

PROSPERITY IN DEPTH: VENEZUELA

# The Curse of Oil-Stoked Populism

By Albert Fishlow



2013 LEGATUM PROSPERITY  
INDEX<sup>™</sup> RANKING: VENEZUELA

78/142

## THE LEGATUM INSTITUTE

---

Based in London, the Legatum Institute (LI) is an independent non-partisan public policy organisation whose research, publications, and programmes advance ideas and policies in support of free and prosperous societies around the world.

LI's signature annual publication is the *Legatum Prosperity Index*<sup>™</sup>, a unique global assessment of national prosperity based on both wealth and wellbeing. LI is the co-publisher of *Democracy Lab*, a journalistic joint-venture with *Foreign Policy Magazine* dedicated to covering political and economic transitions around the world.

## PROSPERITY IN DEPTH

---

To complement the annual *Legatum Prosperity Index*<sup>™</sup>, we regularly commission specialists—economists, political scientists, journalists—to provide additional analysis of selected countries. In each case, the Prosperity in Depth papers represent highly original work by distinguished experts that adds depth and insight to the statistical analysis of the index.

## FOREWORD

Venezuela can boast of a per capita income close to \$14,000 (measured in terms of purchasing power), which earns it World Bank status as a high-income country. Yet it ranked just 78th out of 142 countries on the 2013 *Legatum Prosperity Index*<sup>™</sup>, behind a host of far less affluent states, including (to name just a few) Peru, Thailand, China and Mongolia.

In large part, the explanation for its low ranking lies in Venezuela's political and economic legacies. The country has been hooked on petroleum for almost a century, which has corrupted government, fed an opportunistic military establishment, undermined the development of a diversified industrial/service economy and tied the wellbeing of its citizens to the vicissitudes of international energy markets. Its plight is reflected in the sub-indexes on which the *Legatum Prosperity Index*<sup>™</sup> is constructed. While it ranks 60th on the Economy sub-index, it only manages a wretched 110th on Safety and Security and a truly dismal 127th on Governance.

Here, Albert Fishlow, an economist who served as Deputy Assistant Secretary of State for Inter-American Affairs in President Carter's administration (and later, as director of Columbia University's Institute of Latin American Studies), outlines the evolution of Venezuela from backwater Spanish colony to military dictatorship to petroleum giant—and its subsequent unsuccessful struggle to build a cohesive civil society. The big question now, Fishlow says, is whether the death of Hugo Chavez, a leader who reflected Venezuela's weakness for both strongmen and populist ideology, will create an opening for supporters of free markets and social democracy. Ironically, he suggests, the country's best hope lies in the declining fortunes of its oil industry.

**Peter Passell, Editor**



EL PALITO OIL REFINERY, CARIBBEAN SEA

## ABOUT THE AUTHOR

**Albert Fishlow**, a deputy assistant secretary of state of inter-American affairs in the Carter Administration, is the former director of Columbia University's Institute of Latin American Studies.

## ABOUT THE EDITOR

**Peter Passell** is a senior fellow at the Milken Institute and the editor of its quarterly economic policy journal, *The Milken Institute Review*. He is a former member of the *New York Times* editorial board and was an assistant professor at Columbia University's Graduate Department of Economics.

The views expressed in this paper are those of the author and not necessarily those of the Legatum Institute.



# The Curse of Oil-Stoked Populism



*The big question is whether this Venezuela can find a middle way that addresses the grievances of the poor, while allowing the economy to grow and diversify.*

Hugo Chávez Frías, the second coming of Simón Bolívar to Venezuela's poor and a nightmare for its business and professional elites, died in March, this year. But the Venezuelan economy and polity he was attempting to construct lives on. The big question now is whether this deeply divided, oil-dominated society can find a middle way that addresses the grievances of the poor, while allowing the economy to grow and diversify.

Chávez, already gravely ill when he won a fourth term as president in October 2012, succumbed to cancer five months later. His appointed vice-president, Nicolás Maduro, was elected in April to a six-year term in a surprisingly close election, defeating the centre-right opposition candidate Henrique Capriles by little more than a percentage point.

For now, relatively high petroleum prices permit the regime to carry on as before, devoting much of its income to the care and feeding of its populist patronage machine without bringing GDP growth to a halt. Admittedly, though, this machinery is hardly in perfect working order: Inflation, running well above 30 percent, is a source of discontent across the income spectrum. And by no coincidence, the black market exchange rate for dollars is five times the legal rate.

Meanwhile, Diosdado Cabello, the leader of Chávez's Partido Socialista Unido de Venezuela (PSUV) in the National Assembly and head of the military wing of the party, remains a powerful, divisive figure. It's not clear whether the coalition of the military, labour unions, the deprived, and even some opportunistic crony capitalists who support "Bolivarian Socialism" will survive the loss of its charismatic leader for very long.

Here I offer some background—well, a lot of background—for the sake of perspective before taking on the question of what comes next. More specifically, whether Venezuela will shed a dysfunctional legacy, allowing it to build a prosperous economy responsive to the needs of those left behind in the pre-Chávez era of social democracy.

MAIN SQUARE OF SAN JUAN BAUTISTA WITH THE STATUE OF SIMON BOLIVAR



## FROM EUROPEAN PAWN TO BOLIVARIAN NATION

Venezuela (which means “Little Venice” because explorers saw Indian settlements on stilts along Lake Maracaibo) was the first South American country discovered by Christopher Columbus, then on his third expedition in 1498. In contrast to Colombia, Peru and Bolivia, no gold or silver was found to be plundered—and, therefore, the place escaped the tender ministrations of the conquistadors. As was the case in the Caribbean, Spanish settlers grew sugar, indigo (the source of blue dyes) and especially cocoa. Coffee, introduced in the late 18th century, later became the principal export.

When Napoleon installed his elder brother, Joseph Bonaparte, on the Spanish throne in April 1810, the Venezuela colony declared provisional independence with the idea of returning to the fold after the restoration of the old order. But radicals within the Venezuelan elite, led by Bolívar, upgraded their demands to full



*Venezuela paid a demographic and economic price for long decades of political instability and military rule.*



independence in 1811. And while the colony quickly fell to Spanish military forces, Bolívar was more successful in Colombia. By 1821, Spain had been pushed out of the region, making way for Bolívar's Gran Colombia, which included modern Panama, Venezuela, Colombia, Ecuador, northern Peru and the northwest corner of Brazil.

However, Bolívar's centralist vision gave way to federalism. Venezuela, which formally declared its independence from Gran Colombia in 1830, was ruled by unstable coalitions of elites led by military strongmen through the rest of the century. Sixteen presidents served over this interval. Needless to say, the three quarters of the population consisting of Indians, slaves and mulattos had little say or participation in their governance. Slavery was only abolished in the 1850s.

## A BANANA REPUBLIC WITHOUT BANANAS

Venezuela paid a demographic and economic price for the long decades of political instability and military rule. The population stagnated and economic growth was modest at best. Rising output and prices of coffee did bring economic wellbeing during the upswing in the 1830s and early 1840s—Venezuela was the third largest global producer at the time. But the boom was brief, as international prices declined and output was periodically disrupted by violence that more or less pitted landowners against the merchant class.

Venezuela inherited part of the foreign debt from loans made to Gran Colombia in the 1820s, and in 1836, Ecuador, Colombia and Venezuela all defaulted. Government revenue depended almost entirely on customs duties (both import and export), which were largely dependent on coffee production and prices. Expenditures, with large episodic outlays for the military, were even more unpredictable. By 1869, interest owed on foreign and domestic debt equalled more than half of the government's revenues. In April 1870, in part because the government was fiscally exhausted, the country fell to an army loyal to *caudillo* (strongman) Antonio Guzmán Blanco.

This "illustrious American", as Guzmán preferred to be called, managed a period of substantial development. He grabbed power just as both coffee production and prices were increasing. And in his relatively stable reign of 19 years, he rebuilt Caracas and improved transportation infrastructure, as well as reforming the legal and educational systems. He also altered the social and political order by establishing a constitutional requirement obligating the central government to distribute more of its revenue to provincial authorities.

But Venezuela remained dependent, as did the rest of Latin America, upon the "terms of trade"—the relative prices of its exports to its (largely) manufactured imports. So it saw another reversal with the collapse of coffee prices in the 1890s. Data on the purchasing power of exports per capita for Venezuela are revealing. The figure nearly tripled between 1865-69 and 1885-89, but then fell sharply by 1900-04. Purchasing power rose again before World War I, but never recovered to the level of the 1880s.

Foreign dependence, morphed from dependence on the vicissitudes of global markets to the threat of direct intervention. In 1902, German, British and Italian naval vessels blockaded Venezuelan ports in an effort to force the government to make good on defaulted debts. The impasse was only resolved by President Theodore Roosevelt's

assertion that the Monroe Doctrine covered economic, as well as military, intervention in Latin American affairs.

Another *caudillo*, Juan Vicente Gómez, took power in 1908 by means of a coup and didn't release his grip until his death in 1935. His firm hold followed from his success in taming regional strongmen and his sophistication in allying himself with foreigners intent on exploiting Venezuela's newly discovered oil.



*Oil transformed Venezuela into the country with the highest income per capita in Latin America.*

## BE CAREFUL WHAT YOU WISH FOR

---

Oil began to change Venezuela in the years just before World War I. What had been a poor agricultural economy transformed into the country with the highest income per capita in Latin America. What had been a loose agglomeration of quarrelsome regions was decisively centralized and increasingly reliant upon decisions made in Caracas. What had been a political entity of little interest to the great powers became a great prize.

Initial concessions for exploration were granted to Gómez' cronies, who offered them for sale to foreigners. The US remained aloof. But Royal Dutch Shell bought in, and struck oil at Mene Grande, just east of Lake Maracaibo in 1914. Shell took advantage of a government tax subsidy to build a small refinery at San Lorenzo; a much larger one was erected a few years later on the offshore, Netherlands-controlled island of Curaçao.

World War I demonstrated the strategic importance of petroleum. Britain learned the lesson well and extended its pursuit of secure reserves to the Near East and Asia, strictly prohibiting other foreign participation. The US joined the hunt in Venezuela. But progress lagged, as Gómez reached agreement with Shell to extend the terms of its early concessions. Standard Oil of New Jersey, Standard of Indiana and Gulf Oil only managed to lease concessions in the 1920s, paying handsome gratuities to the dictator and his friends. The game changed again late in 1922, when engineers found a gigantic field, reported by the New York Times, as "the most productive in the world".

Oil exports rapidly replaced coffee and cocoa in the 1920s, generating four fifth's of the economy's foreign earnings by the end of the decade. Indeed, production represented a quarter of Venezuela's GDP in 1929 and largely explained why national income grew by more than half over the 1920s—far more than anywhere else in Latin America.





BREAD MADE FROM CASSAVA



## LEFT BEHIND

Gómez created a modern dictatorship, tripling the size of the professional army while gaining the support of the business elite and managing (despite his own enthusiasm for the Kaiser) to build a strong relationship with the US. He even found favour with some intellectuals, hoping for modernisation. Political centralisation was buttressed by the extension of decent roads and the telegraph. The weakening of regional governors not only meant more power for Gómez, but more efficient government expenditure aimed less at patronage and more at state-building.

Gómez used his considerable powers to acquire vast tracts of land for himself, creating a ranching empire that supplied Caracas with half its meat. Moreover, what was good for General Gómez proved to be good for Venezuela's other landowners. He funded the Banco Agrícola y Pecuário, using oil revenues to subsidize cheap credit for rural elites whose exports no longer mattered—but whose political support did.

Yet while oil made many things possible, life changed little for the majority. Venezuela remained predominantly rural through the 1920s. Textiles, sugar processing and beer,

## FAVELAS SUBURB OF CARACAS



which were protected by import restrictions, represented almost the entire invested capital in manufacturing. All were located in just three centres: Caracas, Maracaibo and Valencia. Three out of four Venezuelans were illiterate, while life expectancy was just 33 years.

In the 1930s, other export-dependent Latin American countries suffered from global commodity price declines and a subsequent inability to manage their debts. Most were lured by the siren song of self-sufficiency in manufacturing as a driver of growth and source of independence from foreign pressure, using tariffs, quotas and subsidies to lock themselves into "import substitution" regimes. (Most only managed to extract themselves in the 1980s and 1990s.) But thanks to the surfeit of cheap-to-extract oil, Venezuela was able to keep up with payments on its debts; production increases offset price declines, allowing the country to shrug off the global economic slowdown.

Venezuela did suffer from what would later be dubbed "Dutch disease"—the inability to compete with other economies in the production of most goods, thanks to an exchange rate inflated by oil earnings. Indeed, the government chose not to follow when the United States effectively devalued the dollar in 1934 by dumping the

gold standard. The resulting overvaluation of the currency (a phenomenon that has episodically dogged Venezuela to this day) assured a continuing supply of cheap imports and little pressure for market-driven economic diversification.

When Gómez died in 1935 at the age of 78, the military retained command. Nonetheless, they retreated from his absolute control and indifference to public perceptions. Less than a year later, for example, Congress voted to reclaim Gómez's largely ill-gotten fortune. Labour was allowed to organize, apparently with the aim of cementing support in urban areas and in 1941, the regime made it legal to organise political parties.

This loosening of power proved the junta's undoing. In 1945, the reform-minded Acción Democrática (AD) party, led by Rómulo Betancourt, joined with the young officers of the Unión Patriótica Militar to overthrow the regime. However, a brief democratic interregnum ended in 1948 when the military intervened once again—this time to thwart Betancourt's AD party, which had won the election.

Opposition to the takeover was muted by the AD's lack of finesse in navigating the treacherous waters of interest-group politics. It had pursued corruption charges against former government officials, begun agrarian reform at the expense of large landowners, and alienated the Church by challenging its monopoly on education. The military gradually grew bolder. While it allowed an election to take place in 1952, it did not abide by the results: When their candidate, General Pérez Jiménez, lost the popular vote, he asserted power anyway. His rule marked the return to unalloyed repression and a centralised autocracy.

There were two reasons Pérez was able to survive until 1958. One was the balm of rising oil exports and consequent royalties. The other was the belated start of industrialisation, based on the doctrine of import substitution, complete with subsidies for industrialists (and urban labour).

Propelled by the Korean War and later, instability in the Middle East, petroleum exports increased by more than 10 percent annually between 1949 and 1957. The revenues gave Caracas the wherewithal to accelerate domestic industrialisation. Output in manufacturing soared by 17 percent a year between 1948 and 1957 (albeit from a very modest base). An emphasis was placed on "strategic" industry, especially firms owned by the government, such as steel, petrochemicals and energy generation. Multinationals, some allied to local heavyweights, went along by shifting production to Venezuela in order to gain access to the protected market.



*Overvaluation  
of the currency  
assured a continuing  
supply of cheap  
imports and little  
pressure for market-  
driven economic  
diversification.*



But despite copious government lagniappe funded by oil revenues, opposition to Pérez Jiménez mounted. In January 1958, a general strike by AD-affiliated trade unions was supported by Church hierarchy and even components of FEDECÁMARAS, the syndicalist umbrella group for Venezuelan industry. The police killed 300 and wounded 1,000 during the clampdown on the industrial action. However, the army did not join in the suppression. Pérez Jiménez got the message, departing so rapidly that he left a suitcase full of currency behind at the airport.



*As the World Bank  
(uncharacteristically)  
wryly noted at the  
time, Venezuela was  
the world's most  
prosperous less-  
developed country.*

## DEMOCRACY, VENEZUELAN-STYLE

---

Betancourt subsequently inaugurated a period of civilian rule that lasted for 40 years by redirecting the politics of the leftist AD party toward the centre. That meant less populism and more compromise, with fig leaves extended to industrialists, landowners, Church hierarchy and even the military.

One reason the strategy worked was because abundant oil revenues served as rewards. But it was far from a simple task, nonetheless. As the World Bank (uncharacteristically) wryly noted at the time, Venezuela was the world's most prosperous less-developed country.

For starters, it wasn't easy to turn off the leftist activism that had returned Betancourt to power. The Cuban revolution had impressed younger AD leaders, and their unwillingness to stick with the Betancourt script of moderation effectively forced them out of the party. Competition in elections initially rose, with more parties participating. But by the end of the 1960s, only AD and the centre-right Christian Democrats (COPEI) were contesting the presidential elections.

The US, despite its official enthusiasm for Venezuelan democracy, was not entirely helpful in terms of Betancourt's efforts at political triangulation. When Washington bowed to domestic US oil interests and placed quotas on oil imports in 1959, it exempted Canada and Mexico—but not Venezuela. Venezuela repaid the favour by joining the nascent OPEC cartel in 1960, and public opinion turned against the US-based oil companies.

Moreover, import substitution policies so popular with urban interests became more problematic as oil prices fell in the early 1960s and less money was available to subsidise the higher cost of manufacturing at home. Public participation amounted to around 40 percent of total investment in the economy, much higher than in other Latin American countries. Note, too, that money invested in dead-end import substitution projects was money not available for education, housing and health in the increasingly crowded cities.

FISHERMEN PREPARING THEIR BOATS, MARGARITA ISLAND



Growth in oil production slowed in the 1960's, but Venezuela's appetite for revenues did not. This appetite was only partly slaked by an increase in royalties negotiated with the oil companies. The government also tightened conditions for foreign direct investment, requiring partnership with Venezuelan interests. Like most countries during this period, Venezuela was inching toward a policy of total nationalisation of oil and gas.

At the end of 1973, OPEC announced the quadrupling of the price of petroleum, to \$12 a barrel. Venezuela's national income soared as a result, with oil revenues jumping from 13 percent of GDP to 20 percent. The state took control of both oil production (by PDVSA, the national oil company) and iron ore mining, and progressively accumulated more than 100 subsidiaries. Thereafter, Venezuela was truly hooked on petroleum: Close to 90 percent of government revenues derived from oil production.

But the flood of cash could not entirely isolate Venezuela from the effects of external price shocks or domestic industrial inefficiency in an economy dependent of government subsidies and largely undisciplined by competition. Between 1975 and 1980, real growth fell to about two percent a year—less than the pace of population growth. And much of the great increase in investment activity generated little of value. Domestic prices rose and union wages compensated, feeding inflation. Those with capital sought ways to park



## VALLEY OF CARACAS



it abroad, even as the government was forced to borrow from foreign banks.

The doubling of oil prices in 1979, triggered by the Islamic revolution in Iran, gave Venezuela a few more years of breathing room. But the spike masked the long-term price trend, which did not favour economies so dependent on petroleum. After thriving for most the 20th century on an ever-richer diet of oil, the Venezuelan economy now faced two decades of decline.

Unable to generate the needed foreign exchange, Venezuela defaulted on its external debt. Currency devaluation—the first since 1964—followed, as did capital and import controls and a multiple exchange rate system that gave the government (and its friends) access to foreign currency at a far lower cost than was available to businesses and households without good connections. The government managed to coax the economy out of the subsequent recession with public spending, but at the cost



*The flood of cash could not isolate Venezuela from the effects of external price shocks or domestic industrial inefficiency in an economy dependent of government subsidies and largely undisciplined by competition.*



of accelerating inflation and ever more distorting price controls. Another devaluation in 1986, almost doubling the exchange rate, was unavoidable.

Carlos Andres Pérez returned to his second presidency in 1989. He was chosen by voters nostalgic for AD's earlier, free-spending populism that had been financed by soaring petroleum prices. His campaign offered no reason to doubt his intent to replicate that experience. Instead, he opted for rapid, far-reaching reform and stabilisation, following similar efforts of shake off bad economic habits in Argentina and Brazil.

Over the years, Venezuela had evolved into a classic state-dominated, rent-seeking economy rooted in petroleum riches and excessively dependent on the whims of the global commodities markets. The reform plan, *El Gran Viraje* (the Great Turnaround), was announced 12 days after Pérez's inauguration in February.

It began badly. Riots broke out in response to higher bus fares as subsidies were pared, which spread rapidly as police proved unable to restrain roving gangs. The army was called in, and matters calmed over a week. But *El Caracazo*, as the unrest came to be known, left 300 dead and cost Pérez a lot of the good will left over from the former populist days.

Pérez did not yield in his commitment to remake the economy according to the so-called Washington Consensus, aiming to free markets, contain inflation and open the economy to competition. Among his reforms, initiated by executive decree, were a big currency devaluation, higher interest rates, increased prices for subsidised public services and lower barriers to imports. He also restructured the external debt with support from the IMF, World Bank and Inter-American Development Bank and lifted capital controls.

Subsidies to private firms (a toxic legacy of import substitution dogma) were cut, while social service outlays increased. After a large decline in GDP in 1989—and serendipitously bolstered by an unexpected rise in oil prices in 1990-1991 as a consequence of the war against Iraq—growth resumed. Yet in pursuing technocratic reforms, Perez exhausted his remaining political capital. The weakened president survived two military coup attempts, but not congressional impeachment on charges of embezzlement of state funds.

Breaking with COPEI (which he had founded), Rafael Caldera now had his second act. He was elected in 1994 with support from an odd mix of left and right constituencies—an outcome that was as much a mark of the collapse of the two-party system as a vote of confidence in Caldera. Despite his public repudiation of Perez's "eat-your-spinach" policies and a return to exchange rate and price controls after the election, he was forced in 1996 to bend



*Venezuela had evolved into a classic state-dominated, rent-seeking economy rooted in petroleum riches and excessively dependent on the whims of the global commodities markets.*

a knee to the IMF and pursue stabilisation as a condition of its financial support. That included (another) devaluation and some budget discipline.

Little came of Caldera's *Agenda Venezuela* (Latin American economic revival plans all seem to have uplifting names), however, which dangled free-market reforms as a lure to foreign investors to return. It didn't help, of course, that oil prices sank to new lows in the wake of the 1997-98 Asian financial crisis or that the Venezuelan bolívar came under speculative attack. Popular discontent with neo-liberalism was rampant, as the numbers of the poor continued to grow over the decade. In the 1998 presidential election, the candidates of AD and COPEI managed less than 4 percent of the votes each. The winner, with 56 percent, was Hugo Chávez—the former military leader who had led the first coup attempt against Pérez.



*By 1998 Venezuelan leaders had run through the spectrum of familiar Latin American remedies for economic ailments—populism, neo-liberalism, unorthodox efforts to shock inflationary expectations out of the system—without success.*

## NOTHING LEFT TO LOSE?

Stepping back, it's clear that by 1998 Venezuelan leaders had run through the spectrum of familiar Latin American remedies for economic ailments—populism, neo-liberalism, unorthodox efforts to shock inflationary expectations out of the system—without success. Chávez, for his part, offered no clues of what he would try in this regard, but he made no secret of his intention to manage Venezuela in *caudillo* style.

If he was to consolidate power, he needed a way to rule without the congress, where his party controlled only a modest fraction of the votes in both houses. A first step, then, was a popular referendum to create a constitutional assembly to rewrite the rules in his favour. Chávez managed to win 93 percent of the seats in this body, which delivered a new constitution that sharply increased executive authority, extended the legal reach of the military, and replaced the bicameral legislature with a more easily manageable single chamber.

Chávez survived a coup attempt in the spring of 2002 and a politically motivated strike at PDVSA (the national oil company) the same year. But dissent did not disappear. Under the leadership of Súmate, a Venezuelan organisation funded in part by the US government's National Endowment for Democracy, Chávez's opponents managed to generate enough support to force a recall election in August 2004. Chávez won the vote easily, which was a puzzling result in light of pre-referendum polls. But foreign monitors found no decisive irregularities. The opposition's decision to boycott the 2005 congressional election further cemented Chávez's place at the helm.

POLITICAL RALLY, DECEMBER 2002



By this point, any chance of rapprochement with Washington was gone. Chávez aggressively promoted ties with Cuba, Nicaragua, Bolivia, Ecuador and the Caribbean through his Bolivarian Alliance for the Peoples of Our America (ALBA), dangling discount oil as bait to join the anti-American coalition. Sticking to the principle that "my enemy's enemies are my friends", he used any available excuse to make common cause with Russia, China and Iran. He also reached out to centre-left governments in Brazil and Argentina, joining the Mercosul free trade pact and opposing US efforts to negotiate a free trade agreement spanning the Americas.

Chávez's crowning effort to define his rule in ideological terms was called "21st century Bolivarian Socialism." He sought to repurpose the Marxist-Leninist game plan, adding a touch of jingoism and foreswearing authoritarian rule. Having easily won re-election in 2006, he sought further changes in the constitution to flesh out the first steps, named the "Plan



## LUXURY CONDO, PUERTO LA CRUZ



Nacional Simón Bolívar". But in the December 2007 referendum called to approve it, Chávez suffered a narrow defeat. The anger following the closure of RCTV, the country's opposition television station, may well have contributed to Chávez's only electoral loss.

Before the referendum, Chávez had nationalised the country's largest telecommunications company, CANTV, and the Caracas electricity company, EdC. Their American owners, Verizon and AES respectively, quickly accepted the offered reimbursement. Meanwhile, both ExxonMobil and Conoco opted to withdraw from their concessions in the oil shale fields of the Orinoco Valley, but were not compensated.

The widening global recession after 2008—and the resulting fall in commodity prices and government oil income—further eroded Chávez's popularity. His left-wing umbrella party, the PSUV, won a majority of seats in the congressional elections of 2010, but not a sufficient number to override the minority on key initiatives. That did not matter much, though, as the legislature



*As a result of  
Chavez's policies,  
most foreign private  
investors ceased to go  
near the place.*

extended his power to govern by decree for 18 more months, and Chávez marched ahead with a variety of changes intended to socialise the economy, weaken property rights and override market forces.

Chávez continued to deepen his commercial relations with countries unallied with the United States or even openly opposed to its influence. When he needed foreign exchange, he sold oil at a discount to China for future delivery. When he wanted military supplies, he applied to Russia. And while he had little to barter with Iran, he delighted in tweaking the beard of Uncle Sam by cosying up to Mahmoud Ahmadinijad. Not surprisingly, most foreign private investors ceased to go near the place.

In the beginning (1999), Chávez offered no startling economic initiatives to match his populist/nationalist rhetoric; with low oil prices and substantial opposition to his rule from the middle class, he had little choice. Only in 2003, with rising oil prices, was there opportunity for Chávez to reach out and apply his signature anti-poverty policy, which targeted efforts at the grassroots level to improve education, health and access to food at low prices—to name but a few.

The *misiones* (missions) incorporated Cuban approaches for raising literacy rates and childhood health, as well as thousands of Cuban physicians to deliver medical care at local clinics. In terms of outlays per person, the *misiones* exceeded expenditures on the widely hailed Latin American cash subsidy programs for the poor (the Oportunidades programme in Mexico and the Bolsa Familia in Brazil) that tied monthly household stipends to school attendance and regular health check ups for children.

In light of the high profile of the *misiones*, surprisingly little is known about their actual impact. Certainly a variety of indicators suggest that the quality of life for the poor improved. For example, the mortality rate for children aged under five fell from 24 per 1,000 in 1998 to 15 per 1,000 in 2011. But the rate had been falling steadily for decades under the old social democratic regimes, halving between 1978 and 1998.

Between 2002 and 2008, the poverty rate fell by 21 percent by the measure of the UN's Economic Commission for Latin America—more than in any other country in the region. But Venezuela also benefited most among them from the commodities price boom in the period. And it is hard to disentangle the effects of rising employment on poverty rates from the effect of social spending. Indeed, economists Darryl McCloud (Fordham University) and Nora Lustig (Tulane University) argue that the apparent greater success of populist regimes in Venezuela, Bolivia and Argentina in reducing poverty (compared to social democratic ones in Brazil and Chile)



*As oil prices (and national income) sank after 2008, the movement toward Bolivarian Socialism—market regulation, outright expropriation of private businesses—accelerated.*

was entirely due to the impact of the commodities cycle. Indeed, when commodities are teased out of the analysis, social democracies actually seemed to perform better in reducing poverty.

As oil prices (and national income) sank after 2008, the movement toward Bolivarian Socialism—market regulation, outright expropriation of private businesses—accelerated. The World Bank ranked Venezuela 180th out of 185 in terms of ease of doing business as of June 2012, behind (among many other countries) Zimbabwe, Haiti and Afghanistan. Venezuela will have to dig itself out of a deep hole if it ever chooses to return to the free-market fold.

## SO WHAT HAPPENS NEXT?

---

Predictions about Venezuela have a way of missing the mark. Democracy was widely assumed to be a fact of life in Venezuela after the election of Betancourt in 1958, but the threat (and occasional reality) of military intervention was always lurking in the shadows. Oil-fuelled prosperity has been hailed more than once as the catalyst to social change and responsiveness to the needs of the poor, but it hasn't always worked that way. Now, with the departure of the charismatic, authoritarian-minded Chávez, analysts see an opening for the forces of market-friendly social democracy. I'm more cautious: Here are two scenarios.

Both begin with bad news about dependence on revenues from energy exports. Venezuela has vast reserves of oil and natural gas. But a good portion of it is relatively expensive to produce, and attracting foreign capital to extract and refine it won't be easy. Of Equal importance, is the fact that fracking technology has opened up massive amounts of oil and gas for exploitation in most every part of the world, promising an era of relatively low prices.

Yet, to sustain social spending, Maduro needs an oil price of close to \$100 a barrel. The government already rations access to imports, and lacks the resources to invest the billions of dollars needed to update technology in the petroleum sector. Moreover, inflation is high and government foreign exchange reserves are low. The politically expedient path of financing social spending by borrowing would almost certainly spark a price spiral with no happy ending.

Thus, Maduro, who won only a narrow victory in the election, has an incentive to edge Venezuela away from Bolivarian Socialism toward de-nationalisation, deficit containment, and a fresh start with foreign oil companies. This path has a nearby precedent in Mexico, which has been inching toward free-market democracy since the 1980s, when a financial crisis forced reforms on the IMF's terms. Politics became more or less open, with multi-party elections taking place. Most of the state monopolies were privatised in the 1990s, social spending has been partly redirected from political patronage toward real needs, and the economy has diversified by becoming an important element in global manufacturing supply chains.

But it's far from clear that the left would follow Maduro toward a Mexican-style compromise. The Chavistas' preferred leader is the hard-liner Diosdado Cabello, the aforementioned speaker of the parliament. Nor is it clear that the centre-right would offer Maduro any political cover were he to try to form a more moderate coalition.





Venezuelan society is so divided that, as in the past, a lurch rightward would require the assent of the military—which, one can only hope, believes its parochial interests lie in a turn away from “Chavismo”.

The alternative is just more of same. In this scenario, the government takes its chances on the global oil roller coaster, with every dollar in the price of petroleum translating into \$800 million in annual earnings. In good times (like now), exports generate sufficient revenue to feed the Chavista constituencies. In bad times, when the oil price falls, the hardliners must rely on tighter political and economic control to weather the storm.

But time is not on the Chavistas’ side since the medium-term prospects are for relatively low energy prices, and Chávez’ brand of socialism makes it nearly impossible to diversify efficiently. Hence, as the supply of carrots to feed the true believers wanes, staying in power would require greater use of sticks. Inflation continues, at the expense of the poor, as well as the middle class. Required service on foreign debt goes up, even as foreign exchange reserves are under pressure. Schemes to ration dollars add another layer of confusion and corruption when dealing with the government.

Probably the first important indicator of where Venezuela is headed will come with the results from the municipal elections in December of this year. But the more decisive sign will probably arrive in 2015, with the congressional elections. The great forces of globalisation have yanked much of Latin America—think Mexico, Brazil, Colombia, Peru, Chile—toward market-friendly social democracy. May Venezuela feel the same pull.



*With the departure of the charismatic, authoritarian-minded Chávez, analysts see an opening for the forces of market-friendly social democracy.*

OVERALL RANKING: (TOTAL 142)

78

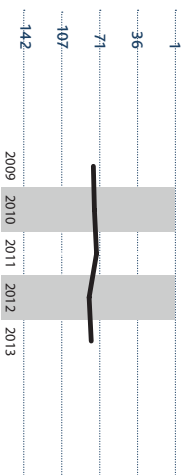
## AMERICAS RANKING

Canada	3
United States	11
Uruguay	30
Costa Rica	31
Chile	35
Panama	40
Trinidad and Tobago	42
Argentina	45
Brazil	46
Jamaica	56
Mexico	59
Belize	65
Colombia	67
Paraguay	68
Dominican Republic	70
Nicaragua	73
Ecuador	74
Peru	75
Venezuela	78
El Salvador	85
Bolivia	86
Guatemala	90
Honduras	96
Haiti	134

LEGATUM INSTITUTE | THE 2013 LEGATUM PROSPERITY INDEX™ COUNTRY FACTSHEET

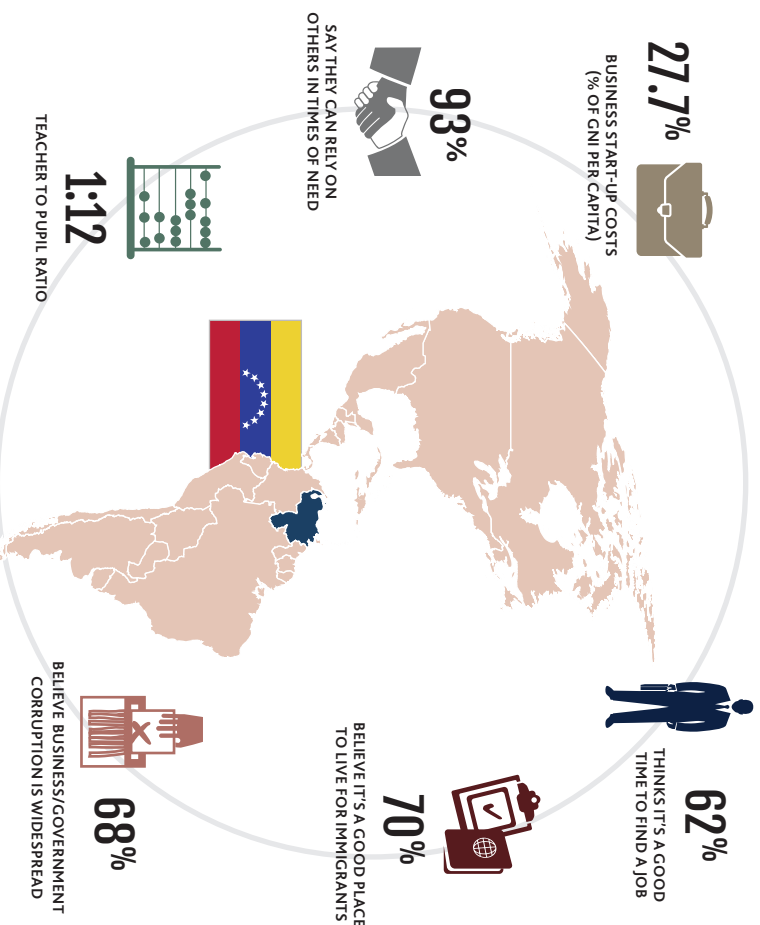
# VENEZUELA

## PERFORMANCE



"The decline over five years is, in part, due to the addition of 32 new countries in the 2012 Prosperity Index. In this instance, 5 of these new countries placed above Venezuela."

- » Venezuela has moved up three places to 78th in overall Prosperity since 2009.
- » Over the last five years, the country has declined two places to 127th in the Governance sub-index, due to decreases in government effectiveness, guarantees of the rule of law, and separation of powers.
- » The Health sub-index has risen seventeen places to 69th since 2009, because of increases in immunisation rates against infectious diseases and measles, life expectancy, health expenditure per person.



DATA IN FOCUS:

## SUB-INDICES

60	ECONOMY	Year	Data	Global Avg
	5 year growth rate	2011	1%	2.7%
	Confidence in financial institutions? * (% yes)	2012	70.9%	59.5%
	Satisfaction with living standards? * (% yes)	2012	79.3%	58.2%
89	ENTREPRENEURSHIP & OPPORTUNITY			
	R&D expenditure (% of GDP)	2011	0.7%	0.8%
	Mobile phones (per 100 ppl)	2012	102.1	103.9
	Will working hard get you ahead? * (% yes)	2012	94.6%	81.0%
127	GOVERNANCE			
	Confidence in the government? * (% yes)	2012	56.6%	51.5%
	Confidence in the judiciary? * (% yes)	2012	52.9%	52.1%
	Government effectiveness <sup>1</sup>	2011	-1.1	0.04
58	EDUCATION			
	Gross secondary enrolment rate	2011	83.5%	79.3%
	Satisfaction with education quality? * (% yes)	2012	78.1%	66.3%
	Perception children are learning? * (% yes)	2012	79.2%	70.2%
69	HEALTH			
	Self-reported health problems? * (% yes)	2012	20.3%	23.9%
	Hospital bed* (per 1000 people)	2011	0.9	3.1
	Satisfaction with health? * (% yes)	2012	89.2%	78.2%
110	SAFETY & SECURITY			
	Human flight <sup>2</sup>	2012	61	5.3
	Safe walking alone at night? * (% yes)	2012	26.0%	62.8%
	Property stolen in past 12 months? * (% yes)	2012	21.9%	16.5%
84	PERSONAL FREEDOM			
	Civil liberties <sup>3</sup>	2012	3	4.7
	Tolerance for ethnic groups? * (% yes)	2012	65.4%	68.0%
	Satisfaction with freedom of choice? * (% yes)	2012	80.4%	71.7%
68	SOCIAL CAPITAL			
	Volunteered time in past month? * (% yes)	2012	19.0%	20.1%
	Donated to charity in past month? * (% yes)	2012	13.7%	28.3%
	Helped strangers in past month? * (% yes)	2012	45.3%	47.9%

NOTES: <sup>1</sup>Gov. effectiveness: values range from -1.66 to 2.25, higher values indicate higher effectiveness. <sup>2</sup>Human flight: values range from 1 to 10, higher values indicate higher levels of human flight. <sup>3</sup>Civil liberties: values range from 1 to 7, lower values indicate lack of civil liberties. \*Survey data are taken from Gallup World Poll.



BUILDING A MORE PROSPEROUS WORLD THROUGH LIBERTY AND RESPONSIBILITY



[www.li.com](http://www.li.com)  
[www.prosperity.com](http://www.prosperity.com)

**LEGATUM INSTITUTE**  
11 Charles Street  
Mayfair  
London W1J 5DW  
United Kingdom  
t: +44 (0) 20 7148 5400

Twitter: @LegatumInst



ISBN 978-1-907409-32-5

NOVEMBER 2013