Hugonomics:

Venezuela's fight against poverty, and against the private sector

By Philip Peters ★ September 2009

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Summary

Hugo Chavez was elected President of Venezuela in 1998 and has proceeded to lead and symbolize a new variant of the Latin American political left. His Bolivarian Revolution and his push toward socialism have been characterized by strong rhetorical commitment to the poor, a larger state role in the economy, and authoritarian practices in political affairs.

Chavez is a former military officer whose first bid for power came in a failed coup attempt in 1992. He did not come from an elite social background and had no affiliation with either of the political parties that dominated Venezuelan politics since the late 1950's. Given Chavez' background, his stated economic goals, and Venezuela's oil wealth, it seemed that his government would find a way to lift many Venezuelans out of poverty, and perhaps to create a new model for poverty reduction policies in a continent whose record on that score has been spotty. If ever there was a government that had the opportunity to fund social programs while preserving the benefits of private sector economic development, it was Venezuela's.

A decade later, the degree to which Chavez has lifted Venezuelans out of poverty is subject to debate. What is clear is that the Bolivarian Revolution has developed new means of delivering services to low-income Venezuelans, and is developing an economic model that not only relies less and less on the private sector, but is in fact reducing the ability of private businesses to operate.

In the economic sphere, the drama of the next decade of the Bolivarian Revolution will be the extent to which private economic activity can continue and prosper, and whether Venezuelan social programs – in a context of lower oil revenues – can address not only the social problems that Chavez inherited, but also those created by own his policies' squeeze on the private sector.

This paper is based in part on visits and interviews conducted in Caracas in July 2008.

The Bolivarian anti-poverty mission

At the western end of the Caracas subway line is the working-class neighborhood of Propatria. A block from the subway stop, there's a line of "metros," four-wheel drive vehicles that carry you up the steep mountainside to the neighborhoods that look down on the capital.

From below, the mountainside looks like it is stacked with slums. But after a 25-minute, 50-cent, bone-jarring ride that climbs 1,000 meters up the mountain, things look different. It's a mixed income neighborhood – some houses are poorly and recently built, others established and well decorated; some residents seem unemployed, but one sees professionals and a few children in private school uniforms too.

Deep into the neighborhood, called Brisas de Propatria, there's a little building that one sees all around Caracas. It's hexagonal, red brick, two stories with blue trim – a neighborhood health clinic, one of the most visible manifestations of the Chavez government's social services efforts.

Inside are a doctor and nurse from Granma, Cuba, a married couple who work in the examination rooms downstairs and live in the small apartment upstairs, just as family doctors do in Cuba. Also as in Cuba, they hold office hours in the morning and make house calls in the afternoon. Their mission is to treat patients as they come in, to educate their patient population about disease prevention, and to carry out vaccination programs.

They serve a neighborhood population of about 3,000. In the waiting room are a mother and son waiting to have the boy's fever checked out. Before the clinic was built, the mother says, there was no doctor in the neighborhood, and if her family needed medical attention they had to go to a hospital or private clinic a long distance away and pay for the service. The clinics manned by Cuban doctors are nearby and free.

Also following the Cuban model, the neighborhood clinics feed into a network of larger, more elaborate clinics that provide intermediate care.

Elsewhere in the neighborhood is a physical therapy center staffed by Cuban doctors from Granma and Pinar del Rio, and Venezuelan medical students who receive training from the Cubans. The center serves about 200 patients a day, the doctors say.

There is also a sports and recreation center that opened in 2000 and has two Cuban trainers on its staff. The administrators say that hundreds use the facility daily for activities including youth soccer, dance, and exercise therapy for 86 senior citizens in the neighborhood. One administrator described a summer camp program, funded by the state oil company PDVSA, that gives 4,000 urban youths a chance to spend a month getting recreation and energy-themed education in the countryside.

Propatria and neighborhoods across Venezuela also feature food stores where the state provides rice, cooking oil, flour, sugar, powdered milk, chicken, and other staples from a central distribution system at prices that were typically one-third to one-half those in private markets. These markets are called Mercal (run by the food ministry) and PDVAL (run by the state oil company).

In a Mercal store in Propatria, the manager explained that these government retail initiatives are necessary because of "hoarding" – the alleged practice of private producers holding back supplies from the market in the hope of forcing price increases. This allegation is repeated by government officials and loyalists alike.

Enrique Acosta and Carlos Cumare, two officials in the central Mercal office, say the system was set up in 2003 in response to sabotage and stoppages of domestic production. They say that Mercal subsidizes 14 elements of a basic food basket and is the biggest food distributor in the country, moving 160,000 tons per month of mostly imported food through more than 15,000 points of sale. The stores are located in low-income neighborhoods but are open to all. They dismissed the idea that price controls, as opposed to hoarding, might explain supply deficiencies: "Unfortunately, the private producers are not hand in hand with the government."

The programs described above are all Chavez government initiatives. Venezuela has organized its social programs in a series of "social missions," which are organizations set up in parallel to the structure of government ministries as part of an effort, in the government's parlance, to replace the old "bureaucratic" state with a "revolutionary" one. The missions, the president of Venezuela's state oil company PDVSA said in 2004, are "the seed of the new institutionality."

Most of the programs mentioned above are part of the *Barrio Adentro* mission, a neighborhood-based health services program that began in 2003. Others include:

- *Mision Alimentacion*, a food security program, began in 2004 and features the Mercal stores and other food programs for low-income citizens.

- *Mision Arbol* is a reforestation program begun in 2006.

- *Mision Che Guevara* dates from 2007. It is a training and labor organizing program geared toward "developing ethical consciousness and revolutionary morality as determinant factors in the formation of the new man and new woman."

- *Mision Habitat* is a housing development project funded by a "special petroleum fund."

- *Mision Milagro*, founded jointly with the Cuban government in 2004, is a health program geared to restoration of vision.

- *Mision Robinson* and *Mision Ribas* are literacy and education programs for citizens who stopped schooling at an early age.

- *Mision Zamora* began in 2001 "with the goal of reorganizing the holding and use of idle lands to eradicate the *latifundio*, promote rural development…and guarantee food security."

What impact are these efforts having?

It is undeniable that the Chavez government has spent substantial resources to create an entirely new structure of social service delivery, from health care to subsidized food, that has broad reach among low-income Venezuelans. This point is conceded even by some political critics of President Chavez. A business executive interviewed in Caracas said that the services provided by Cuban doctors are not of the same quality as those offered by Venezuelan doctors, but the Cuban-staffed clinics "are positive and they have reached the poor." Ricardo Gonzales, a legislator from the opposition Podemos party, says the missions are "among the most successful and effective programs of this government." He says that their design owes in part to the bureaucracies controlled by entrenched unions; President Chavez' style is to go around them, creating new parallel organizations rather than confront the existing ones.

There are also data that indicate that poverty has been reduced. Mark Weisbrot of the Center for Economic and Policy Research, an economist who has written extensively and positively about Chavez government policies, cites official Venezuelan data to show a reduction in the poverty rate from 55.1 percent in 2003 to 27.5 percent in 2007. Moreover, he points out that there is an additional social welfare benefit in the delivery of health care services to the poor:

> In 1998 there were 1,628 primary care physicians for a population of 23.4 million. Today, there are 19,571 for a population of 27 million. In 1998 there were 417 emergency rooms, 74 rehab centers and 1,628 primary care centers compared to 721 emergency rooms, 445 rehab centers and 8,621 primary care centers (including the 6,500 "check-up points," usually in poor neighborhoods, and that are in the process of being expanded to more comprehensive primary care centers) today. Since 2004, 399,662 people have had eye operations that restored their vision. In 1999, there were 335 HIV patients receiving antiretroviral treatment from the government, compared to 18,538 in 2006.

Weisbrot cites other official data to show that between 1998 and 2006, government spending on social programs increased from 8.2 percent to 13.6 percent – and when the state oil company PDVSA's social spending is added, the 2006 figure rises to 20.9 percent.

But others question Venezuela's claims of dramatic improvements in poverty and social welfare indicators. Luis Rodriguez, a Wesleyan University professor who served as chief economist in Venezuela's legislature from 2002 to 2004, is among the most prominent of those who take an opposite view.

Rodriguez argues that systematic and independent measurements of the impact of the social missions have not been performed, and when he and his colleagues examined one, the anti-illiteracy program *Mision Robinson,* the results were not impressive. After two years of the mission's operation, the government declared in October 2005 that it was a complete success and Venezuela was an "illiteracy-free zone." However, Rodriguez' examination of Venezuelan census data yielded an estimate of more than one million remaining illiterate Venezuelans, representing a modest reduction in illiteracy that Rodriguez attributes to "nothing more than the continuation of a long-term trend" that began before Chavez took office.

The squeeze on the private sector

Venezuela's brand of socialism does not envision the end of private businesses and a complete turn to state planning following the former models of Soviet bloc countries. However, Chavez government policies create doubt about the role of the private sector and the state's relationship to it, and about the future economic performance of the private sector itself.

Food production. As discussed above, the provision of subsidized food to low-income Venezuelans – much of it imported – is a major social policy initiative of the Chavez government. However, it is an initiative that at least in part aims to cure a problem of the government's own creation, as Chavez policies have damaged private producers' incentives to produce food supplies.

Venezuela has long had high levels of food imports, opposition party legislator Ricardo Gonzales says, but President Chavez' income transfers drove demand up. At the same time, his policies toward producers, especially the price controls imposed in 2003 and land confiscations, drove production down. Gonzales says that price controls "smother producers," as the maximum allowed prices for sugar, coffee, milk, beef, corn, and other grains is below the cost of production. Venezuela's food imports are effectively subsidizing foreign producers while helping to suppress domestic production, he says.

The lack of security for private property creates another disincentive for food producers. A February 2007 decree-law signed by President Chavez aims to protect against hoarding, speculation, and other offenses related to the supply of food products subject to price controls – offenses considered "contrary to social peace and the people's right to life and health." It allows the executive, "without any other formality, to initiate expropriation by decree for reasons of food security and sovereignty." While nodding to producers' rights, it places above them "the people's right to the construction of a just and peace-loving society," and gives the state the right to "temporary preventive occupation," seizure of goods, and other measures against food producers "in an effective, timely, and immediate manner." It establishes prison terms of two to six years, plus fines, for those judged guilty of the separate offenses of speculation or hoarding.

Foreign exchange controls. Also in 2003, the government took control of the market for foreign exchange, leading to one of the Venezuelan economy's most bewildering features: a dual exchange rate. For foreign visitors, the dual exchange rates cause confusion; for Venezuelans engaged in foreign trade, they cause real difficulty.

Soon after arrival, a traveler to Venezuela is surprised to learn that the local currency, the *bolivar fuerte*, trades at two different rates. The official rate is 2.15 to the U.S. dollar, and the "parallel" rate is 6.52. As a result, travelers are advised to carry cash and to trade it on the black market. For those who follow that advice, it makes a big difference – 67 percent on meals, hotel bills, and other charges at current rates.

A second surprise involves the nature of the black market itself. When I changed money in Caracas last year, I was met not by someone who looked like a black marketeer, but rather by someone that Central Casting might have sent to portray an average, middle-aged businessman. His business operations require imported chemicals, and he needs dollars to pay for the imports to keep them going.

To obtain the foreign exchange through normal channels, he and other Venezuelans go to the government's foreign exchange administration commission, known as CADIVI. But this businessman, like many others, doesn't always get authorization to buy the currency he needs. (Venezuelan economist Francisco Rodriguez compared the foreign exchange allocations received by firms from CADIVI with the political leanings of those firms' directors, and found that pro-government firms "received an average of 55 percent more foreign exchange than firms that remained neutral; pro-opposition firms, in contrast, received 51 percent less foreign exchange than neutral firms.")

So our businessman goes to black market brokers, or he takes time to meet a foreign visitor in a hotel to exchange a relatively small amount of currency.

On its website, CADIVI explains why foreign exchange controls are necessary, and the reasons all amount to intervening in activities governed in most countries by markets and monetary and fiscal policy:

> "to avoid flight of capital abroad, and thereby to impede reduction of international reserves; to avoid price increases resulting from currency devaluation; to defend the Bolivar's value against speculative attacks; to exercise control over certain types of imports that might be considered not to be of priority; to avoid excessive demand for foreign currency, beyond the real needs of the national economy."

Those objectives notwithstanding, the government is not satisfied with the current situation, and on August 25, 2009, Venezuela's finance minister announced that the government will take unspecified steps to reduce the gap between the official and parallel exchange rates.

<u>Monetary policy.</u> Venezuela has the worst inflation in Latin America, 26.7 percent as of August 2009 according to the Central Bank. 2008 inflation was 30.9 percent. From 2000 to 2008, a period where the International Monetary Fund reports that annual inflation in western hemisphere countries dropped from 8.4 percent to 7.9 percent, consumer prices rose 348 percent in Venezuela.

<u>Labor policy.</u> In 2001, the government banned the firing of workers by private firms, and has kept this ban in place ever since.

<u>Constitutional change.</u> In December 2007, Venezuelans went to the polls to consider a series of constitutional amendments proposed by President Chavez and the legislature. The proposals included repealing limits on presidential re-election; in economic policy, they would have ended the independence of the central bank and increased executive authority, including in decisions involving takings of private property. The constitutional reform, in its own words, aimed "to build a new order with the preeminence of the social collective," for which it was seen to be necessary:

> "to overcome obstacles generated by capitalist social relations, manifested in the imposition of minority interests over the interests of the original [*originario*] power, the concentration of property in few hands, the political difficulty of democratizing power, an institutionality that leads to the establishment of a bureaucratic body that keeps our people chained to misery, alienated, and distanced from their own reality."

The constitutional reform was rejected at the polls, but as parts of the following selection of economic news items from press reports shows, President Chavez proceeded to use his existing executive authority to increase state control of the economy nonetheless:

- July 2005: On his weekly broadcast, President Chavez complained about factories allegedly producing below their capacity and threatened to confiscate as many as 1,149 of them.

- January 2007: Nationalization of CANTV telecommunications company and Electricidad de Caracas power utility.

- February 2007: Buy-out of foreign partners' share of energy joint ventures: Chevron-Texaco, BP, Exxon Mobil, and Total.

- March 2008: Nationalization of dairy producer Lacteos los Andes.

- April 2008: Nationalization of cement companies Lafarge, Cemex, and Holcim.

- May 2008: Nationalization of SIDOR steel company.

- May 2008: Government moves to take over more than 30 sugar plantations.

- March 2009: Venezuela's food security law leads to takeovers of rice plants owned by the American agribusiness company Cargill and the Venezuelan company Empresas Polar. Various farms, a tuna cannery, and a pasta factory met the same fate.

- May 2009: The government announced its intention to take over the assets of 60 Venezuelan and foreign oil services companies.

- May 2009: The government reached agreement on terms for purchase of the Bank of Venezuela from Spain's Santander, which in 2008 had been seeking to sell to private buyers when Chavez announced the government's intention to purchase it.

- May 2009: From a Deutsche Presse Agentur dispatch: "…the left-wing populist government of President Hugo Chavez said that five metal firms and one ceramics manufacturer were going to be nationalized. The trade unions had complained that the workers of these firms had not been paid for at least six months, and that production had virtually stopped. Chavez argued that 'social justice' required their nationalization."

- July 2009: Venezuela prepared to import large quantities of coffee for the first time; producers blame price controls that cause illegal exports of coffee; the government blames producers for speculation.

- July 2009: “Golf is a bourgeois sport,” President Chavez declared in his weekly broadcast, and within weeks supporters were taking steps to take over two golf courses, added to seven already closed in the past three years.

- August 2009: The Minister of Health threatened to occupy temporarily two Pfizer factories located in Venezuela because, he says, they were not producing medications. The purpose of a temporary occupation would be to revive production.

- August 2009: The U.S. mining company Gold Reserve announced plans to seek arbitration of a dispute with the Venezuelan government to recover funds invested in a gold mining project that the government is not allowing to proceed.

The confidence deficit

While the end-point of Venezuelan socialism is not clear, the mixture of concrete actions and less-than-concrete policy rhetoric have caused a distinct loss of confidence in the Venezuelan economy.

One result is capital flight; a Business Week story cited an estimate that between 2004 and 2007, $1 billion of private capital was leaving Venezuela each month.

Another effect is the flight of human capital. The number of highly educated Venezuelans who have emigrated to Organization of Economic Cooperation and Development countries rose 39 percent between 2000 and 2007, according to a 2009 study of migration trends by the Latin American Economic System.

“I go abroad, and I think, why not pack my bags and leave for good,” says a young financial services executive. His frustrations include working in an economy where the government distorts markets such as that for foreign exchange, where he estimates that 20 percent of transactions occur in the black market. The government, he says, is “the most capitalistic of all” when it comes to creating conditions for its own businesses to prosper, but at the expense of private companies such as Fiat, Procter and Gamble, and foreign oil companies. “Companies come here, they train Venezuelans, and they recruit us to work abroad. Many of my friends have left the country, and they are all prospering.”

Independent organizations such as the United Nations, the World Bank, the International Monetary Fund, and Transparency International also show a clear loss of confidence in the Venezuelan economy in their measurements of worldwide indicators of business confidence.

Table 1. Worldwide Governance Indicators – Venezuela's percentile ranking

	1998	2008
Political stability	29.8	12.4
Government effectiveness	36	17.1
Regulatory quality	43.9	4.8
Rule of law	25.7	2.9
Control of corruption	19.9	9.2

Between 1998 and 2008, Venezuela's percentile ranking dropped significantly in key indicators of the quality of governance that affect business activity, as measured by the World Bank.

The World Bank's Worldwide Governance Indicators "combine the views of a large number of enterprise, citizen and expert survey respondents in industrial and developing countries."

Source: http://info.worldbank.org/governance/wgi/index.asp

Table 2. 2008 World Bank World Governance Indicators percentile ranks

	Rule of law	Quality of regulation	Control of corruption
ARGENTINA	32.1	28.8	40.1
BRAZIL	46.4	58.0	58.5
CHILE	88.0	92.8	87.0
COLOMBIA	37.8	59.4	50.2
MEXICO	29.7	65.2	49.8
VENEZUELA	2.9	4.8	9.2

Venezuela's single-digit percentile scores rank well below those of other large Latin American economies in key measures of governance that affect the climate for private business activity.

Source: http://info.worldbank.org/governance/wgi/index.asp

Table 3. Business conditions in Venezuela…2009 World Bank ranking

Ease of ...

Doing Business	174
Starting a Business	142
Dealing with Construction Permits	96
Employing Workers	180
Registering Property	92
Getting Credit	163
Protecting Investors	170
Paying Taxes	177
Trading Across Borders	164
Enforcing Contracts	71
Closing a Business	149

In comparison to 180 other countries measured by the World Bank in 2009, Venezuela's mostly rock-bottom rankings indicate high degrees of difficulty in the basics of operating a private business.

Source: http://www.doingbusiness.org/ExploreEconomies/?economyid=201

Table 4. Foreign direct investment – Venezuela and neighbors ($ billion)

	1998	2002	2006
ARGENTINA	7.3	2.1	4.8
BRAZIL	28.9	16.6	18.8
CHILE	4.6	2.5	8.0
COLOMBIA	2.8	2.1	6.3
MEXICO	12.4	19.4	19.0
VENEZUELA	5.0	0.8	-0.5

Source: United Nations Conference on Trade and Development (unctad.org)

Table 5. Good place to do business?

Transparency International 2008 "Corruption perceptions index"

ARGENTINA	109
BRAZIL	80
CHILE	23
COLOMBIA	70
MEXICO	72
VENEZUELA	158

Transparency International ranks Venezuela 158th among 180 countries in its "corruption perceptions index," a ranking of countries "by their perceived levels of corruption, as determined by expert assessments and opinion surveys." Venezuela ranked 77th in 1998.

Source: http://www.transparency.org/policy_research/surveys_indices/cpi

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Table 6. Highest inflation in Latin America

Consumer price inflation 2000-2008 (index: 2000 = 100)

ARGENTINA	212
BRAZIL	173
CHILE	133
COLOMBIA	161
MEXICO	141
VENEZUELA	448

Source: IMF. For example, in Argentina's case, the figures mean that an item that cost one unit of currency in 2000 cost 2.12 units of currency in 2008.

Table 7. Venezuela's government debt is rated "speculative"

Standard & Poor's Sovereign Ratings Scale

ARGENTINA	B-
BRAZIL	BBB-
CHILE	A+
COLOMBIA	BB+
MEXICO	BBB+
VENEZUELA	BB-

Source: May 22, 2009 presentation by Roberto Sifon Arevalo of Standard & Poor's. S&P's Sovereign Ratings Scale is defined as an "assessment of a sovereign government's ability and willingness to service its debt on time and in full." Of the six countries listed, all are "investment grade" except Colombia's and Venezuela's, which are "speculative grade."

Conclusion

As the Chavez government proceeds in its second decade, Venezuela's economic prospects are dominated by uncertainty.

Most fundamentally, at the policy level, the end-point of Bolivarian "socialism" is not defined in terms of the state's ultimate role in the economy, the degree to which it will own and operate businesses, and the degree of state intervention in and control of private business operations. This uncertainty is compounded by the Venezuelan executive's broad ability to legislate and act by decree.

To the degree that Venezuela continues to rely on private sector growth and foreign investment, this uncertainty in itself is damaging, and has already caused damage: capital flight, emigration of skilled personnel, losses in business confidence and inward foreign investment. There is no sign that President Chavez and his government view this uncertainty as a problem; one can almost conclude by default that the goal is to keep the private sector off balance.

The Chavez government's signal achievement is the creation of a new social services delivery network that reaches people and areas that were previously underserved, or lacked basic social services entirely. But this network is sustained by government revenues, and one can ask how well it will be sustained in a period of lower oil prices than the 2002-2007 period, when it was initiated. Compounding the oil price factor is lower Venezuelan output; the U.S. government and many industry analysts estimate that production by Venezuela's state oil company is down 30 percent. Finally, how will the Venezuelan economy fare in general, and how will the need for state social services be affected, under economic policies that increasingly squeeze the private sector?

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