

VENEZUELA: DESCENT OF AN OIL RICH STATE INTO ABYSS

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Abstract

This paper aims to outline and examine the major political and economic drivers which have contributed to the current crisis in Venezuela. It focuses mainly on the policies and triggers that led to the present scary condition in the country. Venezuela, which has more oil reserves than any other country in the world, was at one time the richest country in Latin America. Many consider Venezuela as a classic example of "Dutch Disease" a term used to describe an economic phenomenon when growth of natural resources sector in the country attracts considerable attention and leads to decline in other sectors like manufacturing, agriculture etc. While this notion is not wrong, the facts in the study point to something more serious. It brings out that more than the 'Dutch disease' it was the country's political dispensation and grossly misplaced economic policies that have brought this misery to the nation. Venezuela is a grim reminder to the world of what can be expected when a government goes all out on populist measures and takes shelter in leftist ideology. The sheer waste of Venezuela's resources and foreign exchange and its transition to a failed state is a sad story of modern political and economic history. The fortunes of Venezuelan economy are linked to recovery in oil sector, but the Oil industry itself has been hurt by Government policies and needs massive investments which are nowhere in sight as the country is already reeling under debt burden. A broader political and economic restructuring needed to break this impasse appears nowhere in sight.

Keywords: Venezuela Economy, Venezuela Debt, Hyperinflation, Chavez Legacy, Oil Crisis

Introduction

Venezuela represents one of the dramatic growth experiences in the world and equally quick fall as a failed nation. It is a paradox that a country with the largest oil reserves stands at the door steps of an economic breakdown.

While Venezuela's economy has many times moved in tandem with oil prices and a fall in oil prices had a negative impact on the economy, the damage to its social and economic fabric appears much large and may not be due to downswing in oil prices alone. As the country economy stands totally crippled, it is evident that Venezuela has landed into this mess not only due to decline in oil prices but more due to policies followed by its political leaders and mainly policies of Late President Hugo Chavez (1998-2013). President Chavez in a bid to consolidate his power over all wings of Government and perpetuate his rule imposed his leftist ideology on the country, followed populist policies, took massive debt when oil ruled high, left little scope for private investments, tinkered with country's oil production companies, imposed capital curbs and weakened almost every institution in the country.

The country's ongoing economic problems got accentuated by the drop-in oil prices became serious from 2013 onwards. The negative impact on the economy was very swift as years of mismanagement had left the economy quite vulnerable. The economic drift became harsher as

export revenues continued to nose dive. Poor economic policies, large flight of capital, leaving of multinational companies due to unjust demands have led to decline in oil production in a country with the highest oil reserves. Additionally, a substantial amount of oil production is mortgaged and held up towards debt payments, leaving only a fraction of the oil exports to generate revenue. Thus there was not enough money left to import essential items in a nation which was largely dependent on imports even for essential items.

Recession which became prominent in 2013 continued to deepen and has taken the shape of economic, social and political crisis of unforeseen magnitude. The country is faced with hyperinflation, electricity and water cuts, acute shortages of many essential goods, price and foreign currency controls and rising political and social conflict. The policies of government has not only led to flight of foreign investment and packing up of international companies but has also led to exodus of people from the country. More than a million people had left the country before the start of crisis due to repressive policies and many others are leaving now as they find hard to survive in the country beset with total breakdown.

Venezuela: An Oil Rich Country

Venezuela, named as the “Bolivarian Republic of Venezuela” since 1999 (by President Chavez), is located on the northern coast of South America. The country comprises a continental mainland and numerous islands in the Caribbean Sea and is bestowed with Andean peaks in the west, Amazonian jungles in the south and considerable natural resources. Large reserves of crude oil were first found in Venezuela in 1914. Production began during World War I and the resource quickly replaced agriculture as the base of the Venezuelan economy.

As on 2014, the proven oil reserves in Venezuela are recognized as the largest in the world, totalling 297 billion barrels surpassing that of Saudi Arabia. This represents approximately 20% of world's oil reserves. Venezuela is a founding member of the Organization of the Petroleum Exporting Countries (OPEC). The country's reserve-to-production rate is among the highest in the world, as a spate of wrong policies followed by those at helm of the country has led to shrinkage of country's oil production capacity particularly in the last two decades.

Venezuela: A History of Political Turmoil (Before President Chavez)

Venezuela political history has been characterised by considerable coup attempts, fragile governments and internal strife with overall leftist leanings.

A time line which is indicative of its restive political past is as follows:

1. 1810: Venezuela which was Spanish colony declared freedom taking advantage of Napoleon Bonaparte's attack on Spain in Europe.
2. 1908-35 - Dictator Juan Vicente Gomez took reins. In this period Venezuela becomes world's largest oil exporter.
3. 1945 - A military coup established first democratically elected government.
4. 1948 – The democratically elected Government is overthrown in military coup
5. 1958 - Admiral Wolfgang Larrazabal throws out the military Government and restores back democracy. A Government with leftist leaning comes to power.
6. 1973: The Gulf crisis of 1973 leading to boom in Petroleum prices rakes in significant gains

for Venezuela. The Government continuing with its leftist agenda nationalises oil and steel industries.

7. 1989 - Carlos Andres Perez elected president amid economic depression, launches austerity programme with IMF loan. Riots and violence on street claims many lives, martial law and general strike follow
8. 1992 - Colonel Hugo Chavez and supporters make two coup attempts. Col Chavez jailed for two years before being pardoned.
9. 1993-95 - President Perez impeached on corruption charges.
10. 1998 - Hugo Chavez elected president

Venezuela: The Chavez Era

Colonel Hugo Chavez who had earlier attempted two coups in 1992 and was granted amnesty two years later, was elected the President in the general elections of 1998. He served as Venezuelan president from 1999-2013. He saw himself as an anti-imperialist revolutionary and his policies were a mix of Latin American leftism, socialism and extreme nationalism. He ushered in policies better known as "Bolivarian Revolution," a socialist revolution that brought in a new constitution with populist economic and social policies & renamed the country as 'Bolivarian Republic of Venezuela'. A slogan coined by him as part of Bolivarian Revolution was "Motherland, socialism, or death. Apart from various measures to strengthen his hold over the country that included rewriting the constitution, some of his key policies included nationalization of key industries, large spending on social welfare, vocal anti US rhetoric, Opposition to neoliberalism, support for participatory democracy at workplace etc. The high oil prices at that time allowed him to fund these populist measures. With the oil riches he donned the mantle as the defacto leader of the left leaning Latin American countries and tried to curb the U.S. influence in the region. He also pulled Venezuela from the World Bank and the IMF.

All along his policies were aimed at consolidating his power and he gradually assumed sweeping powers. In further continuation of his leftist policies and signs of his tilting further towards Cuban political and economic model, President Chavez in 2001 passed various laws aimed at redistributing land and wealth. In 2002 there was violent standoff between government and Petroleos de Venezuela (PDVSA) state oil monopoly managers and unions and President Chavez was taken into custody as part of coup which failed, and he got elected again.

In the year 2003, President Chavez struck back at state-run oil corporation, PDVSA where he had been trying to extend his complete influence. In an autocratic move that had a devastating effect on oil production in Venezuela, President Chávez, fired more than 18,000 employees of the state-controlled oil corporation, PDVSA. The employees had participated in a strike call to protest the politicisation of the company. This represented about half of the company's workforce. Further to punish them even more, they were barred from seeking employment with any company that was doing business with PDVSA. In one action, Venezuela lost its oil intelligentsia and professionals with specialised knowledge of the field and oil production never recovered from this shock.

Pursuing his leftist policies further in 2005, President Chavez signed decree on land reform to eliminate Venezuela's large estates. Later in 2007 his nationalisation efforts extended to key energy

and telecommunications companies. Two leading US oil companies, Exxon Mobil and Conoco Phillips, refused to hand over majority control of their operations to the Venezuelan government and left the country.

Though his policies benefitted a large section of poor and working class, the economy took a downturn as it remained dependent on oil export and his policies gradual decline of both government sector industries as well as private sector. It is estimated that during his time 1.5 million people left the country, including highly qualified oil sector professionals and as the end of his period approached, country started facing food and water shortages, high inflation rates, shortages of medicines and black outs. He died of cancer in 2013.

Venezuela Post Chavez: Continuing with his Legacy

When President Chavez realized that his cancer had reached a terminal stage, he appointed Nicolas Maduro, a former bus driver and union leader, as his political heir. In subsequent elections in April 2013 Maduro won with a very narrow margin amid complaints of vote-rigging. There were violent protests in which many people died. The regime not only continued with Chavez era policies but became more authoritarian and made frequent arrest of dissidents.

The President Maduro whose re-election chances in next general elections are rated quite low by independent observers, has taken a leaf from Chavez era and has gone ahead with creation of a “Constitutional assembly” which will rewrite the constitution and will have more powers than legislature itself. Marred by allegations of fraud, a controversial electoral process has been conducted to form a constituent assembly tasked with rewriting the constitution. Venezuelan constituent assemblies have sweeping power not only to change the constitution but also to dismiss existing officials and institutions and even delay forthcoming elections.

Venezuela: Political & Economic Events & Current State of Economy

At the political level, Venezuela has proactively promoted the advancement of leftist ideas and President Hugo Chavez tried to consolidate anti US and leftist forces and provide leadership in the region. He also tried to make a group of Latin American nations and nurtured close bilateral ties with governments such as Cuba, Bolivia, Brazil and Ecuador. His other international friends included Libya, Iran, China and Russia.

While it cannot be denied that Bolivarian revolution at one point of time distributed the largesse from oil sales to the lower/middle income class people. it was not a sustainable way of doing it and its legacy has resulted in a defunct economy and divided the nation. The scarcity of essential items is highlighted by the fact that government has banned desperate shoppers from lining up overnight at supermarkets. Apart from slowdown due to downtrend in oil prices the economy suffered from inefficiency in oil production sector and a lack of investment in other sectors. Some indicators showing the drift in economy are shown in **Table 1**.

Indicator	2013	2014	2015	2016	2017*
GDP PPP (\$ Billions, 2011)	534	514	482	395	
GDP per capita PPP (\$ Thousands, 2011)	17,651	16,733	15,483	12,533	
Inflation	40.60%	62.20%	121.70%	475.80%	1660.10%
Unemployment rate	7.50%	6.70%	7.40%	18.10%	21.40%

Source: IMF World Economic Outlook

* Estimated

As shown in above **Table 1** inflation quickly galloped and turned into hyperinflation clocking a rate of 1660% in 2016, which may be the highest rate in the world. Hyperinflation was fuelled by high monetization of the public debt by the Central Bank and strong depreciation of the currency. Additionally, Currency controls had resulted in a black market and the fall in actual value of currency has been much steeper. Further left with little money to import meant severe shortage of goods leading to acute scarcity and scramble. There were incidents of stores or food vans being looted by agitated people. The unemployment rate has been rising due to systemic closure of private sector due to Government policies. Further the regime's hostility to foreign business created a corporate exodus. Pepsi, General Motors and United Air Lines are some of the companies that either left the country or significantly cut down their operations.

The situation in the country is scary with extreme shortages of food, medicine and other essentials and the government has to make a hard choice between buying imported goods or making due payments to the institutions and bondholders from which it had taken enormous debt. Venezuela's foreign reserves have dropped below the \$10bn mark for the first time in 15 years as after effect of misplaced policies, gross mismanagement, inefficiency in government sector, corruption and subdued oil prices have taken their toll. As is evident from the **Figure 1**, the decline has been steep.

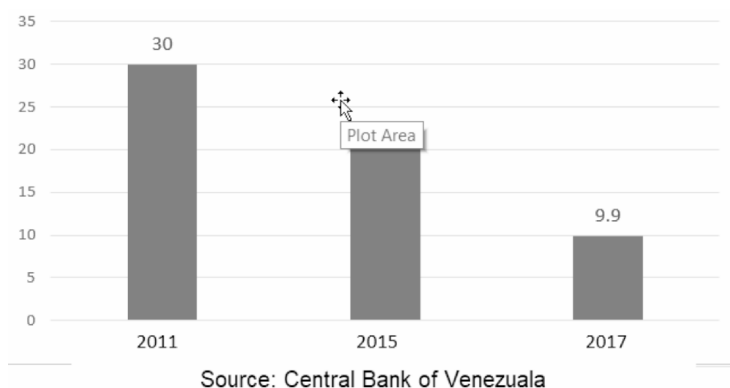


Figure 1 : Venezuela Central Bank Reserves (Billion US \$)

Venezuela's economy has seen repeated cycles of economy moving in tandem with oil prices and every boom in oil cycle has led to a binge of government spending with difficult periods thereafter. However, President Chavez in his bid to consolidate his power under the garb of revolution and to create a large devoted vote bank made blatant use of oil income to give disproportionate benefits to

some sections of society. He even gave subsidised oil to other countries to project him as a leader of the deprived world capable of standing against US capitalism. His single pursuit of this idea along with steps like price and capital control etc. were injurious to the economy and even the oil sector which was bread and butter of the country got hurt.

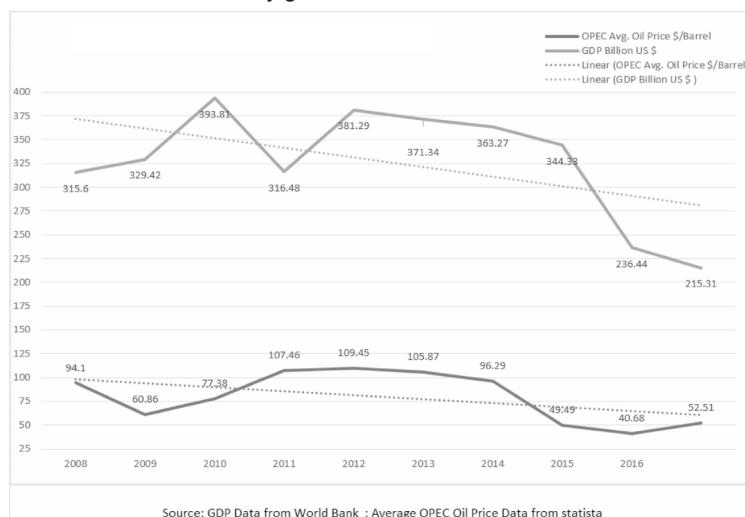


Figure 2 : Venezuela: Trend in Oil Prices and GDP

The above **Figure 2** is indicative of the fall in GDP as prices of oil plummeted over the last few years. It is also suggestive that that the fall in GDP has been more and a look towards the end of the chart (2016 onwards) indicates that even a slight recovery in oil prices, contrary to general expectations has seen the GDP going further downhill. This has happened because damage to economy and investments in oil sector was so high that it was not able to take advantage of positive external triggers and failed to raise output of its oil sector.

When to feed his political and social agenda, President Chavez went out on a borrowing spree many nations and capital market were happy to lend to Venezuela considering its huge cushion of oil reserves. In 2004 the public external debt was in region of \$25 billion and in 2017 it nears \$180 billion, more than a seven-fold increase.

The biggest disservice by President Chávez's "socialist revolution" came when he shook the foundations of state oil company PDVSA by firing half the employees in 2003. The loss of skilled personnel was a such a big blow which handicapped the oil exploration and development, running of operation, safety and created a management void. Consequently, oil production stagnated and even during periods when oil prices skyrocketed, Venezuela was unable to lift its production and take the benefit.

As per figures of 'The Centre for Energy Orientation', a Venezuelan NGO, the number of incapacitating injuries due to accidents at PDVSA rose from 1.8 per million man-hours in 2002 to 6.2 in 2012. Further price controls, expropriation of numerous farmlands and various industries, changing government policies, freeze on any access to foreign currency not only made people's life worse but also suffocated the industry and several technological and automobile companies shut down ther operations in the country.

Chávez's nationalisation of industries extended to cement and steel and many other core sectors and left the country increasingly dependent on imported goods putting further pressure on scarce foreign exchange. The lack of domestic supplies of building materials like steel, aluminium and cement led to contraction in construction sector as well leading to loss of jobs. This happened even as the Government was giving high priority to housing for the poor.

Need for Comprehensive Economic Reforms & Restructuring:

Under Chavez's leadership, the state slowly achieved control of the oil sector and later other core industries as well. Ownership of these resources by the state and frequent meddling together with taking possession of oil assets of large multinationals who had access to considerable know how took its toll on the oil sector in the country. As pointed out earlier in the paper, the biggest blow to the oil industry was dismissing of about half the work force in one stroke and disallowing them even to seek any alternative employment with other companies. These professions left for foreign shores and many of them played a vital role in revving up the oil industry in Canada and Colombia. The impact of all these together with exchange controls was no modernisation and expansion of this vital industry and instead of raising the Oil production the regime policies resulted in almost the opposite.

Venezuela faces a contradictory or Catch 22 situation with respect to the options to shore up its economy. To come out of the debt trap it needs to ramp up its oil production. However, to quickly shore up its oil production it needs considerable investments and technical knowhow which it lacks as this juncture and cannot achieve without rise in oil revenue i.e. oil production. Also, with the present trend of oil prices, the country cannot generate sufficient revenue from oil exports to service its debt and still leave enough money to buy essential items required to meet the basic needs of people. Venezuela may need a sea change in its outlook and policies to break this vicious cycle. Sadly, by all indications the present rulers are focusing predominantly on consolidating their own power and are subverting all possible institutions that may come in their way.

The country may need to seriously change its basic policies and realize that they are at the root of its problems and have wrecked more havoc on its economy than fluctuations in oil prices. The only course left may be a serious effort at debt restructuring and making conditions amenable for investment from other countries. Venezuela needs to negotiate with several nations, variety of lenders and financial institutions where the options are again limited due to strong anti US leaning of the Government, bad experience of earlier multinational oil companies and other international companies. The willingness of large donors like china and Russia to restructure their loans or to take a haircut can provide some relief. Further reforms in direction of letting the market mechanism take over and dismantle price controls, move towards free float of exchange and selectively disinvest Government owned companies etc. may be needed to raise resources and bring some order in the economy. All this must be accompanied by broad economic reform package and restructuring and may need a regime change accompanied by ideological shift at the political level.

Conclusion

Venezuela was counted as an affluent country with the largest proven fossil-fuel reserves in the world. In past few years its economy has been shrinking at an alarming rate. Inflation is spiralling out of control, there is shortage of essential items and medicines and violent protests have become norm of the day. The paper has examined the irony that how a country that is bestowed with abundant

resources and that proclaimed to have set out on the path of a revolution with the aim to wipe out poverty has today ended up making more people poor.

The miserable state of the Venezuelan economy given that the country has the largest proven capacity of oil reserves has important political and economic lessons for other nations as well. Venezuelan people are going through a very painful period as the country has a meagre amount left after catering to external debt. There seems to be no end to this debt burden as in addition to present debt, the country in the long run owes vast sums to China, Russia and Development institutions like Latin American Development Bank. Additionally, there is a string of international cases and arbitration proceedings with companies whose assets were seized or where contracts were not honoured. These cases are at various stages with international bodies and ultimately Venezuela will have to settle them at considerable cost if it wants to tap finance from a wider gamut of nations.

Despite hardships of unbearable magnitude being faced by the citizens, a corrupt and authoritarian Government is engaged in the dangerous game of amassing unrestrictive power over all institutions in the country and has vested interest to carry on with its populist measures which have brought the country to present state. As highlighted earlier in the paper the damage to oil production industry due to misdeeds of the Government is of such proportions that it is difficult to ramp its capacity on need basis and even a relief rally in oil prices may only provide a marginal relief to the economy. The repressive and whimsical policies of the regime in last two decades has caused irreparable damage to Venezuelan economy in many ways. Apart from flight of capital, there has been a massive outflow of talented and qualified professionals. Similarly, departure of many important business organisations including multinationals like Pepsi and oil companies like Exxon Mobil has hurt the economy financially as well led to lack of investment in country.

This paper shows that the malaise the country faces is much larger and only part of the problems that Venezuela faces today can be attributed to what is accounted by a phenomenon called 'Dutch Disease' which refers to an economic phenomenon when growth of natural resources sector in the country attracts considerable attention and leads to neglect/decline in other sectors of economy. Drop in Oil prices has also contributed to this state of economy, but the country has more to blame itself as it has used every rise in oil cycle in the past to go on a binge of spending and add to its debt burden. The problem lies more in political ambitions and in a country that has a history of political instability, the final and most damaging blow has come from the repressive and wrong economic policies of President Chavez whose legacy continues. Thus a potent mixture of problems of country rich in one natural resource (Dutch disease), market fluctuations in oil prices, inability to use this surplus effectively and on top of all revolutionary socialist policies which many times actually were aimed at preserving the power of few have contributed to this collapse.

The paper shows that Venezuela is typical of what can be expected when left leaning governments talk of revolution to solve problems of impoverished citizens of a country. While Venezuela has a history of political strife and mismanagement of oil revenues, the squandering of nations resources when oil prices ruled high crossed all limits under President Chavez. His policies and urge to further his rules at any cost is the single most factor that outweighs even losses due to downtrend in oil prices. President Chavez paralyzed all state institutions by rewriting the constitution, indulged in witch hunting of dissidents and played havoc with the economy by mis allocation of resources, giving windfalls to certain sections of society, establishing price and exchange controls leading to rampant

black market and corruption etc. Further outspending on social programs, government interfere in every sphere and finally chasing of foreign companies from Venezuela and resulting destruction of private sector has led to this grave situation. Today the country is left with a shattered private sector that could have otherwise provided employment, imports all goods as most industrial units have shutdown, exchange restrictions have ensured that the official currency is now worthless and debt to fund social extravaganza has made inflation to cross 1000% and the stores are empty. There is no opportunity in the private sector, since it has been systematically destroyed by periodic nationalization, confiscation and resultant exit of international private companies.

At the end, the revolution has perhaps only benefited the ruling political elite and sections like military whose interests are in line with political class. Sadly, the political class in power continues to pursue Chavez legacy. The study brings out that contrary to widely held notion that Venezuelan economy has gone into abyss due to rock bottom oil prices, the blame lies significantly on the wrong political and economic policies of erstwhile President Chavez who has deceived the nation with the promise of a revolution for betterment of masses. The present political dispensation is likely to further harm the economy which has totally collapsed and seems to be at the point of no return. In a narrative that is reminiscent of George Orwell's Political satire 'Animal Farm', the present Venezuelan regime blames its opponents for Venezuela's economic woes and says United States is waging an economic war on Venezuela.

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