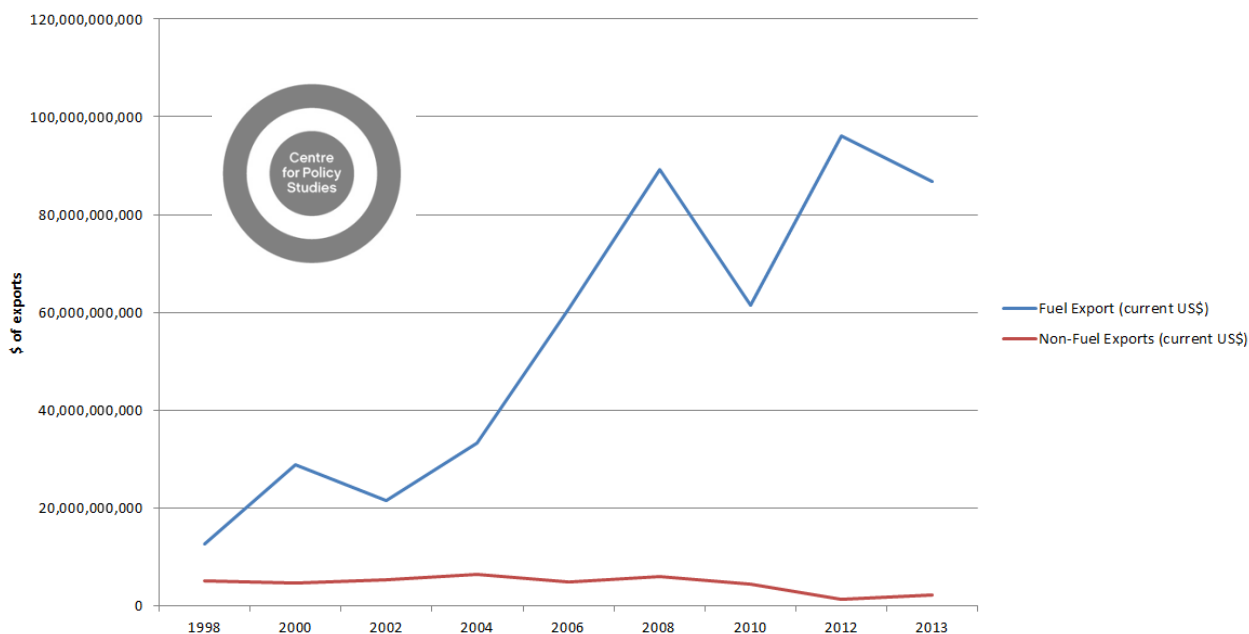
The social programmes were being funded by a dramatic increase in oil revenues. While non-fuel exports saw a decline over the Chavez era, export revenue from oil exploded by nearly 600% from 1998 to 2013 (see Figure 3). It is important to note that this was not achieved from improved productivity or production. In fact, production of oil in Venezuela actually fell from 3,167 thousand barrels a day to just 2,500 in 2013, according to [Index Mundi](#). President Chavez effectively benefitted from global oil prices that were as low as \$18 a barrel at the beginning of his tenure rising to over \$100 a barrel towards the end.

¹ Poverty headcount ratio at \$3.10 a day (2011 PPP) (% of population)

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Figure 3: Venezuelan fuel and non-fuel exports



Note: Merchandise exports show the f.o.b. value of goods provided to the rest of the world valued in current U.S. dollars.

Table 1: % of export revenue from fuel

YEAR	1998	2000	2002	2004	2006	2008	2010	2012
%	72%	86%	80%	84%	92%	94%	93%	99%

Figures are rounded to the nearest percentage

Source: Data comes from the World Bank for both Figure 3 and Table 1

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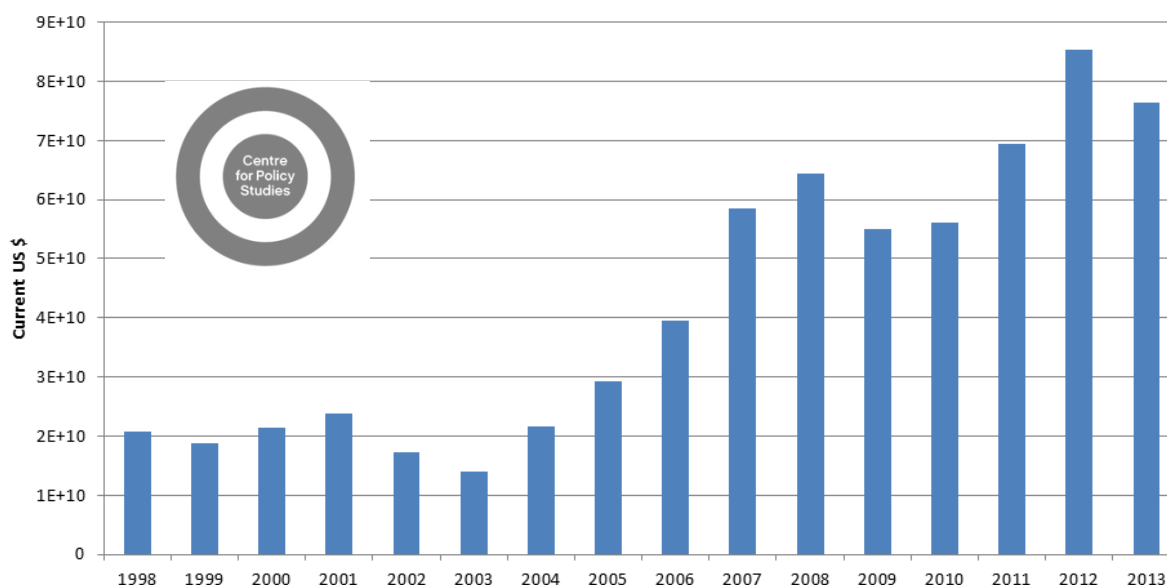
THE CATALOGUE OF PROBLEMS EMERGING DURING THE CHAVEZ ERA

As can be observed in Figure 2, Venezuela has plummeted from being average in terms of economic freedom to having one of the most repressive systems in the world. The consequences of this change were already being observed during the oil boom years.

A. The problems with price controls were already emerging....

President Chavez introduced caps on the prices of basic goods shortly after being elected. As a result, even in 2006 – when oil revenues were booming – Venezuelans [were facing](#) a growing shortage of foods. Wholesalers stopped deliveries due to tightening price controls and collapsing profit margins. Chavez's response to this was to encourage a major food importing campaign, and in 2008 the State-run oil company was tasked with overseeing this. This was a strange objective for someone that [advocated the expropriation](#) of farmland to “end dependence on food imports”. Yet as a consequence of his price controls, imports into Venezuela saw a dramatic increase. Figure 4 outlines the dramatic increase in Venezuela's imports (which grew nearly four-fold over President Chavez's term and were mostly paid for by oil revenues) to counteract the impact that price controls were having on domestic production.

Figure 4: Imports of Goods and Services into Venezuela



Source: Data comes from World Bank

Not only did price and currency controls disincentivise domestic production, they also created perverse incentives for both government and private individuals to game the system and siphon off public money for private gain. In particular, subsidies for food, fuel and consumer goods ended up creating a thriving smuggling economy based on sending products from Venezuela to Colombia and Brazil, where they could be sold for an easy profit. Even President Maduro [conceded](#) in 2014 that nearly 30-40% of domestic goods were being smuggled to Colombia.

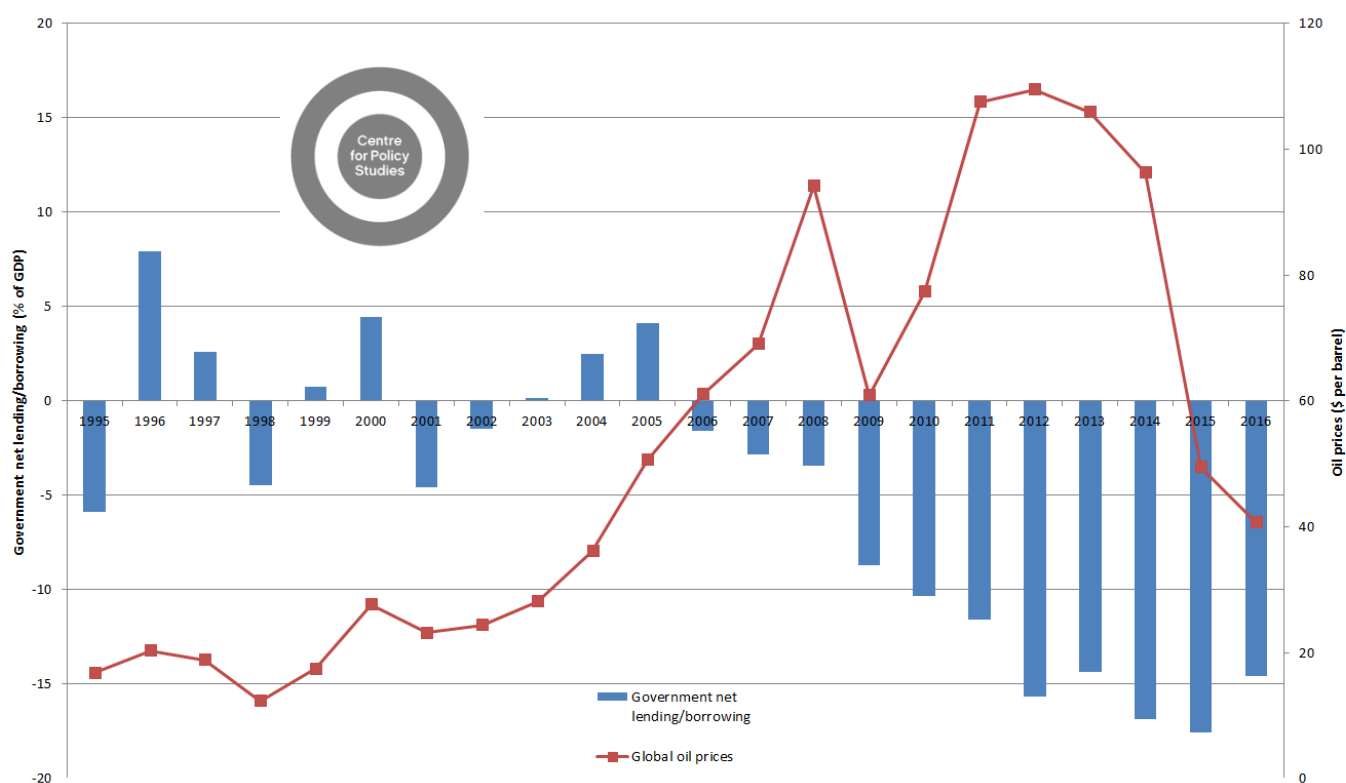
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B. Venezuela's unrestrained spending was evident since 2006

Ricardo Hausmann, a professor at Harvard Kennedy School, [commented](#) that during the oil boom years, Venezuela's government "were spending as if the price of oil was \$200 a barrel". This is supported by the evidence. In 1999, Venezuela ran a budget surplus. By the end of President Chavez's tenure in 2013, Venezuela's budget deficit hit a whopping 14.3% of GDP (see Figure 5 and Table 2) – despite global oil prices growing exponentially over Chavez's term in office (see Figure 5). And do not be fooled by the recent fall in [Venezuela's debt to GDP ratio](#). This is only occurring due to, among other things, Venezuela [selling off its](#) foreign exchange reserves as well as gold reserves to repay debts (see Figure 6).

Figure 5: Venezuelan Government Borrowing vs Global Oil Prices



Source: International Monetary Fund and Statista

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Table 2: Venezuela's budget deficit since 2006

YEAR	BUDGET DEFICIT (% OF GDP)
1998	4.5%
1999	-0.7%
2000	-4.4%
2001	4.6%
2002	1.5%
2003	-0.2%
2004	-2.5%
2005	-4.1%
2006	1.6%
2007	2.8%
2008	3.5%
2009	8.7%
2010	10.4%
2011	11.6%
2012	15.6%
2013	14.3%
2014	16.8%
2015	17.6%
2016	14.6%

Source: International Monetary Fund [link](#)

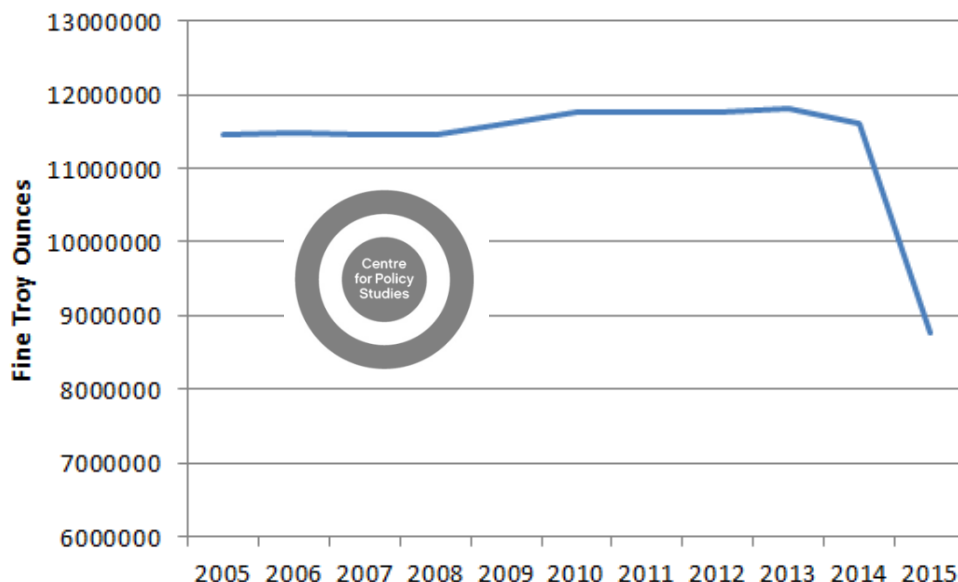
Note 1: Figures are rounded to 1 decimal place

Note 2: Positive figures are budget deficits, negative figures are budget surpluses.

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Figure 6: Venezuela's Gold Reserves



Source: Data comes from UK data service [link](#)

C. Nationalisation has often hampered productivity and exacerbated corruption

Nationalisation was a costly business for the Chavez government. The Arbitration Tribunal of International Centre for Settlement of Investment Disputes (ICSID) has ordered a succession of compensation agreements as a result of assets being expropriated by the Chavez Government. In 2014, for example, Venezuela [was ordered to pay](#) Exxon Mobil \$1.6bn in compensation. Venezuela must honour ICSID rules to avoid a default on sovereign bonds.

Yet this is the least of Venezuela's problems. Nationalisation has led to a worrying collapse in productivity in many areas. A paper [published by the Journal of Economics and Finance](#) has found that increasing state control of the State-run oil company PDVSA has led to a decline in productivity, and there is now no accurate record of the amount of income flowing into the national treasury. The nationalisation of the country's leading steel producer in 2008 has been associated with a [collapse in production](#) from 4.3 million tonnes in 2007 to just 307,000 tons in 2016. And a similar story is observed with the sugar industry. In 2006, Chavez nationalised ten of the 16 privately owned sugar refineries and last year Venezuela produced just 242,306 tonnes of refined sugar. This is less than one-third of what was being produced in 2006, according to the [Los Angeles Times](#).

Nationalisation programmes have also often been associated with a loss of expertise and rampant corruption. In 2002-03, President Chavez [sacked around](#) 18,000 employees from the State-run oil company, many of them skilled technicians and managers, and replaced them with 100,000 of his own supporters. This is symptomatic of the cronyism associated with Venezuela's nationalised oil sector. In 2011, it was reported that [\\$500 million from](#) a PDVSA pension fund found its way into a pyramid scheme run by government-linked financiers, none of whom faced

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prosecution. Moreover, in 2012, [a refinery exploded](#), killing at least 40 and causing \$1.7 billion in damage, suggesting that even maintenance budgets may have been siphoned off.

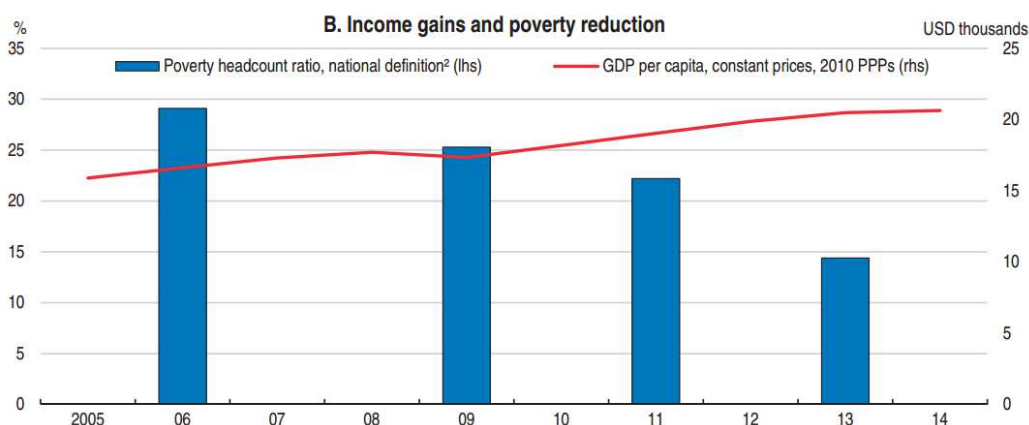
4. THE DIFFERENT STORY FOR OTHER LATIN AMERICAN COUNTRIES: THE EXAMPLE OF CHILE

Sometimes referred to as “the lonely success story”, Chile is now Latin America’s wealthiest country with a GDP per capita of over \$22,500. The quality of life of Chileans has improved significantly over the last few decades, and it is no coincidence that the country’s economic policies could not be more different to those in Venezuela. Chile is now the most innovative country in Latin America, according to the [Global Innovation Index](#).

The increase in average disposable income and reduction in poverty has been among the most rapid of all OECD countries. The OECD [attributes this](#) to economic reforms such as trade and investment liberalisation and sound macroeconomic policies that have controlled inflation. A [study](#) from the Central Bank of Chile supports this, arguing that structural market reforms since the 1970s have helped improve manufacturing performance in the country.

Over the past decade, GDP per capita has seen healthy growth and the absolute poverty headcount ratio had dropped significantly (see Figure 7) – despite there being a fall in demand for copper (see Figure 8), which is one of Chile’s [largest exports](#).

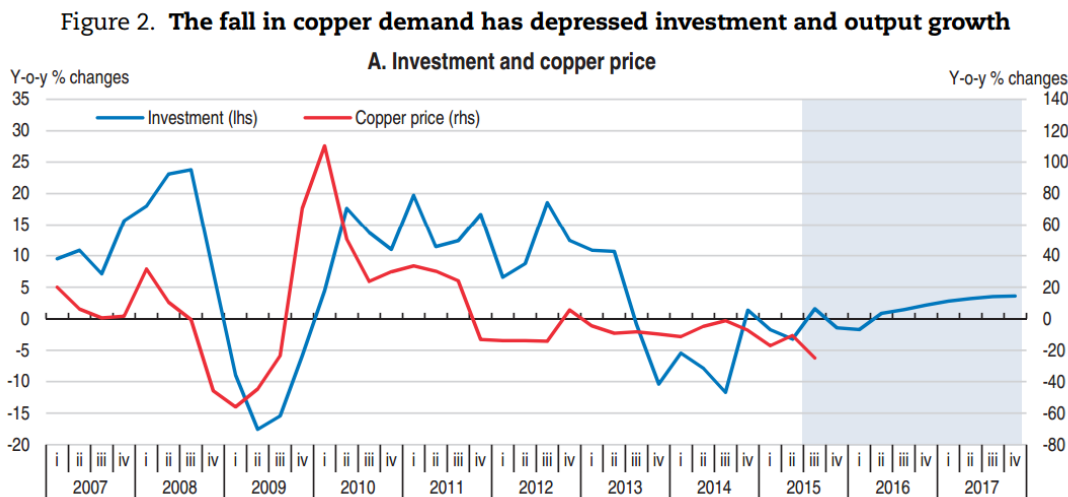
Figure 7: Poverty headcount ratio and GDP per capita (Chile)



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Figure 8: Copper prices and investment (Chile)



Source: OECD [link](#)

5. CONCLUSION

Unable to pay for the array of subsidies and welfare programs, Venezuelan President Maduro is doubling down. In [response to the crisis](#) he printed more money, which inevitably led to extraordinary inflationary pressures. Further price and currency controls have made imports even more expensive, causing them to slump by 34% from 2013 to 2015. A vicious cycle is in the making.

Apologists for the Chavez regime argue that, along with “external influences”, Venezuela’s over-reliance on oil is the major cause of the current crisis. While it is a cause, it is not the only one. Price controls, mass nationalisation, profligate fiscal policy and ever-growing corruption under the Chavez era – followed on by Maduro – have sown the seeds of the current major economic and political calamity. Jeremy Corbyn’s comment that President Chavez “*showed us a better way of doing things*” is therefore deeply troubling.

Daniel Mahoney

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