

BY ROBERT LOONEY

***I was overwhelmed** by the feeling that I had just been traveling and chatting pleasantly with two opposing men. One to whom the caprices of fate had given an opportunity to save his country. The other, an illusionist, who could pass into the history books as just another despot.*

– Gabriel García Márquez

Hugo Chávez, Venezuela's enigmatic leader, came to power in 1998 by trumping the two political parties that had dominated the government for years. This amounted to quite a reversal of fortune: in 1992, as an army officer, he had led a failed coup attempt that landed him in prison.

Chávez campaigned for the office without any clear ideology other than hostility to the existing regime and its institutionalized corruption. Indeed, back in 1998, many wrote him off as an all-too-familiar phenomenon in Latin America – either a populist who would soon run out of money or another outsider who would become a *caudillo* corrupted by the opportunities of power. As things turned out, both views were far off the mark.

In a country where wealth is displayed ostentatiously and millions live in bitter poverty, Chávez was able to win the presidency because he promised the masses a series of social benefits to be financed through the diversion of oil revenues from foreign oil companies and the country's domestic elite. But Chavistanomics is continually evolving.

It is a variant on the old theme of Latin



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American structuralism in that it attempts to shape the country's economic structure through non-price incentives, and clearly represents an alternative to the free-market, free-trade policies of the so-called Washington Consensus that dominates thinking at the International Monetary Fund and other establishment institutions. But, with time, Chavistanomics has changed in ways that reflect the country's shifting economic constraints as well as its evolving politics. It is now closely identified with both anti-globalization and Latin American nationalism.

### NO ONE WRITES TO THE PRESIDENT

Like many other Latin American strongmen with a populist bent, Chávez has a distinct penchant for plebiscites. In the two years after taking office, he called for five separate votes: one to convoke a new constituent assembly to rewrite the constitution; another to elect members of that assembly; a third to win approval for the charter it produced; a fourth to hold new elections for president, governors and mayors; and fifth, to dismantle the institutions of the existing labor movement.

In the process, Chávez replaced a two-party Congress with one overwhelmingly dominated by his supporters, and rewrote the constitution to allow him to serve for six years (up from five) and to run for consecutive terms. The spate of elections also replaced the traditional political landscape with a cadre of governors and mayors largely of the president's own choosing.

A brief digression is needed here. For much of the first half of the 20th century, Venezuela was perhaps the Latin American country most severely afflicted by the disease of militarism. Indeed, Simon Bolívar once referred to his own country as a "barracks." In 1958, the founders of Venezuela's Fourth Re-

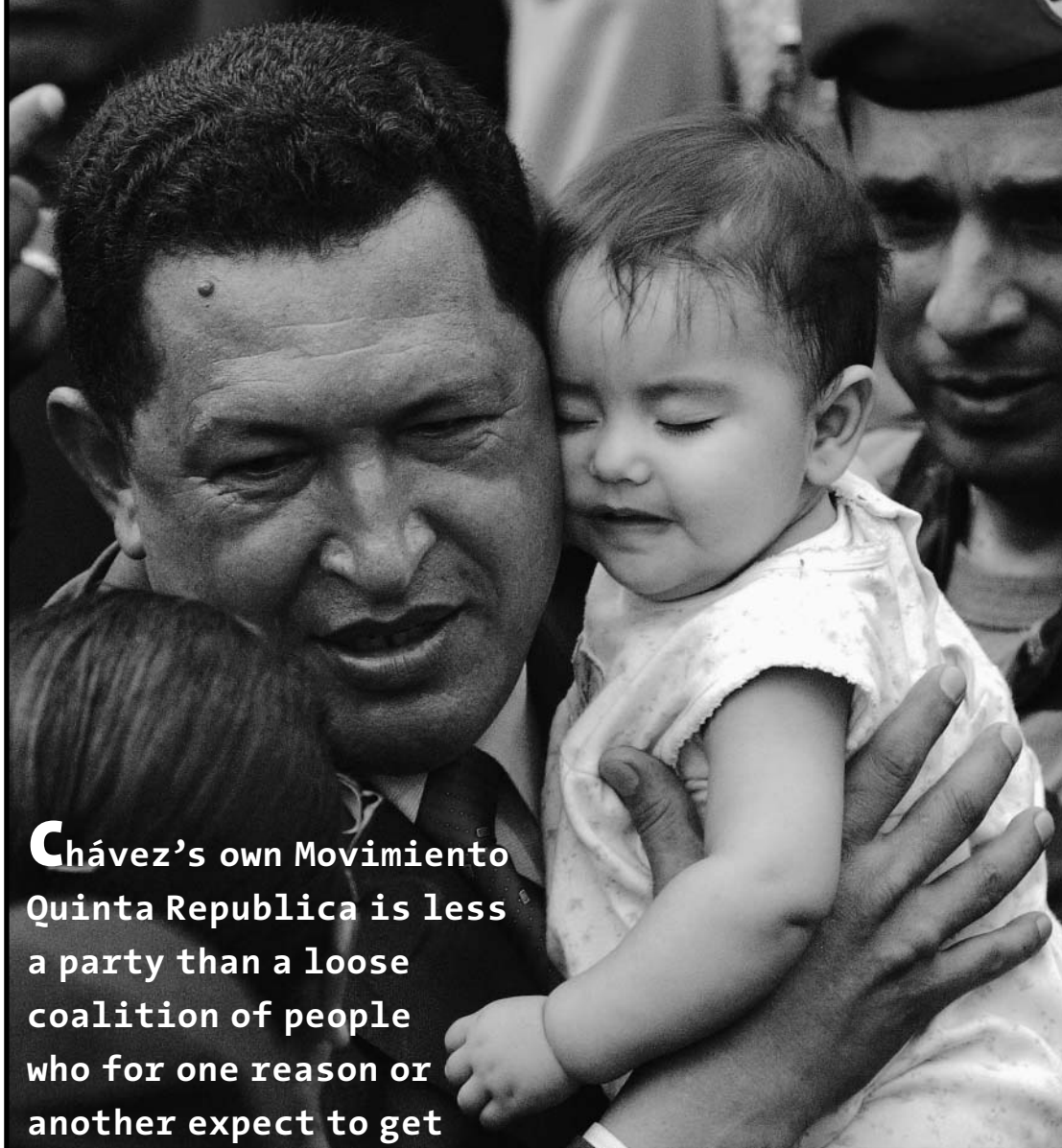
public struck a bargain with the generals. In exchange for their permanent retirement from the political arena including even the surrender of their voting rights, the armed forces were given salaries, fringe benefits and other privileges far surpassing those of other vested interest groups. This arrangement, a commendably pragmatic solution to a chronic problem, was financed by the country's mushrooming oil revenues.

But Chávez had no use for this grand arrangement. Lacking a true party of his own, he decided to rely upon the military for key administrative tasks. Under Plan Bolívar 2000, vast amounts of money were entrusted to serving officers to oversee the construction or renovation of schools, clinics, roads and private housing. Unfortunately, except for the Corps of Engineers, few Venezuelan officers had any experience in such work.

In the years since, many high-level officers have expressed deep concern over the sudden shift in roles and the potential for corruption – no bidding process is involved in funding – although corruption may have been exactly what Chávez had in mind. The plan bought him political support from the military by creating a new patronage system. And it made the officer corps complicit in corruption, providing him with the means to blackmail his uniformed associates in the event they became tempted to turn against him.

More fundamentally, Chávez replaced Venezuela's pluralist democracy, however flawed, with a political system that revolves around him.

While the traditional parties of the old regime, particularly the once-dominant Acción Democrática, have not been completely extinguished, they are no longer a force. Chávez's own Movimiento Quinta República is less a party than a loose coalition of people who for one reason or another expect to get ahead by



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Under Chávez, the country has experienced a marked deterioration in economic freedom. Venezuela is now one of the world's least economically free countries, ranking 144th out of 165 worldwide and 28th out of 29 in the Americas on the Heritage Foundation's Index of Economic Freedom. Its commercial regulation is burdensome and con-

fusing. Its judiciary is heavily influenced by the government and does not enforce contracts well. The labor market is rigid, and the financial market, though sophisticated, has become more vulnerable to political interference. Corruption pervades the civil service and, in tandem with the fear of expropriation, helps to deter foreign direct investment. With much of the authority of the central bank usurped, inflation has soared.

In the main indices of governance calculated by the World Bank, deterioration has been most striking in political stability,

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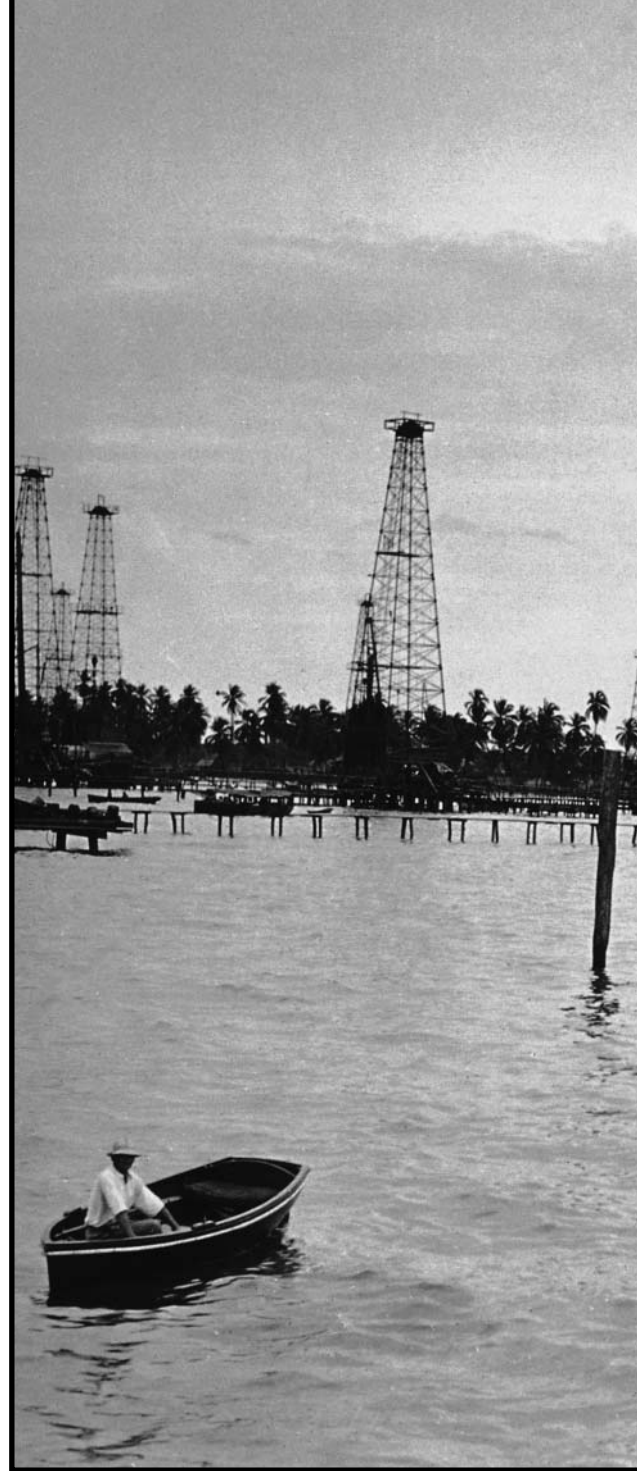
followed by the rule of law, regulatory quality, control of corruption, and voice and accountability. While there has been an improvement in effectiveness of government under Chávez (which isn't saying much since pre-Chavez governments weren't known for their competence), Venezuela still ranks only in the 23rd percentile.

### GOVERNANCE IN A TIME OF HIGH OIL PRICES

Chávez is staking his regime – and the promise he represents for ordinary people – on two premises. The first is that the price of oil, which, fortuitously, has increased dramatically since the president took office, will remain at its present level or even edge upward in coming decades. The second is that the government will be able to use the windfall to build a productive non-oil economy.

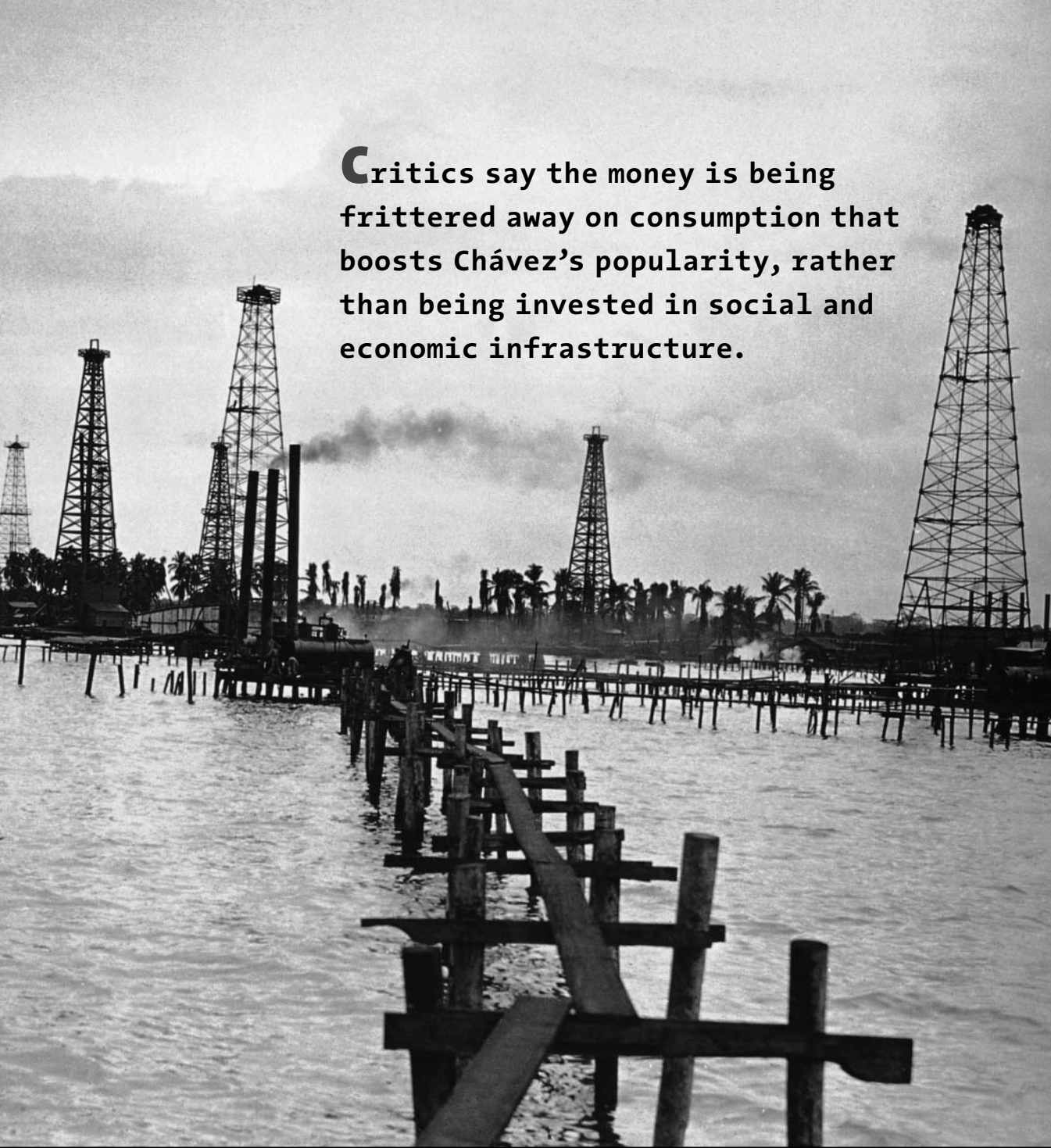
Chávez supporters contend that the redirection of oil money is already transforming the lives of the poor. But critics, including senior economic officials who have broken ranks with Chávez, say the money is being frittered away on consumption that boosts Chávez's popularity, rather than being invested in social and economic infrastructure. Even planners loyal to Chávez worry that, without strict oversight, a good portion of the money is being lost to corruption, and that little is being saved for the rainy day when oil prices fall.

It is very difficult to get an objective assessment of Chávez's short-term economic accomplishments. Data from the country's National Statistics Institute show unemployment has dropped from 16.6 percent when Chávez took office to 10.2 percent in 2006. However, critics contend that unemployment is minimized by arbitrarily defining "informal" workers, such as street vendors and



adults participating in government-sponsored educational programs, as employed.

In 2004, the Institute released figures showing poverty had risen more than 10 percentage points under Chávez. But the agency effectively backtracked after a stinging cri-



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tique by the president, creating a "social well-being" index suggesting that poverty – now defined as people unable to afford basic food and services – had fallen.

Perhaps the most controversial of Chávez's initiatives are the vast array of social pro-

grams and services known as *misiones*. There are currently some 20 such social *misiones* in Venezuela, offering a diverse menu of social services in the fields of education, health, nutrition, environmental protection, sports, culture, housing and indigenous rights. They are

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funded from the government's central budget and allocations from the state oil company, PDVSA, and function primarily through a parallel social service system that is not a part of the traditional state bureaucracy. The popularity of the *missiones* was instrumental to Chávez's re-election in December 2006, and

the *missiones* should be integrated into existing ministries and institutions in order to institutionalize good government and program oversight. The *missiones* also tend to focus on alleviating the harsh conditions associated with poverty, rather than addressing the structural roots. This reality has led to widespread criticism that they are paternalistic



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In principle, the *missiones* provide an integrated package of poverty-reduction measures. As such, they are potentially more effective alternatives to the simple cash transfers that have been the primary basis for poverty-alleviation programs in Latin America.

But a case can be made that the work of

and create permanent dependence on the state.

Sustainability is also a major practical concern. Since the *missiones* are funded primarily from oil revenues, most would likely be cut back if oil revenue declined. And here, two factors come into play: future oil prices and the ability of the state oil company PDVSA to expand production.

Objective forecasts of the global oil market clash with the optimistic assumptions of Chavistanomics. The widely respected Cambridge Energy Research Associates (CERA) is projecting that world petroleum supplies will expand faster than demand over the next five years. (This forecast does not rely on fortuitous new discoveries but, rather, is based on an analysis oil field by oil field.) As the supply grows, CERA expects prices will fall in the middle-term, possibly below \$40 a barrel. “We expect supply to outpace demand growth in the next few years, which would take the pressure off prices around 2007-2008 or

undertake major oil field development.

While it enjoyed an enviable reputation for technical competence during the 1980s and 1990s, PDVSA emerged as a focal point of opposition after Chávez was first elected in 1998. In 2002, PDVSA officials backed a general strike aimed at toppling Chávez, bringing daily oil production from 3.3 million barrels to a near trickle of 700,000 barrels. Chávez broke the strike and then retaliated by firing 19,500 veteran PDVSA employees, roughly half the firm’s workforce.

Today, employment exceeds pre-strike levels, and Venezuela claims to be producing 3.3

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thereafter, and even lead to a period of price weakness,” concludes Peter Jackson, a co-author of the report.

The projected increase in supply follows from the fact that higher prices are justifying the use of expensive technologies to wring more oil from older fields. According to the report, approximately 20 to 30 major projects, defined as those producing more than 75,000 barrels per day, will come onstream every year until 2010. As a result, we can expect global supply to increase by 3 million to 4 million daily barrels (the somewhat awkward terminology of the oil business) each year.

While world oil production is set to expand more rapidly than demand over the next several years, Venezuela will have a hard time simply maintaining production at today’s levels. That’s because PDVSA, Venezuela’s state oil company, is in no position to

million barrels of oil per day. However, the International Energy Agency in Paris puts current production at 2.4 million barrels, and analysts say PDVSA continues to suffer the lingering effects of its recent political battles. Indeed, the company’s crash effort to recoup lost production after the strike may have damaged the country’s underground oil reservoirs in ways that will hasten future production declines.

Complicating PDVSA’s troubles is its struggle to cope with responsibilities that go far beyond the oil business. Because Chávez taps the state-owned giant to finance an array of social programs at home and to cement his regional influence through subsidized oil exports to allies such as Cuba and Bolivia, the company’s finances are severely stretched. Just to maintain current production, PDVSA must invest \$3 billion annually in its aging fields. But Chávez has drained PDVSA’s

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coffers to fund generous health, education, literacy and food programs, leaving insufficient cash for its core operations. Furthermore, the company's obligations to the poor appear to be mushrooming: PDVSA recently disclosed that it spent \$13.3 billion last year on social programs, almost twice as much as in 2005.

Instead of selling more oil on global markets during a period of record world prices, Chávez is using increasing amounts of PDVSA oil in barter with Caribbean and Central American countries that is designed to boost

power in 1998, he cited UK Prime Minister Tony Blair as a role model. Chávez's "third way" initially emphasized respect for private property and free markets, rejecting "communist" approaches by looking to state intervention only when the market failed. But Chávez's views have since moved left, with the drift from European-style social democracy to utopian socialism accelerating over the past two years.

Chávez first revealed his plans for "21st Century Socialism" in 2005 at the World Social Forum, the anti-globalization meetings held as a counterpoint to the establishmen-

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his regional clout. Some of his political allies pay for discounted oil with bananas or sugar; the Cubans, who receive nearly 100,000 barrels per day, send doctors to treat the poor.

Incredibly, at a time of \$60-a-barrel-oil, PDVSA's net income in 2006 year fell 26 percent to \$4.8 billion on \$101 billion in revenue. By way of comparison, Norway's state-run oil company, Statoil, was twice as profitable during the same period in terms of the ratio of net income to revenue. In April 2007, PDVSA was forced to float \$7.5 billion in bonds to finance planned expansion of daily production to 5.8 million barrels by 2012, a figure no one outside the Chávez administration believes will be attained.

### ONE HUNDRED YEARS OF SOCIALISM?

The abrupt shift in Chávez's economic policies following his landslide December 2006 re-election has only compounded PDVSA's financial problems. When Chávez came to

tarian World Economic Forum in Davos. However, he never got beyond generalities, even during the presidential election campaign of 2006 when it was a key component of Chávez's election program.

The meaning of 21st Century Socialism and proposed methods of achieving it have been made clearer in the months since. The planned changes will reshape the economy, at the cost of heightened dependence on oil export revenues. The proposals call for a significant redistribution of political power to the grassroots, although skeptics see an authoritarian trajectory – echoes of Lenin's dictatorship of the proletariat – in getting from here to there.

Plans include the revocation of central bank autonomy and the elimination of bank reserve requirements, as well as an end to term limits for the president. More generally, state control will be reasserted in strategically important areas of the economy, including





telecommunications, electricity and gas, and projects to develop the country's vast deposits of tar-like "heavy" oil. Although private companies will be allowed to retain minority stakes in this difficult-to-exploit raw material, PDVSA will control production and refining.

A new "geometry of power" will replace the functions of municipal and regional government with new "socialist cities," based on federations of councils of "communal power." The councils were first introduced in April 2006, and there are now approximately 13,000 across the country, typically involving 200-400 families.

Through this model of "direct democracy," local communities are essentially self-govern-



ing, identifying their own welfare, education and employment needs. The \$1 billion in state financing provided to the councils in


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2006 will rise to \$5 billion this year.

Fifteen new state ministries have also been created, bringing the total to 27. Most are drawn from Chávez's own MVR party, have in the past been associated with the radical left, and are now in the vanguard of efforts to accelerate Venezuela's divergence from the economic and political mainstream. On taking office, they swore to "never rest arm or soul in the construction of the Venezuelan path toward socialism."

Many aspects of the announced changes remain vague: for example, the framework for nationalization has not been elaborated. Another area of concern is the country's new enthusiasm for arming the military. Venezuela has spent more than \$4 billion on weapons over the last two years, making it Latin America's largest weapons buyer and placing it ahead of other major global arms importers including Pakistan and Iran. This surge in weapons acquisitions will spawn a follow-on set of service and spare parts costs, placing further stress on future budgets.

The grandiosity of Chavez's vision and the lack of constitutional checks on his power make it difficult to predict how Chavez will respond to bumps along the road – or, for that matter, to the possible cliff at the end. A lot will depend on who Chávez becomes in his next incarnation.

Will he evolve in the image of Juan Perón, the con man who crippled the wealth-creating institutions of Argentina for at least two generations? Or as a Robert Mugabe, whose permanent war on colonialism no longer disguises his determination to hang on to rule of a failed state by force? Or as another Castro, whose perplexing mix of charisma and ruthlessness has blocked Cuba's transition to a civil society? None of these possibilities, alas, bodes well for Venezuela. 

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