Venezuela: The Effects of Socialist Socio-economic Reform-The Chavez Legacy

Kimberly A. Foreman
St. John Fisher College

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Abstract
The intention of this paper is to examine the economic and social reform policies implemented in Venezuela under the administration of President Hugo Chavez to determine whether the policies have had a positive effect on the welfare of the country as measured by the human development index. Further, the paper will explore the impact of continued economic reliance on oil exports and the ramifications of this dependency for future economic and social development. The evidence suggests that the reforms promised in Chavez’s campaign of 1998 have been, for the most part, implemented with some level of success. Overall, the success of his programs have improved the socio-economic position of his people, buoyed by, not because of, changes in oil prices.

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**Venezuela:**
The Effects of Socialist Socio-economic Reform - the Chavez Legacy

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Master of Science in International Studies

By

Kimberly A. Foreman

Dr. John Roche, Advisor

Dr. David MacGregor, Second Reader

Dr. David Baronov, Program Director

Rochester, New York, the United States of America

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Abstract

The intention of this paper is to examine the economic and social reform policies implemented in Venezuela under the administration of President Hugo Chavez to determine whether the policies have had a positive effect on the welfare of the country as measured by the human development index. Further, the paper will explore the impact of continued economic reliance on oil exports and the ramifications of this dependency for future economic and social development. The evidence suggests that the reforms promised in Chavez’s campaign of 1998 have been, for the most part, implemented with some level of success. Overall, the success of his programs have improved the socio-economic position of his people, buoyed by, not because of, changes in oil prices.
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The Bolivarian Republic of Venezuela is a country renowned for its beauty and distinct geographical identity. Situated at the northern end of South America, Venezuela is bordered to the north by the Caribbean Sea and the Atlantic Ocean, on the east by Guyana, on the south by Brazil, and on the west by Columbia. Shaped somewhat like an inverted triangle, Venezuela contains 882,050 square kilometers of land area and an additional 30,000 square kilometers of water area, making it nearly twice the size of California.¹ It boasts the third longest river in South America, the Orinoco, and the world’s largest waterfall, Angel Falls located in the Guiana highlands. In reviewing human development in the country, Venezuela does not fare poorly and in fact is ranked 61st of 179 countries on the Human Development Index (HDI) ranking² placing it in the lower quartile among high human development countries. Life expectancy in the country is a robust 73.2 years, exceeding many other high human development countries. Adult literacy also compares quite favorably to countries in the high development category (see Appendix I) with a 93% rate (exceeding the literacy rate of fourteen countries ranked in the high human development category). Moreover, Venezuela has shown a .064 improvement in their long term (1980-2006) HDI score that places them squarely between improved scores in Switzerland (.059) and Norway (.068) (see Appendix 1).


However, Venezuela’s continued economic dependence on oil exports, coupled with persistent wealth distribution disparities among the wealthiest and poorest citizens, presents ongoing challenges to the country’s leadership. Despite nearly tripling GDP per capita (PPP $US) over the last three years, Venezuela’s GDP index continues to drag down its overall HDI ranking. Its 2006 GDP per capita of $11,115 ranks in the bottom quartile of other high development countries and, in fact, four medium develop countries enjoy a higher GDP index.

In 1998, a charismatic former military leader of “mestizo” (mixed race) heritage, Hugo Chavez, capitalizing on the raging discrepancy in wealth between the relatively small elite and the teeming masses of poor, blew to power in a whirlwind of economic reform promises. Immediately after election, Chavez successfully pushed through approval of a new constitution that granted rights with potentially massive socio-economic implications for the country. They included: the right to housing, free health care, social security benefits after even minor injuries, a minimum wage indexed to the cost of living, free public education through college, and a clean and healthy environment. The economic implications of these “rights” are staggering. By some estimates, institutionalizing these rights could impact GDP by as much as 14 percent per annum. Providing free nationalized health care alone would require a rise in public spending of 6 to 7 percent of GDP a year.

This paper examines the economic and social reform policies subsequently implemented during the Chavez presidency juxtaposed against the
historical development of the country's economy. In particular, I will demonstrate that the economic reforms instituted since Chavez's election have had a positive effect on the human development of the country; however, I will show evidence that the continued economic dependence of the country on a single export commodity, oil, could have negative consequences with respect to long term economic recovery. Finally, I will discuss the potential for Venezuela's economic future in light of Chavez's politico-economic position in Latin America.

**Historical Framework**

Venezuela was discovered by Christopher Columbus on his third voyage, 1 August 1498. The name “Venezuela” means “little Venice” and was named by explorer Alonso de Ojeda during his exploration of the coastline in 1499 because the stilt houses lining the shores of the Maracaibo resembled Venetian homes of the era. By 1600 Spanish conquest of the country was complete. The colonial rule of Venezuela was characterized by a general neglect of the country. In the absence of discovery of valuable resources, the Spanish basically ignored the land. Interestingly, the “discovery” of oil was noted by early Spanish explorers, however there was no commercial use for the crude dubbed “Satan’s excrement” by the colonists. What little resources Venezuela possessed, primarily agricultural in nature, were exploited by colonial rulers

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until the liberation of the country in 1821 by Simon Bolivar (pictured above right).

The colonial beginnings of the country are important to understand if for no other reason than to identify the lasting legacy left by the colonists in the social strata of the country. The fair-skinned Spanish colonists oppressed the dark-skinned indigenous populations both socially and, more importantly, economically. Despite the eventual mixing of races that created the “mestizo” class (mixed race) which comprises the vast majority (67%) of Venezuela’s population⁴, the social strata dictated by the light-skinned colonial aristocracy continued to play a major role in dictating political and economic power long after the last Spanish colonial ruler was opposed. This legacy of colonial rule is important in understanding current political and economic issues facing the country and the social justification for the grass roots support of the current political regime.

Another significant legacy of colonial rule, shared by many Latin American countries, was the development of caudillo (literally translated as “man on horseback”) rule.⁵ This concept of political domination by a strong, charismatic, often military, figure will be explored in more detail as the development of the democratic system in Venezuela is analyzed, specifically with respect to Venezuela’s current leader, Hugo Chavez.

A final important facet of development best understood in the historical framework is the evolution of the Venezuelan economy. Early colonists exploited

the agricultural resources of the country exporting cocoa until the bottom fell out of the cocoa market, then coffee. In the 1910s, oil was discovered in the Maricaibo Basin. By this time, technological developments had found a use for the resource and in the early 1920s Venezuela began to export oil internationally. By 1928 Venezuela was the 2nd largest producer and the largest exporter of oil in the world. Development of the oil industry, however, was largely dictated by foreign investors.

As the economy's dependence on the oil industry grew, disagreements over the handling and sharing of profits between the government and investors escalated. In an attempt to gain further control over the global oil market price, Venezuela joined with four other oil economies (Iran, Iraq, Kuwait, Saudi Arabia) to create the first permanent intergovernmental organization whose purpose was to unify petroleum policies among members – OPEC (Organization of Petroleum Exporting Countries). The effect of this development was to provide OPEC members with an effective vehicle for controlling the supply and pricing of the oil commodity. In 1976, in response to continued growth of its oil dependence and its fear of foreign control over so great a segment of the economy, Venezuela nationalized its oil industry.

Upon nationalization, the oil sector became the single largest employer in Venezuela. Agriculture diminished to the point where Venezuela could no longer fulfill its own requirements for basic food supplies. Economists refer to this

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phenomenon as the "Dutch disease". Dutch disease refers to the inverse relationship between natural resource endowment, on the one hand, and manufacturing and agricultural resource allocation, on the other hand. The larger the natural resource endowment, the more resources (capital and labor) are directed at the extraction of the resource, as well as the non-traded goods sector, and away from manufacturing and agricultural endeavors.\(^6\) This tends to have a negative impact on industrialization in general, as well as economic diversification. In the specific case of Venezuela, further complications arose from massive urbanization (away from agricultural areas and toward city centers) which created tremendous hardships on already overburdened metropolitan resources, exacerbating issues of poverty and lack of basic housing resources.

**The Politics of Oil: Development of Democracy in Venezuela**

The "rediscovery" of oil in the 1910s corresponded with the authoritarian rule of Juan Vincente Gómez who controlled Venezuelan politics from 1908 until 1935. Gómez, having overthrown his predecessor, General Cipriano Castro, with the aid of the United States, found himself heir to a weak government administrative structure in which clientelism and personalismo dominated the political arena.\(^7\) Furthermore, the poor, agriculture-based economy was ill-prepared for the capital investment required to effect Venezuela’s entry into the

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\(^6\) Furthermore, research shows that "economies with a high ratio of natural resource exports to GDP... tend to have low growth rates during the subsequent period." Sachs, Jeffrey D., Andrew M. Warner, *Natural Resource Abundance and Economic Growth*, Cambridge: National Bureau of Economic Research, 1995 (working paper 5398)
oil market. In order to maximize Venezuela's profit from the oil industry, Gómez negotiated lucrative contracts with U. S. companies for exploration and extraction of the oil. The resulting positive effect on State coffers, combined with the historical legacy of clientelism served to centralize power in the hands of the president, and thus instilled a realization of the power of petrodollars as a regime stabilizer.⁸

During Gómez's rule, the economic structure of the country transformed virtually overnight from an agricultural to an oil export-dependent economy. Critics cite rampant government corruption and failure to channel oil profits into social reform and economic diversification as reasons for eventual failure of the regime. Nevertheless, when Gómez's twenty-seven year tenure ended in 1935, it was followed by essentially more of the same: "transitional" military dictatorships that ruled by military and police suppression, rife with corruption, and clinging to the old patronage paradigm.

Raging demand for oil following the end of World War II, combined with the Iranian crisis of 1954 and the closing of the Suez Canal created a huge oil boom that lasted from 1950-1957. During that time, the Venezuelan Treasury reserves nearly tripled. However, it was precisely this prosperity which led to the end of Venezuela's long history of military rule and provided the catalyst for democratic conversion. As Venezuela's government coffers swelled, the military ruler at the time, Marcos Pérez Jimenez elected to curtail social expenditures and

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cut general subsidies to industry. This proved fatal to the regime. In 1957, 12% of Venezuelans received 50% of the nation’s income. The remaining 88% of the country’s citizenry split the other 50%. Discontentment over obvious economic inequities fueled by Jimenez’s miscalculated economic policies and fairly overt corruption provided the impetus to rival political factions to band together with one common goal: the overthrow of Jimenez and the foundation of a democratic institution.

However, in order to formulate the power necessary to remove Jimenez and effect positive political change, rival factions found it necessary to formalize their coalition through written pacts. The resulting democratic processes born of this union became known as “pacted democracy”. It was characterized by formal written agreements to share power and restrict access to prime government job opportunities. Until 1994, the office of president has been dominated by either one of two controlling parties: the Democratic Action (AD) and the Independent Electoral Political Organizing Committee (Social Christian Party, or COPEI). Venezuela’s Independent Party president elected in 1994, Rafael Caldera, had been a founding member of COPEI and, as a member of COPEI, also served as president from 1968-1973.

The section which follows examines the effects of Venezuela’s dependence on the oil economy on the disintegration of the pacted democracy system.

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8 Ibid, pg. 80
9 Ibid, pg. 97
11
Trouble in Paradise - the Demise of Pacted Democracy and the rise of Hugo Chavez

In December of 1998, a charismatic ex-military figure in the true legacy of the caudillo tradition, swept to victory in the Venezuelan presidential election. Hugo Chavez Frias succeeded at the polls where he had failed in two unsuccessful “golpes” (military interventions or coups). Riding to victory under the Bolivarian Movement (MB 200) on a solid platform of social reform, Chavez captured the popular vote from the millions of disenfranchised dwelling in the “88%” mentioned above. Chavez, an avowed socialist, was a man of the people, a dark-skinned mestizo who rose from the ranks in the military and spouted social and economic reforms designed to capitalize on the failings of prior administrations to manage the effects of fluctuations in the oil economy, most notably the utter economic chaos created by the dominant AD party under Carlos Adrés Perez during the oil boom of the mid-1970s.

The below chart\(^\text{10}\) graphically depicts the phenomenal oil price spikes of the 1970s caused chiefly by political unrest in the Middle East. The effect of this boom on Venezuelan oil profits was unmistakable. “Rents” generated from royalties and taxes on oil production swelled the Venezuelan Treasury. The new president, Perez, went on a spending spree. Aided by legislation designed to enable the office of the president to rule by decree (the Special Powers Act),

Perez set in motion his plan for “La Gran Venezuela”, an ambitious network of government programs the purpose of which was to promote modernization and effect economic diversification. Government spending tripled. But a number of problems plagued the Perez administration:

1. The nationalization of the oil industry in 1976, designed to ensure political and economic control over Venezuela’s primary source of government funding, created unforeseen issues. The administrative structure for managing the oil industry under nationalized rule was weak and inefficient. Furthermore, oil revenues were initially impacted heavily by the pullout of foreign investment and the subsequent loss of royalties and taxes. Further implications of the management of the nationalized industry are discussed below.
2. Oil revenues were insufficient to finance the economic diversification projects envisioned by Perez. He thus initiated an aggressive campaign of financing through borrowing, causing public debt to soar. In 1973, the year before Perez took office, public debt was 470M Venezuelan bolivares (VEF) on government expenditures of 15,042M VEF. When Perez left office in 1978, public debt had ballooned more than five hundred percent to 2,564M VEF against a tripling of total expenditures to 49,905M VEF.\textsuperscript{11} The combination of increased revenues, soaring debt, and skyrocketing government spending had the inevitable economic effect of producing unprecedented inflation.\textsuperscript{12}

3. The administration failed to effect meaningful change to the tax structure of the economy. Debt was growing because the oil revenues were failing to keep up with government spending and the general population could never grasp the concept of taxes in the face of plenty. Why should the man on the street be expected to pay increased taxes during a time of plenty?

Competing factions within the dominant parties (AD and COPEI) capitalized on the struggles of the Perez administration and in 1979, Luis Herrera Campin (COPEI) took the presidential reins from Perez. First Campin (COPEI -

\textsuperscript{11} Karin, Terry Lynn, \textit{The Paradox of Plenty - Oil Booms and Petro-States}, Los Angeles: University of California Press, 1997, pg. 165

\textsuperscript{12} Evidence suggests that the rise in inflation (which had been a stable 3% prior to 1970 and had risen to 25% by the mid-1980s) was driven by a combination of currency devaluation and fiscal debt. (See: http://www.mongabay.com/reference/country_studies/venezuela/ECONOMY.html Accessed 27 January 2009.
1979-83), then Jaime Lucent (AD - 1984-88) suffered the legacy of the Perez unfettered spending and borrowing patterns. When oil prices began their fall to earth in the mid-1980's, the government was left chained to an outrageous government spending program with no visible means of support. The endless cycle of borrowing and spending, which drove inflation to 25% by the mid-1980s\textsuperscript{13}, was creating serious public unrest.

The reeelection of Perez in 1988 (AD 1989-93) was largely attributed to association of the Perez regime with the relative economic prosperity of the 1970s. Thus, it came as a nasty shock when Perez, the big spender, instead went on an austerity program designed and mandated by the International Monetary Fund (IMF). The result was economic chaos. Real GDP per capita (1990 dollars) fell from $3,157 in 1976 (midway through Perez’s first term) to $2,514 in 1990 (midway through his second term). Meanwhile, Venezuela’s Consumer Price Index in the same periods skyrocketed from 7.9 (1990 = 100), to 100 and the exchange rate (VEF per dollar) ballooned from 4.29 to 46.9.\textsuperscript{14}

Rafael Caldera, former COPEI member, running on the Independent ticket wrested power from the AD party once (and possibly for all) in 1993. Unfortunately, Caldera was hampered by commitments made to the IMF under Perez and by the inability to turn the oil slump around due in large part to the lack of any economic diversification and continued dependence on oil profits. Oil prices bottomed out in 1998. That, coupled with the ongoing failure of

\textsuperscript{13} Ibid
\textsuperscript{14} Levine, Daniel H., Brian F. Crisp, \textit{Venezuela The Character, Crisis, and Possible Future of}
government to address the raging poverty among Venezuela’s masses, created the perfect environment for the political entry of the charismatic Chavez.

**Economic and social reform**

Hugo Chavez was elected to the presidency of Venezuela in 1998 and took office in 1999, the arguably democratic result of long term disenfranchisement of the poor. Immediately, Chavez began a campaign of economic and social reforms designed to wrest power from the moneyed elite and redistribute wealth based on Chavez’s vocal Marxist leanings. Such reforms were widely disparaged by the opposition which sought to overthrow the Chavez government by both force and by economic sabotage. In April of 2002, barely two years after Chavez assumed office, opposition factions staged a coup d’etat that temporarily replaced Chavez with a local business leader, Pedro Carmona.\(^{15}\) Less than 48 hours later, the pro-Chavez Presidential Guard, backed by a pro-Chavez grass-roots uprising, reinstated Hugo Chavez to office. Subsequently, driven by a coalition of oil magnates, labor unions and oil workers, and supported by the anti-Chavez upper management of the national oil company, Petróleos de Venezuela S.A. (PdVSA), a general strike in December of 2002 shut off access to oil revenues needed to fund Venezuela’s government coffers. The strike of 2002 crippled Venezuela’s economy. The percentage of

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population declared "poor" or "extremely" poor increased from 48.1% in the first half of 2002, to 62.1% in the second half of 2003 (see Appendix 2). Chavez’s handling of the general strikes in late 2002 did nothing to endear him with his adversaries in the business sector. He fired thousands of PdVSA workers and management, anyone who had joined in the general strike to shut down production. Then he replaced these workers with his own allies, regardless of qualification. However, once Chavez took control of the oil industry in the second quarter of 2003, the political climate began to stabilize, and subsequently Chavez was able to pursue his social and economic reform platform.

The early political instability of the Chavez presidency is important to note due to its significant impact on the economy of the country and the ability of Chavez to effectively implement and fund his social and economic reform agenda.

The Reforms

Economic reform – the means to fund a social revolution.

From day one of his presidency, Chavez targeted the oil industry for reforms directed at wresting control from the elite and returning the industry to sufficient profitability to sustain his social reform programs. Such reforms included:

1. Re-nationalization of the industry. When Chavez created a new Venezuelan constitution in 1999 ratified by an overwhelming majority of the citizenry, he effectively squashed plans to privatize the oil industry by including a provision
that the oil industry would remain a nationalized industry in perpetuity.

Needless to say, this did not win him friends in the country’s oil company
hierarchy, Petróleos de Venezuela (PdVSA), a hierarchy heavy with
Venezuela’s privileged elite. The move was interpreted as a power play by
PdVSA management, creating a backlash that contributed greatly to the strike
addressed above.

2. **OPEC relations** - Chavez is credited with having re-energized the dominance
of OPEC in the control of petroleum exports. Working with other OPEC
members, Chavez “promoted successfully a new understanding on quotas
and higher prices between OPEC members and other exporting countries.”\(^\text{16}\)

3. **Changes in calculation of revenue base.** Revenues from the oil industry are
generated in two ways: through a fee per barrel (royalty), and through
income taxes. Royalties and taxes were calculated at 73% of export revenues
in 1981, but had fallen to 41% in 2000, averaging only 36% since 1993.\(^\text{17}\)
The reason for this decline can be traced to the methodology employed in
calculating taxable income. In general, royalties are calculated at 16.67% of
the price per barrel (though there are some special arrangements with
developers for a substantially reduced fee). The income tax rate, on the other
hand, is 67.7% for hydrocarbons. PdVSA, through manipulation of foreign
investment, imported expenses from outside the country to offset in-country
income, thus reducing their overall liability. Chavez put in place measures to


\(^{17}\) Ibid
reduce the effects of these loopholes by increasing the royalty rate to more than 20% while decreasing the income tax rate to the non-hydrocarbon rate of 34%. The effect is two-fold:

- Calculations are simplified. The number of barrels exported is a known quantity. Simple multiplication against a royalty base eliminates the potential problem of income reporting accuracy.

- Disincentives to recognize expenses (as they do not produce the same tax benefit as previously) served to improve efficiencies and expense control at PdVSA. Naturally, this too, did not cement friendships between Chavez and the management of PdVSA.

Overall, the reforms proposed by Chavez made sense. Chavez, on the other hand, has not been completely successful at gaining popular support for his economic reforms for two reasons: 1) The elite, dominant economic class continues to feel disenfranchised and has made a number of attempts to oust Chavez in favor of a leader more sympathetic to their needs, most notably the strike of December 2002 previously addressed which crippled the economy by virtually ceasing all oil production for several weeks. In addition, the opposition attempted a recall referendum in August of 2004. Chavez successfully thwarted the recall by a 59% to 41% margin, effectively reaffirming the "people's" endorsement of his social and economic agenda. 2) Chavez can be very abrasive in the international political scene, particularly towards the United States of America. While this U.S. bashing has proven to be supported by the
nationalistic masses, alienation of such a large country and large customer is not
generally expected to have a positive long-term effect on one’s economy.
Furthermore, Chavez continues to threaten private business concerns with
policies of nationalization (which are poorly received despite compensation),
coupled with government joint ventures with diplomacy-challenged countries
such as Cuba and Iran.

Chavez has continued to implement socialist economic reforms in an
attempt to diversify and expand Venezuela’s economy. In December of 2007,
Venezuelan voters rejected a referendum to amend the Constitution that would
have greatly expanded Chavez’ presidential power, amendments generally
condemned as granting Chavez a dictatorship over Venezuelan politics. Despite
this defeat, the first in his nine year presidency, Chavez has taken steps to
enhance government control of the economy by nationalizing more and more
companies. Chavez has, in 2008, pursued nationalization of an Argentinian-
controlled steel maker (Sidór), Mexican, Swiss, and French owned cement
companies, and dairy, sugar and cattle concerns.¹⁹ Chavez rationalizes his
economic reform as necessary to diversify the Venezuelan economy and finance
his successful social reform programs.

**Social reform – promises kept.**

Chavez rose to power in a social environment of want. The result of long

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term misuse and abuse of political power, the majority of Venezuelan citizenry lived in poverty with 61% of the population declared poor (29.5% declared extremely poor).\textsuperscript{20} Chavez told the people of Venezuela what they wanted to hear – he was “one of them” – he was for the people. His promises of social reform included: the right to housing, free health care, social security benefits after even minor injuries, a minimum wage indexed to the cost of living, free public education through college, and a clean and healthy environment.

\textit{The right to housing}

On July 31, 2008, Chavez issued a piece of legislation which became widely known as “The 26 Laws”. The legislation was designed to reform and codify some of the public administration and social reform issues Chavez had promised in his election campaign of 1998. Included in the 26 is the “Law of Housing and Habitat Lending.” Designed to make housing more accessible and affordable to the poor, elderly and minority communities, the law allows for 100% mortgage funding coverage and subsidizes the poorest citizens to meet their housing needs. The legislation is specifically designed to facilitate rapid housing growth and meet the Chavez goal of providing affordable housing to all. Political detractors point to the costs associated with subsidizing home ownership, and the disincentives in the lending market posed by the risk of carrying 100% financing on a mortgage in disparaging the law. The long term success or failure of the law will play out over the next few years; however, Chavez supporters point to this action as a positive step in the President’s social reform journey.

Free health care

Articles 83-85 of the Constitution of the Bolivarian Republic of Venezuela, drafted by Hugo Chavez in 1999, established free health care throughout Venezuela.\textsuperscript{21} Article 84 mandated the mechanism for providing this health care and in 2003, shortly after Chavez took action to end the oil strike at PdVSA and take control of oil revenues, Mission Bario Adentro (literally translated as "Mission into the Neighborhood") opened for business and accepted its first class of medical students. Bario Adentro both trains Venezuelan medical personnel and provides free comprehensive health care via a system of clinics throughout the country staffed by Venezuelan personnel as well as 20,000 Cuban healthcare workers. Since the inception of its universal health care program, infant mortality rates have dropped by 7.4\% (from 23.79 deaths per thousand in 2003 to 22.02 in 2008)\textsuperscript{22}, although life expectancy has actually gone down marginally during the same period (about .5\%).

However, the Chavez government has greatly increased spending on health care programs, from 1.4\% of GDP in 1998 to 1.8\% of GDP in 2006, an increase of more than 28\%. The number of primary care physicians has increased exponentially, from one doctor for every 14,000 Venezuelans to 1 doctor for every 1,400.\textsuperscript{23} The impact of government expenditure on health care and the provision of universal free health care benefits has had a measurably positive impact on the standard of living for the poorest in the country. One

\textsuperscript{23} Weisbrot, Mark, Luis Sandoval. "Update: The Venezuelan Economy in the Chavez Years." Center for
source estimates that the positive impact of free health care on poverty levels is somewhere between 2-5%. In other words, when analyzing poverty level figures pre-Chavez and since the constitutional reforms of 1999, decreases in poverty levels should be incrementally altered to account for this additional 2-5% “non-cash” impact.24

**Social Security Benefits**

Impact on social security benefits under the Chavez regime is unclear. In The 26 laws, under the “Law of Partial Reform of the Law of Social Security,” Chavez mandated penalties for employers who failed to withhold the mandatory 3% from employees paychecks for social security. The law also provided access to the employee portion of the social security contribution toward housing payments and funeral costs. However, benefits available prior to The 26 Laws appear to be at least as good if not better, and there is no apparent evidence of positive reform impact in the social security sector. In fact, in January of 2000, the Chavez administration chose to provide funding to bail out the bankrupt Venezuela Institute of Social Security (IVSS), but promised reform has yet to be implemented.25 Despite stagnation in the social security reform arena,

Government spending on social security has increased a whopping 157% from 1.4% of GDP to 3.6% of GDP (see Appendix 3). A primary concern, in light of the fact that government spending is financed almost entirely from oil revenues,

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is whether a major downturn in the price of oil will drive a massive social reform “bust”. This concern will be addressed later in this paper.

**Minimum wage indexed to the cost of living**

The minimum wage in Venezuela has steadily increased during the Chavez presidency. In 1998, when Chavez was elected, the minimum wage was $183 per month. In May of 2008, Chavez raised the minimum wage to its current rate of $372 per month (excluding government subsidized food stamps), an average annual increase of just over 10%. However, the minimum wage has failed to keep up with inflation (cost of living index), which has averaged closer to 20% over the same time period. In all fairness, however, it should be noted that inflation pre-Chavez averaged well over 40% per year for the ten years before he took office, peaking in 1997 at more than 115%. Furthermore, while Chavez’s goal of indexing minimum wage increases is laudable, in an economic environment of average 20% inflation, it is far less realistic and may, according to many economists, aggravate the very inflation against which it is indexed.

**Free public education**

While compulsory education through age fourteen has been the norm in Venezuela for decades, the constitution of 1999 established free higher education. Government spending on education in the Chavez years has increased from 3.4% of GDP to 5.1%, a 50% increase. To increase attendance and access at the higher education level for the poor and middle class, the

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Universidad Bolivariana de Venezuela (UBV) system was established by Presidential decree in 2003. It admits students regardless of economic situation or prior education and provides them with a free university education. In addition, in July of 2003, Chavez launched “Misión Robinson”, a program designed to eradicate illiteracy in Venezuela.

While access to higher education and literacy programs may indeed provide potential for improved standards of living and may contribute to decreases in poverty levels, there is no statistical evidence that increased education expenditures by the government or access to free higher education and literacy programs has improved the overall education of the country (as measured by literacy rates). Literacy levels in Venezuela have remained a stable 93% over the last ten years and studies of the specific Misión Robinson literacy program have found no statistically relevant impact of the program on literacy levels.28 Unfortunately, the impact of Chavez’ educational reforms can be qualitatively speculated, but not quantitatively proven.

Clean and healthy environment

A long standing issue of the Venezuelan economy pegged to the oil industry involves Venezuela’s environmental issues. Severe pollution has been a by-product of oil exploration and extraction. Lago Maracaibo (Lake Maricaibo) in northern Venezuela is the largest lake in South America. It is also the most polluted, with fishing villages along its shores virtual ghost towns.29 The rivers

that feed Lago Maricaibo have also become rife with oil pollution, destroying
delicate biological habitats. Since 2005, mandated by the Chavez administration,
PdVSA has been "going green" with environmental recovery plans that include
recuperating green areas, water decontamination projects and emissions
reduction.

In 2005, Chavez enacted “Mišion Arbol” (Mission Tree) in an effort to fight
against the ravages of rainforest deforestation. The program’s goal was to
emphasize conservation of Venezuela’s forests through a socially responsible
community-based plan of development. In early 2007, Chavez announced
stricter emissions control laws targeted at reducing environmental
contamination.30

**Impact of Chavez’s reforms on the economy of Venezuela**

**Government expenditures**

Bolstered by oil price increases through 2007, the Chavez administration
has pumped tremendous financial resources into ensuring its social and
economic reform success. Real GDP has steadily risen since bottoming out in
the first quarter of 2003 (following the PdVSA strike), averaging about 4.4% since
2003. Public spending as a percentage of GDP has increased just under 1% per

---

year, from 23.7% of GDP to 31.0%. More than two thirds of this increase is attributable to increases in social spending (see Appendix 3). As a percentage of public spending, social expenditures now account for more than 44% of the total. The top areas of increased social spending reflect the focus of Chavez’ social reform programs: Education (50% increase in spending from 1998 to 2006); health (28.6% increase); housing (60% increase); and social security (157.1% increase).

While government expenditures clearly support significant pursuit of the social and economic reforms on which the Chavez presidency based its campaign, the larger question is - how vulnerable are Venezuela’s tentative reform successes to fluctuations in its single largest source of income: oil revenues? This topic will be discussed in the final section of this paper.

**Poverty levels**

![Graph showing population below poverty line in Venezuela from 2000 to 2008](image)

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31 See: [www.indexmundi.com](http://www.indexmundi.com). Accessed 26 December 2008
As the above graph clearly demonstrates, poverty levels have improved dramatically during the Chavez presidency. While the distribution of wealth (as measured by share of consumption) has not significantly changed, the distribution of consumption in Venezuela does not compare unfavorably to that of the United States, with the lowest and highest 10% of income levels consuming .7% and 35.2% of GDP respectively in Venezuela, and 2% and 30% of GDP respectively in the United States. GDP per capita (see above) has also shown a marked increase during the Chavez administration, reversing a downward trend. From 1975 to 1998, GDP per capita fell from $4,195 to $3,499 (1995 dollars). Changes in GDP, while arguably linked to fluctuations in oil prices, can not be solely calibrated to that index. GDP fell from 1975 to 1998 despite

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32 Ibid
dramatic increases in oil prices resulting from the “oil crisis” of the late ’70s and into the ’80s. Furthermore, there were declines in GDP per capita from 2000 to 2004 that did not appear to trend with oil prices (see Appendix 4). However, certainly the political instability of the early Chavez presidency (the coup, the strike, the recall referendum) are directly reflected in the economic performance of the country. Recovery shown since 2004 is likely attributable to some extent both to the political stabilization and subsequent implementation of economic and social reforms as it is to the increases in oil prices.

*Economic and Social Reform Under Chavez – Is it real, or is it Memorex?*

Chavez’s detractors claim that improvements in the economic and social condition of the company are both marginal and transient, attributable to oil revenue-generated government spending. In an economy where more than 50% of government revenues are from a single source, oil, are price increases in that commodity creating a smokescreen to mask the lack of real socio-economic progress? Is Chavez on the right track or are his reforms doomed to failure by choices the government has made to link its economic dependence to a non-renewable resource? Current proven reserves are estimated at 80 billion barrels^34^ (approximately 80 years). Hanging the future of a country on such a commodity may be disastrous down the road, even as it has been credited by some as providing the foundation for growth over the last ten years. However, evidence suggests that Chavez has not been hanging his hat entirely on the
whims of the volatile oil market.

First, growth in government spending has not kept up with oil price increases. One factor universally attributed to the downfall of prior administrations was the out of control government spending that accompanied oil price increases.\textsuperscript{35} Vast and expensive infrastructure projects were left unfinished and in ruins following the oil price collapse of 1981. However, the Chavez administration spending has not kept pace with oil price increases. In 1998, total government spending was 23.7\% of GDP. In 2006, government spending had increased to 31.0\% of GDP, a 30.8\% increase. During that same time period, oil prices increased from an average of $15.70 per barrel in 1998 to $62.11 per barrel in 2006, a 295.6\% increase.\textsuperscript{36} As oil prices have increased, government revenues have increased commensurately. By keeping the rate of increases in spending lower than the rate of increases in revenue, Chavez has managed to bring the central government budget in balance as of 2006. Furthermore, Chavez' 2007 budget presumed an average price for oil of $29 per barrel, against an actual of $66.40 per barrel. Chavez has channeled additional revenues into creating a financial cushion for Venezuela to weather potential downturns in oil prices. Venezuela has built up international reserves of $34.3 billion (2007) and has significant access to foreign lending markets (most notably China with which Chavez has been cementing relations).

\textsuperscript{36} See: \url{http://www.inflationdata.com/inflation/Inflation_Rate/Historical_Oil_Prices_Table.asp}. Accessed 26 December 2008.
Second, there can be no dispute that Venezuela has improved its socio-economic position as measured by the Human Development Index. Venezuela has improved its index by approximately 13.8% from 1998 (.726 HDI) to 2006 (.826 HDI - year of last available data – see Appendix 1). There are two important notes to this improvement: 1) As the HDI measures human development using a wide range of measurements including both social and economic factors, the improvement reflects more than just a single element; 2) The improvement is not purely numeric, but is positional as well. Venezuela improved from a ranking of 65th in 1998, which placed it in the “medium human development” category, to 61st in 2006, which moved it to the “high human development” category. One can not attribute this improvement entirely to increases in oil revenues. For example, the improvement in HDI from 2005 to 2006 was .011. This improvement was driven not just by per capita GDP (.005 improvement, which could arguably be the result of increased oil revenues), but also by life expectancy (.001) and gross enrollment ratio in education (.005). Positive gains in these two areas would suggest a correlation between the implementation of Chavez’s social reforms (free higher education and health care) and improvement in Venezuela’s human development. What’s more, if one argues that positive HDI fluctuations track oil prices (and, by default, oil revenues), then one would expect to have seen a measurable drop in HDI when the bottom fell out of the oil market in the early eighties. Instead, Venezuela’s HDI was flat from 1980 through 1985.

Furthermore, Chavez has channeled resources into economic
diversification intended on reducing economic dependence on oil. Non-oil sector GDP growth has vastly outpaced oil sector growth (which in fact has declined 1.5% on average each year since Chavez took office). The communications, and financial and insurance sectors have seen the greatest growth, growing on average 11.2% and 13.9% respectively since 1998.

However, despite diversification efforts, the economy continues to rely on oil to fund more than 50% of government spending. The downturn in oil prices over the last twelve months has not left Venezuela unscathed. Chavez’s 2009 budget calls for oil prices of $60 per barrel, which are currently hovering just above $50 per barrel. External debt climbed to $46.2 billion in June of 2008, up 71% from 2006 year end levels. In December of 2008, Standard and Poor’s lowered Venezuela’s debt rating outlook from stable to negative. S&P analysts cite Chavez’ reluctance to cut government spending, likely driven by political motives as he has struggled to enact constitutional reforms that would eliminate term limits, allowing him to seek another six year term as president.

Clearly there have been measurable, meaningful economic and social gains as a result of reforms instituted by Chavez. But what happens when the oil runs out? What happens if oil prices sink and fail to recover (they’ve already sunk... will they recover?). Can Venezuela revert to an agricultural economy? Such a conversion is unlikely unless Venezuela effects serious change in its current economic focus. Currently, Venezuela imports 80% of its food.

Agricultural capacity has been sacrificed for petroleum sector development. Furthermore, agriculture’s contribution to GDP has actually decreased during the Chavez administration from 5.2% of GDP in 1998 to 3.8% of GDP in 2007. However, in July of 2008, Chavez enacted, as part of “The 26 Laws”, the “Organic Law of Agro-food Security and Sovereignty” to encourage development in food-related technology and transportation. Under Plan Zamora 2003, Chavez empowered the National Land Institute to expropriate unused land at fair market value (similar to eminent domain) and redistribute government held lands to peasant farmers. The purpose of these two laws is to encourage growth in the agriculture sector and reduce Venezuela’s dependence on foreign food imports.

Venezuela’s economic future under Chavez

Clearly the majority of Venezuela’s economic and political issues can be traced to its dependence on a single commodity: petroleum. While Chavez has, without doubt, instituted many positive economic and social reforms, long range planning for economic growth in the country must necessarily be directed at reducing its financial dependence on oil. It is essential for Venezuela to diversify if it is to survive long-term.

Possibilities for diversification can be found in some of the less developed sectors of the economy:

- Hydroelectricity – Venezuela has a highly developed hydroelectricity program. In 2005, Venezuela generated 25.8 billion kilowatthours more in
electricity than they consumed, exporting the balance (mainly to Brazil). Of that, 75% was hydroelectric.\textsuperscript{39} The state-owned Electrificacion del Caroni operates the three hydroelectric plants that supply more than 75% of Venezuela’s power and a fourth, the 2,200 megawatt Tocoma Dam, is scheduled for completion in 2010. Venezuela currently taps only a small fraction of their hydroelectric capacity.

- Tourism – The llanos and rainforests of Venezuela are home to thousands of species of birds and animals. The country boasts the third longest river in South America and the highest waterfall in the world. It lies on the Caribbean with vast stretches of undeveloped beaches and waterfront.

- Agriculture – Vast areas of fertile deltas remain fallow, primarily the result of urban migration. The fact that Venezuela imports 80% of its own food is a frightening statistic. While Chavez has enacted a number of land reform laws aimed at reversing this trend, to date the government has displayed reluctance to expropriate any of the 60% of fertile farmland held by 2% of landowners.

The level of dependence on this single commodity must be addressed if Venezuela is to prosper and move firmly into a developed country status.

The larger question remains what are the political ramifications of Venezuela’s likely continued reliance on the oil economy, particularly for its current embattled leader, Hugo Chavez? Efforts to call a referendum for the

ouster of Chavez, primarily driven by the elite factions in the political opposition, business and the press, have been unsuccessful. Opinion varies dramatically from analysis to analysis with respect to Chavez's true support, although recent election results (November 2008) show little sign of diminished support, with Chavez's socialist party capturing 17 of 22 states up for election. Some accounts show him with continued strong support among his grass roots constituency, and this remains true especially in the rural areas, Chavez's traditional stronghold. A referendum in February of 2009 eliminating term limits passed with 55% of the vote. Other accounts have him universally despised – though my research seemed to indicate that this was mostly claimed by Western governments and Venezuelan elite.

However, Chavez's attempts to forge a new socialist order have created many political stumbling blocks that threaten to sideline his long term reform efforts. 1) The elite, dominant economic class is feeling disenfranchised and has made a number of attempts to oust Chavez in favor of a leader more sympathetic to their needs, most notably the strike of December 2002 previously addressed which crippled the economy by virtually ceasing all oil production for several weeks. However, the opposition has failed to coalesce behind one strong candidate with a solid platform of reform, and the rural and urban poor, which numerically dominate at the polls, have supported Chavez thus far. 2) Chavez can be very abrasive in the international political scene, particularly towards the U.S. While this U.S. bashing has proven to be supported by the nationalistic masses, alienation of such a large country and large customer can not have a
positive long-term effect on one's economy. 3) Chavez and his socialist party have, since winning the February referendum allowing unlimited terms, boldly and aggressively pursued anyone expressing opposition to his authority. The mayor of Maricaibo is in hiding, charged with corruption. The mayor of Caracas has lost much of his power. Emboldened by his apparent vote of confidence, there is much speculation that Chavez could turn from democratically elected socialist patriarch to fascist dictator should oil prices, and oil revenues, continue to be depressed.

However, Chavez continues to provide tangible proof that his economic and social reforms are more than just lip service. Despite a budget deficit in 2009 that is expected to continue at least into 2010, Chavez continues to pump money into committed non-oil sector development projects, investing $20 billion in 2009 alone.40 The reforms promised in his campaign of 1998 have been, for the most part, implemented with some level of success. Overall, the success of his programs have improved the socio-economic position of his people, buoyed by, not because of, changes in oil prices. In light of the economic positioning of the Chavez administration, there is little evidence that Chavez’s program will not progress in spite of a downturn in oil revenues. 2009 will be a key year in determining the potential for long term success of Chavez’s reforms.

## APPENDIX 1

### 1. Human development index trends

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### 2. Income, education, and life expectancy

- **Long-term**
- **Medium-term**
- **Short-term**

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### 3. Human development index by region

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- **Medium-term**
- **Short-term**

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### 4. Human development index by income group

- **Low-income**
- **Lower-middle-income**
- **Upper-middle-income**
- **High-income**

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### 5. Human development index by life expectancy group

- **Low life expectancy**
- **Lower-middle life expectancy**
- **Upper-middle life expectancy**
- **High life expectancy**

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### APPENDIX 1

#### 1 Human development index trends

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**NOTE:** The human development index values in this table were calculated using a modified methodology and data sources. They are not strictly comparable with those in earlier Human Development Reports.

**REFERENCES:**


**Source:** Human Development Report 2000
## APPENDIX 1

### Human Development Index

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<th>Adult literacy rate (%)</th>
<th>Combined gross enrollment ratio in education (%)</th>
<th>GDP per capita (PPPS)</th>
<th>Education index</th>
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**Legend:**
- **HDI:** Human Development Index
- **Life expectancy:** Life expectancy at birth (years)
- **Adult literacy:** Adult literacy rate (%)
- **Combined enrollment:** Combined gross enrollment ratio in education (%)
# APPENDIX 1

## Human Development Index

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### Notes:
- The above table provides data for various countries on their Human Development Index, including life expectancy at birth, adult literacy, and combined gross enrollment ratio, among other indicators. The data is presented from 2008 to 2020.
APPENDIX 1

2. Human development index

<table>
<thead>
<tr>
<th>Country</th>
<th>HDI rank</th>
<th>Life expectancy at birth (years)</th>
<th>Adult literacy rate (% above 15 yrs of age)</th>
<th>Combined gross enrollment ratio in education (%)</th>
<th>GDP per capita (PPP US$)</th>
<th>Life expectancy index</th>
<th>Education Index</th>
<th>GDP index</th>
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NOTES

a. Data refer to national literacy estimates from censuses or surveys conducted between 1995 and 2000, unless otherwise specified. Due to differences in methodology and definitions of underlying data, comparisons across countries and over time should be made with caution. For more details, see the Human Development Report.

b. A positive number indicates that the HDI rank is higher than the GDP per capita (PPP US$) rank, a negative number implies the opposite.

c. For purposes of calculating the HDI, a value of 90.0% is applied.

[Other notes and sources related to the HDI calculation and data sources]
### APPENDIX 2


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<th>Time Period</th>
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<th>Population (% of total declared)</th>
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**Source:** Instituto Nacional de Estadística (INE), República Bolivariana de Venezuela.

---


42
### APPENDIX 3


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**Source:** Sistema de Indicadores Sociales de Venezuela (SISOV) and Banco Central de Venezuela (BCV)

**Notes:**

// Does not include social spending by PDVSA, the state oil company, which in 2006 contributed $13.3 billion (or 7.3 percent of GDP) to social projects.

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43
Oil Prices, 1994-March 2008
(NYMEX Light Sweet/WTI)

Dollars per Barrel


Bibliography


