DEBATES: VENEZUELA

# Venezuela: Running on Empty

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If you are going through hell, keep going

—Winston Churchill

Where shall we start when it comes to describing the Venezuelan tragedy? I sat for a long while staring at the white page on my screen. After all, there is a limit to what you can convey by means of sheer words. Do we start by saying that Venezuela is on the verge of becoming the only case of hyperinflation ever recorded in an oil-rich country? Or would it be more illustrative to mention that last year Venezuela registered a tenfold increase in inpatient mortality and a hundredfold increase in deaths of newborns,[1] while gasoline sells at less than one cent per gallon? This type of anecdotal evidence gets closer to conveying what is actually occurring on the ground, but some people might prefer to resort to more traditional statistics.

Venezuela has lost 25 percent of its gross domestic product (GDP) per capita in three years, unprecedented in a country that has suffered neither a natural disaster nor a civil war. Fiscal deficits averaged 15 percent of GDP over the previous six years, mostly financed by money printing. Inflation for 2016 is estimated at 720 percent,[2] with food prices increasing by more than 1,400 percent on a twelve-month basis. Domestic currency lost more than 98 percent of its value between the Novembers of 2013 and 2016 (in both the official and parallel black market). At minimum wage, in November 2016 a Venezuelan needed to work five hours to buy a pound of sugar, 20 times more than a Colombian worker and 140 times a U.S. worker. Poverty rates bounced back and surpassed the 75 percent mark, and are now above 1998 pre-Chávez levels.[3]

Venezuela has also become one of the most violent countries in the world. Caracas competes with San Pedro Sula in Honduras atop the list of most violent cities worldwide, while seven other Venezuelan cities rank among the top 50.[4]

Throughout the period, Venezuela has been bleeding both financial and human capital. Ever since the exchange control was implemented in 2003, estimates of capital flight for the following decade run at US$203 billion, roughly equivalent to twenty years' worth of food imports calculated at their peak.[5] With regard to human capital, emigration as a percentage of the Venezuelan population since the beginning of the revolution is appraised to be between 4 percent to 6 percent,[6] and as many as 200,000 Venezuelans have left country in the past 18 months.[7]

Using formal statistics as a means of understanding Venezuela's decline has two serious shortcomings. First, both the quality and availability of official statistics are very limited. As soon as indicators began to depart from the official narrative, the government initiated a blatant manipulation of its estimation methods, distorting figures to fit the discourse. When this was not enough, they simply halted publication. It started with relatively sophisticated statistics such as the consolidated fiscal balance of the public sector (last published in 2011), and gradually moved on to more essential indicators such as the Household Survey (used to measure poverty and other social indicators, last published in 2014), GDP and balance of payments (last seen in the third quarter of 2015), and inflation (no figures published since December 2015). What you have read thus far are highly imperfect estimations, third-party efforts to fill in the information vacuums as the crisis deepens.

More serious is the fact that, in basing an understanding of Venezuela on scattered statistics alone, one runs the risk of missing the big picture. What we have come to know as the Bolivarian Revolution is a loose expression that defines a social experiment: a civic-military alliance that arrived to power through democratic means, only to focus all its efforts on dismantling institutions, creating an almighty state by gradually disenfranchising its citizens, and replacing all forms of social coordination with unhinged central planning. Throughout these 18 years, but most remarkably from 2004 on, economic and social policy have been subjugated to the ultimate purpose of perpetuating the regime in power. It is only within this context that we can start grasping the drivers of the Venezuelan crisis and its tragic consequences.

### Years of Upheaval (1999–2003)

The first five years of Hugo Chávez's rule (1999–2003) were relatively normal, at least by Venezuelan standards. The leader of two failed military coups in 1992 rode the wave of widespread social discontent resulting from twenty years of economic stagnation to the presidency. After a long spell of economic growth, income per capita had fallen by 22 percent between 1978 and 1998, and the share of the population living under the poverty line went from 23 percent to 57 percent over that period. One of the most spectacular cases of economic progress turned into a colossal growth failure. Chávez could not have picked a better time to burst onto the political scene. His timing was crowned in 1998 by historic lows in oil prices, a fact he would greatly benefit from, but also one that he would have to deal with. It was a rocky start.

Within the context of a flexible exchange regime, increased fiscal efforts did not deliver any improvements in growth nor consumption (Figure 1). Instead, they fueled a significant wave of capital flight. The large gap between expectations and actual economic performance hurt the president's approval ratings and spurred significant turmoil. It was then, however, that Chávez's acute gambling and political instincts surfaced. He stalled the presidential recall referendum called for by the political opposition, and in the process, induced its inept leaders into a series of costly mistakes that allowed him to take personal control of the key state powers: the armed forces, after the 2002 coup attempt; and state oil company Petróleos de Venezuela (PDVSA), after the national strike of 2003. These blows gave Chávez a second wind on the electoral front: he won the referendum by a landslide in 2004; his party won 20 of 22 governorships and 270 out of 337 municipalities in the regional elections later that year, and 100 percent of National Assembly seats as a result of an opposition boycott of the 2005 legislative elections. Chávez weathered the storm, just in time to ride on what would become the longest oil bonanza ever recorded in Venezuelan history (Figure 2).

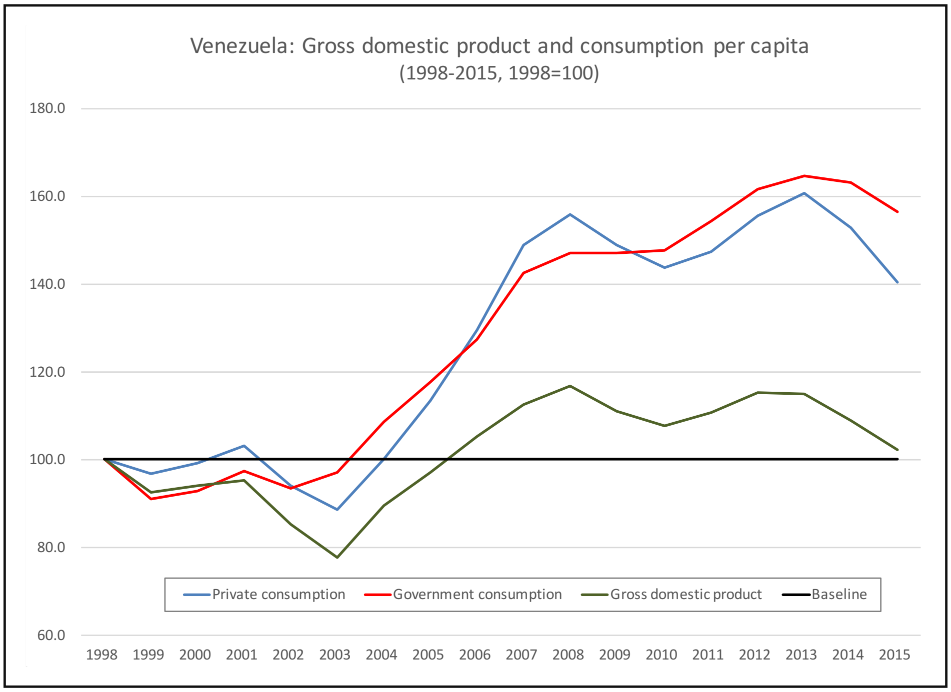


Figure 1. Venezuela: Evolution of gross domestic product and consumption per capita

## Years of Deranged Consumption and Deinstitutionalization (2004–2013)

Oil prices picked up after 2004 and, except for a brief spell after the financial crisis of 2008–2009, would not wane until a decade later. As depicted in Figure 2, real oil exports per capita tripled between 2003 and 2012 and remained high until 2014. This massive inflow of dollars would not come alone: in a classic pro-cyclical fashion, the international credit markets opened up to Venezuela in times of fat cows, and Chávez fully seized the moment.

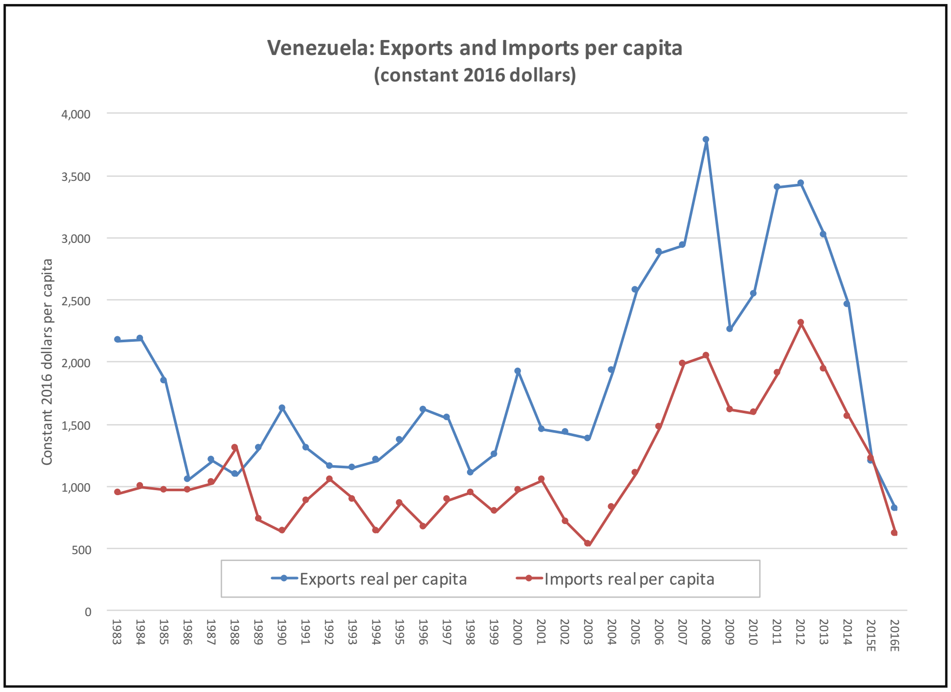


Figure 2. Venezuela: Real exports and imports per capita

Amid the oil bonanza, foreign debt increased fourfold in six years, going from US$27 billion in 2006 to US$113 billion in 2012.[8]

Fiscal policy was a key component of the state takeover strategy. One of the key priorities of the Chávez administration was to increase its room for maneuver in allocating the oil and debt windfalls with no oversight. It would be the beginning of a systematic and sustained effort to break the public accounts into pieces that escaped all institutional forms of scrutiny and accountability. On July 20, 2005, two legal instruments were approved and published in the same Official Gazette that would be the keystones of this effort.[9] A partial reform of the Central Bank Law freed PDVSA from its obligation to sell all proceeds derived from oil exports to the Venezuelan Central Bank (BCV). In parallel, a new entity, Fondo de Desarrollo Nacional (FONDEN), was created to collect all public revenues "in excess" of the oil price contemplated in the national budget, as well as international reserves "above the appropriate level."[10] It was to be administered directly by the president entirely at his discretion.

As the bonanza intensified, these instruments would be complemented by the launching of the Chinese Funds,[11] and the Law of Extraordinary and Exorbitant Prices in the International Oil Market.[12] The former were supposedly joint funds for development projects in Venezuela, but ended up being entirely financed by China. Rolling credit lines (to FONDEN) at the Chinese Development Bank were to be repaid by Venezuela via oil shipments (from PDVSA). The latter was a legal device aimed at further deviating public revenues beyond a certain oil price threshold to a myriad of small, discretionary funds.

The fiscal chaos created by this intricate web of parafiscal entities was colossal. Fiscal spending went from 26 percent of GDP in 1999 to 48 percent in 2014.[13] Consolidated deficits are hard to calculate, since none of the newly created entities carry out any formal accounting. Venezuelans have no way of gauging what the government did with the money flowing through them. In absence of expenditure accounting mechanisms, we are left to quantify the resources assigned to them: according to the last tally, FONDEN received up to US$110 billion in funding from the Central Bank and PDVSA, and the Chinese Funds were allocated another US$54 billion (of which approximately half is still owed to China). Consolidated fiscal deficits went out of control right in the middle of the oil bonanza. They started at 1.6 percent of GDP in 2006 and went all the way up to 21.6 percent in 2014. As the appetite for Venezuelan securities in foreign debt markets gradually faded away, the government resorted to indiscriminate money printing.

From 2005 on, a massive round of expropriations and confiscations of private sector entities allowed the government to increase its command of the economy. The compounded annual growth rate (CAGR) of public GDP was 3.9 percent per year between 2005 and 2015, a cumulative increase of 41.6 percent. Private gross domestic product, in the meantime, lagged at a CAGR of –0.6 percent, a cumulative loss of 5.0 percent. In sum, GDP stagnated throughout. The state also went on to control most of the imports carried at highly overvalued official rates. The share of government in total imports increased from 17 percent in 1999 to 50 percent in 2015. Having eliminated the public financing of political parties and prosecuted recipients of foreign funds on the grounds of "treason," Chávez moved on to eliminate or asphyxiate the private sector and further cash-starve the opposition.

Such a toxic policy mix would have rendered any country bankrupt. Venezuela was not the exception, but the process certainly took longer than one would expect. The oil windfall and massive indebtedness eased by the international financial markets and China allowed the government to escape the ominous predictions of mainstream economists. Moreover, for a while, it even spread the illusion that socialism was possible after all.

As depicted in Figure 1, even though production stagnated, Venezuela enjoyed an unprecedented consumption boom. By 2008, and then again in 2012, an average Venezuelan was consuming close to 60 percent more in volume than in 1998. The country became awash with cheap imports, financed by oil and debt. Imports per capita (Figure 2) quadrupled between 2004 and election year 2012.

The institutional ownership of the means of production was not the only structural change that the Venezuelan economy underwent. The nature of production also shifted, with most of the producers of nonresource tradable goods going out of business, and the nontradable sector, including banking, insurance, transport, logistics, and retail—all strongly linked to imports—thriving. Poverty levels halved between 2004 and 2008. A jubilant Noam Chomsky visited Venezuela in 2009 "to see how a new world is actually being created, and talk to the one that inspired it."[14] It was a fantasy.

In 2012, the last political showdown of Hugo Chávez in the electoral arena, the price of Venezuelan oil averaged $103.5 per barrel. But the government spent it as if the price were at $174 dollars, recording a deficit of 18.6 percent of GDP. As then minister of planning Jorge Giordani himself would recognize later, "with the sole purpose of guaranteeing the electoral victory of Hugo Chávez in 2012, we had to go to financial and economic extremes."[15] Venezuelans would soon pay dearly for these extremes.

**Years of Calamity (2014 and Counting)**

As oil prices plummeted from $88 to $44 per barrel in 2015, and from there down to $34 in 2016, the tragedy fully unraveled. International financial markets effectively shut down for Venezuela. With all its credit capacity exhausted by the windfall years, Venezuela was forced to live within its means as misfortune struck. Worse yet, debt service is particularly steep in 2015–2018, with an average of US$10 billion per year (not including debt service derived from the Chinese Funds).

In 2015, the government faced a foreign exchange deficit of roughly US$40 billion. As if scrambling to find spare change between sofa cushions, Venezuela bridged this deficit by a mix of a 21 percent cut in imports (US$10 billion), Chinese financing (US$9 billion), swapping monetary gold (US$4 billion), discounting oil credits given to the Dominican Republic and Jamaica (US$4 billion), selling Special Withdrawing Rights at the IMF (US$3 billion), losing liquid international reserves (US$3 billion), issuing debt at PDVSA U.S. subsidiary CITGO (US$2.0 billion), and liquidating other public assets (US$ 5 billion). The large fiscal deficit was footed by Central Bank financing, fueling inflation up to 180 percent; 230 percent for food items. Arrears with multinational companies and international suppliers piled up. Price controls amid rampant depreciation and inflation led to massive shortages of basic staples and medicines. There was not any chance for switching expenditure and no possibility of domestic production coming in to substitute for the imports that Venezuela could not afford. By then most of the industrial apparatus has been expropriated, and the surviving private sector was technologically obsolete and deprived of foreign currency with which to import raw materials, parts, and equipment.

By the end of 2015 it was evident that the government had obliterated everything in its wallet. From then on, as President Nicolás Maduro disreputably announced, "God will provide." He did not. He had already provided the longest oil windfall ever recorded. In order to maintain debt service in 2016, the government stopped paying almost anything else. This includes oil contractors and suppliers, leading to a loss of 300,000 barrels per day on average for the year. Imports were trimmed down an additional 50 percent and stand now 74 percent below the infamous extremes of 2012 (Figure 2). All nontradable GDP linked to imports fell down like a stack of dominoes.

The perennially extended Immobility Law forbade companies from firing employees below certain salary thresholds. This put all the burden of adjustment onto real salaries. Prices have been de facto liberalized. Venezuela is suffering the worst of price liberalization without enjoying any of its benefits. Businesses do not dare to use their own dollars to import, and supply remains highly restricted, as the legal traps designed by the government to curtail the private initiative remain intact. Nicolas Maduro has decreed four minimum salary increases over this year, for a cumulative 454 percent rise in nominal wages. Meanwhile, food prices have seen a yearly spike of 1,400 percent; people have lost 63 percent of their food purchasing power. The *bolivar* has lost 74 percent of its value over the eight weeks of October and November 2016, a 99 percent depreciation since the crisis erupted in 2014. As if a spell had broken, poverty levels have bounced back and surpassed pre-Chávez levels in just two years.

As the country descends into economic chaos, the government sticks to the same recipe that engendered the economic crisis but sustained them in power. As I write, a multiple exchange rate system prevails, with the price of the dollar oscillating between 10 and 660 bolívares in the official market, and more than 3,500 in the parallel black market. That allows them to continue feeding the military elite that in turn guarantees their stability in power. It also results in a highly inefficient allocation of the few dollars that Venezuela has left. Default has been barely avoided up until now, at the expense of a deep humanitarian crisis.

But change is not to be expected. By design, all policies that could potentially release the most binding constraints leashing Venezuela today would imply the regime losing political control. And vice versa. Venezuelans have internalized that addressing the crisis necessarily passes through replacing the regime. This is why they voted massively in the parliamentary elections of December 6, 2015, giving the opposition a supermajority in parliament—a majority that the government has nullified via the Supreme Court. As in static games of complete information, the regime also knows that people know. Accordingly, they have suspended all electoral events due in 2016, including elections of state governors and a constitutional recall referendum demanded by the opposition—ironically, put in place by Chávez's constitution.

In the meantime, there is little hope for Venezuelans, other than a strong recovery in the price of oil. In the best-case scenario, this would only alleviate immediate suffering due to lack of basic staples and medicines, at the price of further repression of political and civil rights. Uncertainty is the common denominator. That is story of the Venezuelan crisis—one that I did not know how to begin to tell and that Venezuelans do not know how to bring to an end.

*Notes*

1 According to NGO Venezuelan Health Observatory, http://www.ovsalud.org/.

2 World Economic Outlook, International Monetary Fund, October 2016, p. 238.

3 L.P. España, J.R. Morales y D. Barrios, "Pobreza, cobertura de las Misiones y necesidades de protección social para la reforma económica de Venezuela," Harvard Center for International Development, Research Fellow and Graduate Student Working Paper Series, No. 74, June 2016.

4 "Caracas, Venezuela, la ciudad más violenta del mundo del 2015," Seguridad, Justicia y Paz, January 25, 2016. http://www.seguridadjusticiaypaz.org.mx/sala-de-prensa/1356-caracas-venezuela-la-ciudad-mas-violenta-del-mundo-del-2015.

5 C. Reinhartand M. A. Santos, "From Financial Repression to External Distress: The Case of Venezuela," *Emerging Markets Finance and Trade* 52, no. 2 (2016): 255–284.

6 "De la Vega: Casi dos millones de venezolanos han emigrado del país," Globovision, September 18, 2016. http://globovision.com/article/de-la-vega-venezuela-pierde-capital-humano-por-migracion-de-talentos.

7 Nicolas Casey, "Hungry Venezuelans Flee in Boats to Escape Economic Collapse," *New York Times*, November 25, 2016.

8 These figures correspond to interest-bearing debt and do not include non-interest-bearing liabilities such as arrears, or contingent liabilities such as litigations pending sentence at the International Center for Settlements of Investment Disputes (ICSID).

9 *Official Gazette* 38.232.

10 FONDEN, under direct presidential control, collects oil revenues in excess of those estimated in the budget at lower than oil market prices, and those coming from international reserves in excess of an "optimal level of reserves," whose methodology of estimation has not been disclosed by the executive.

11 The Chinese Funds are legally framed by the Binational Fund for Cooperation subscribed by Venezuela and China (2005); and consist of the Fondo Común China Venezuela (FCCV, *Official Gazette* 39.019, September 18, 2008), and the Fondo Gran Volumen Largo Plazo (FLPGV, *Official Gazette* 39.511 September 16, 2010).

12 *Extraordinary Official Gazette* 6.022 (April 18, 2011).

13 E. Ramseyer, M. A. Santos, and R. Hausmann, "Disentangling the Wreck: Fiscal Policy under the Bolivarian Revolution," Harvard Center for International Development Faculty Working Paper Series, forthcoming.

14 "Noam Chomsky Meets Hugo Chavez," YouTube video, published on March 5, 2013. https://www.youtube.com/watch?v=VXd_rPOampE.

15 "Jorge Giordani, el marxista que critica a Maduro," *Semana*, June 19, 2004. http://www.semana.com/mundo/articulo/maduro-es-criticado-por-jorge-giordani/392486-3. ■