



# Assessing Whether Oil Dependency in Venezuela Contributes to National Instability

Adam Kott

*New York University*, [adamjkott@gmail.com](mailto:adamjkott@gmail.com)

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## **Author Biography**

Mr. Kott is a recent graduate of New York University, where he received his Master of Science in Global Affairs with a dual concentration in Energy & the Environment and International Business. Prior to this, Mr. Kott received his Bachelor of Arts in International Affairs from The George Washington University in May 2009. His research interests include energy security, project finance, and emerging markets. His writing has been featured by the Center for International Relations and Council on Hemispheric Affairs as well as an upcoming publication by the Tanenbaum Center.

## **Abstract**

The focus of this article is on what role, if any, oil has on Venezuela's instability. When trying to explain why a resource-rich country experiences slow or negative growth, experts often point to the resource curse. The following pages explore the traditional theory behind the resource curse as well as alternative perspectives to this theory such as ownership structure and the correlation between oil prices and democracy. This article also explores the various forms of instability within Venezuela and their causes. Finally, the article looks at President Hugo Chavez's political and economic policies as well as the stagnation of the state oil company, Petroleos de Venezuela (PDVSA). This article dispels the myth that the resource curse is the source of destabilization in many resource dependent countries. Rather than a cause of instability, this phenomenon is a symptom of a much larger problem that is largely structural.

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## Abstract

The focus of this article is on what role, if any, oil has on Venezuela's instability. When trying to explain why a resource-rich country experiences slow or negative growth, experts often point to the resource curse. The following pages explore the traditional theory behind the resource curse as well as alternative perspectives to this theory such as ownership structure and the correlation between oil prices and democracy. This article also explores the various forms of instability within Venezuela and their causes. Finally, the article looks at President Hugo Chavez's political and economic policies as well as the stagnation of the state oil company, Petroleos de Venezuela (PDVSA). This article dispels the myth that the resource curse is the source of destabilization in many resource dependent countries. Rather than a cause of instability, this phenomenon is a symptom of a much larger problem that is largely structural.

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## Introduction

The world is experiencing an unprecedented demand for energy as economic development begets rising incomes as well as increased stresses on the international marketplace. While petroleum has the potential to help meet the challenges of economic development, the international oil market is volatile and fragile, and seemingly insignificant changes in oil production can have a disproportionately large impact on global prices. Many states that are reliant on oil and other nonrenewable resources have fallen

victim to the resource curse. Venezuela faces the various attributes of the resource curse, including an unstable economy, the rise of an authoritarian government, Dutch Disease, and corruption.

## The Economic Perspective

### *Volatility and the Boom-Bust Cycle*

Over-reliance on a single commodity for a majority of a nation's export revenue is an especially precarious prospect. Over-reliant countries put their fate in the hands of a capricious global commodity market that regularly cycles through booms and busts. In the case of oil, prices have shifted as much as 70 percent in a year's time. The boom-bust culture presents many problems to countries reliant on a single export or two for a majority of their revenue. When prices are high, the opportunity cost of investing in another good for export becomes extremely great. Capital and labor shifts toward one product may have short-term benefits, but this creates an economic monoculture. A country with an economic monoculture, such as the case of Venezuela and oil, will experience considerable economic hardships when the price of the commodity falls. For instance, the price of oil decreased from \$140/barrel to \$40/barrel between 2008 and 2009. During this same time period, Venezuela experienced a negative 3.2 percent GDP growth rate due largely to the sudden shortage of export revenues, which declined from \$93.5 billion to \$57.6 billion.<sup>1</sup>

Boom-bust cycles also lead to poor governmental expenditure decisions. Overspending during good years and deep budget cuts during bad years have far reaching impacts. Renowned economist Jeffrey Sachs notes, "the benefits in the good years are transitory while the problems generated during the bad years endure."<sup>2</sup> For instance, in 2009 Hugo Chavez slashed 33 percent of the national budget after oil traded well below what the Venezuelan Government initially projected.<sup>3</sup> Poor financial decisions can often have international repercussions. During commodity booms, countries often borrow against future earnings from various international lenders. A prolonged drop in prices, however, may make it impossible for these countries to pay loans back, subsequently forcing the borrower to default or become mired in a deep debt crisis.

### *Dutch Disease*

Dutch Disease is another common trait seen in countries reliant on natural resource exports. The term "Dutch Disease" was first coined in 1977 by the *Economist* to describe the economic impact of natural gas exports in

the Netherlands. Following the discovery of natural gas in the Black Sea in the 1970s, the Dutch manufacturing sector began to experience a significant decline. Essentially, local currency appreciates as a result of high demands for a given commodity. The influx of money into the local economy due to high-value exports causes demand and, consequently, prices to increase. As a result, local currency appreciates and there is an increase of the real exchange rate. With such an overvalued domestic currency, other domestic products such as manufactured and agricultural goods become overpriced and uncompetitive in the global market. This in turn also contributes to what is often called the "resource pull effect."<sup>4</sup>

A dominant natural resource sector attracts a majority of the domestic capital and often becomes the wage-setter, with wages higher than the struggling domestic industries. While some labor shifts towards this natural resource sector cause layoffs in the now less competitive manufacturing and agricultural sectors, many nonrenewable resource industries are not labor intensive. For instance, mining rare minerals may require a large employee base, but oil and natural gas production is primarily a technology and capital-intensive process needing fewer workers. This results in high unemployment rates in petroleum dependent economies that do not have a viable manufacturing or agricultural base. In addition to a shifting work force, natural resource domination threatens to crowd-out entrepreneurial activity and innovation, especially if this industry is the wage-setter, as workers may be more inclined to work in the resource sector rather than create their own businesses.<sup>5</sup> Overall, Dutch Disease creates a vicious cycle that gives primacy to a single sector and helps reinforce the natural resource monoculture.

## The Political Perspective

### *Resource Rents*

A handful of political issues appear in countries that rely on nonrenewable natural resources. Most of them are directly tied to rent-seeking behavior. An "economic rent" is the gap that "exists between the value of that resource and the costs of extracting it."<sup>6</sup> In the case of resources such as oil and natural gas, the commodities' market value far exceeds the cost of production. In these countries, those in control have an inordinate amount of power due to their access to resource rents. Sachs and his co-authors acknowledge that "politicians with an uncertain hold on power have an incentive to spend sooner rather than to leave opportunities on

the table for future political opponents."<sup>7</sup> Premature spending can lead to economic woes such as the shortage of funds during times of low commodity prices. This trend plays out in the political sphere.

### *Authoritarianism, Accountability, and Cronyism*

Analysts find that governments in resource rich nations tend to be more authoritarian than their non-resource dependent counterparts.<sup>8</sup> Thomas Friedman's First Law of Petropolitics notes, "the price of oil and the pace of freedom always move in opposite directions in oil-rich petrolist states."<sup>9</sup> Politicians, for instance, are motivated to remain in office because resource rents offer them power and wealth. Those in power may use resource rents to "successfully repress or co-opt their oppositions, and thus avoid having to relinquish power through electoral competition."<sup>10</sup> Resource rents are not always used in an overtly repressive manner; however, politicians will freely use resource rents to help fund campaigns, systematically outspending their opponents to victory. Furthermore, the governments of resource-rich nations are often unaccountable to the people. Part of this is directly tied to authoritarianism, as politicians will use resource rents to oppress the opposition or to ensure victory through neo-patrimonialism. Alternatively, resource rents often replace taxation as the main source of government revenue. In a country with a tax system and an electoral process, the government is held accountable by the electorate and must use tax revenues to support the economy and develop social programs. A non-existent tax system will often translate to weak linkages between the government and its people. The government will have little or no incentive to work for the people if it is not reliant on them for revenues. As Michael Ross states in his work *Does Taxation Lead to Representation?*, "the need to collect taxes is widely thought to have contributed to the emergence of strong states and even democratic institutions in many Western countries."<sup>11</sup>

Resource rents promote a system of corruption and cronyism. Political scientists have found that rents promote patronage links, most notably in countries that were politically weak prior to the discovery of the resource. This may help explain why Norway and Botswana have been able to avoid political corruption while most others have not.<sup>12, 13</sup> This trend is especially prevalent in Africa where colonialism left behind the legacy of a strong patronage network. Resource rents are zero-sum; one person's gain is another's loss. As a result of this reality, resource-rich countries often have vertical linkage systems: "To get ahead individuals look upwards to get access to a piece of the oil rent, and compete against, rather than collaborate with fellow citizens."<sup>14</sup> This differs greatly from countries without resource rents and more well rounded economies. In

these places, citizens must collaborate horizontally to build networks in order to get ahead, whether that means forging unions to secure work-place rights or building trade ties with other companies.

Further cementing the concept of resource rents being a zero-sum game, the *Financial Times* noted that, "in a society when everyone cheats and takes or pays bribes, there is little incentive not to join in."<sup>15</sup> In resource rich countries, rent-seeking behavior is seen at the highest levels. Countless heads of state have been charged with siphoning state funds towards private, international bank accounts. One example is President Omar al-Bashir of Sudan, who is suspected of funneling \$9 billion dollars of oil profits abroad.<sup>16</sup> Those who do not directly steal from the state will often set up a neo-patrimonial network in which their closest friends, family, or companions are placed in the highest governmental roles so that they may benefit from the power and money that resource rents bring. Cronyism is almost inevitable in resource-rich countries, for "resource rents are concentrated and (in some cases) easily appropriable, government officials in such countries are tempted into rent-seeking and possible corruption rather than pro-growth activities."<sup>17</sup> Sudan's president has used the client-patron relationship to secure power for 25 years. Al-Bashir created the country's legislature and appointed his party-mates to 450 of the 500 seats, securing them federal employment at a time when the national economy was contracting by nearly 4 percent. Al-Bashir also made sure to appease the national army, the group most responsible for national insecurity since its independence. He has more than tripled Sudan's yearly military expenditure since he took power in 1989. Today this number stands at just under \$2 billion a year and looks to only be rising.<sup>18</sup> The Sudanese President has essentially been able to fund the military by directing 60 percent of Sudan's oil revenues toward it.<sup>19</sup>

## Alternative Perspectives of the Resource Curse

### *Ownership Structure*

Not every country that relies on resource exports experiences instability. Perhaps the most well known alternative to the traditional resource curse theory focuses on the structure of ownership rather than the mineral wealth itself. In *Oil Is Not a Curse*, Pauline Jones Luong and Erika Weinthal point out that ownership structure is not constant but rather a variable, and that "which form of ownership structure a country adopts is arguably the first and the most important choice that mineral-rich states make because it shapes incentives for subsequent institution building."<sup>20</sup> Jones Luong and Weinthal examine the Commonwealth of Independent

States (CIS) following the collapse of the Soviet Union in their work. These countries' various ownership structures played a large role in how their political, economic, and social spheres looked a decade later. Those that chose to engage in a state ownership experienced "bloated public sectors, high levels of indebtedness and overzealous spending."<sup>21</sup> Other CIS countries that chose private domestic and private foreign ownership were able to shrink the public sector and control government spending in spite of an oil boom in the first few years of the new millennium. Overall, Jones Luong and Weinthal discovered that petroleum rich CIS countries outperformed the poorer petroleum nations in both social and business environment indicators.

When looking at ownership structure, transaction costs and societal expectations play a large role in the health of the State. Transaction costs often impact the main actors' incentives to create strong versus weak fiscal regimes.<sup>22</sup> Jones Luong and Weinthal theorize that countries with state ownership structures suffer because transaction costs are low and main actors are incentivized to manage the mineral sector with discretion. This, in turn, creates weak fiscal regimes as corruption becomes prevalent and discourages smart economic policies such as the creation of a natural resource fund. Alternatively, a private ownership structure has high transaction costs because the main actors have divergent interests. Countries in which resources are managed by state-owned enterprises are often hampered by societal expectations, as the State "owes its status as direct claimant to its role as society's agent."<sup>23</sup> As many states commit themselves to managing wealth in society's best interest, governments use natural resource revenues as their personal "piggy bank" via mass spending, subsidies, and "white elephant projects" whose cost disproportionately outweighs its usefulness or worth. Under a private ownership structure, society does not feel entitled to the distribution of resource rents. Furthermore, since resource wealth can only be gathered by the State through taxation of the private ownership, society is incentivized to support a viable taxation system.

### *Resource Wealth and the Promotion of Democracy*

While the concept of ownership structures may be the most predominant counter-argument to the classical resource curse theory, it is not the only one. Another school of thought posits that resource revenues can actually promote democracy. Thad Dunning argues that resource rents "reduce the extent to which democratic majorities redistribute private income or wealth away from the rich elites through taxation, land reform, or other measures."<sup>24</sup> Thus, high resource prices allow states to redistribute rents throughout society. This takes pressure off of the nation's elite to act as



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the "load-bearers" for national revenue and acts as a disincentive to stage a coup against the government. Dunning explores Venezuela's relationship with oil in *Crude Democracy*. In this work he notes a positive relationship between oil rents and democratic stability in the South American nation, pointing to a "degree of class 'compromise' and 'consensus' that was highly unusual in Latin American countries during this period."<sup>25</sup> Oil rents allowed the State to increase spending on education and health by twenty and five times respectively, all without placing a heavy tax burden on the country's elite.

## The Causes of Instability

This section explores instability in Venezuela within political and economic dimensions. Each example of instability is complemented with a cause. These causes fall into one of two overarching themes: 1) the role of Hugo Chavez, and 2) the stagnation of PDVSA. Political and social groups in Venezuela, along with misguided economic policies, have effectively "crowded out" democracy and caused instability under Hugo Chavez. Additionally, a structurally unsound PDVSA has had damaging impacts on the Latin American nation. While many claim that the resource curse is destabilizing Venezuela, the resource curse is really a symptom of the problem rather than the cause.

### *Economic Instability*

In spite of Venezuela's vast oil wealth, the country faces a great deal of economic instability. The most noticeable and damaging economic malady is inflation. Venezuela has the highest inflation rate in the world, a staggering 28.9 percent.<sup>26</sup> In fact, purchasing power has decreased by 15 percent since 2003, meaning citizens can now buy 15 percent less than they could in 1998.<sup>27</sup> According to the Index of Economic Freedom:

"Venezuela continues to be mired in a climate of economic repression. Severely hampered by state interference, the formal economy is increasingly stagnant, and informal economic activity is expanding. Monetary stability is particularly weak, and there are extensive price controls on almost all goods and services. Government interference in the financial sector further distorts price levels and constrains private-sector growth by allocating credit on non-market terms."<sup>28</sup>

Another dangerous aspect of the Venezuelan economy is that both domestic and foreign business within the country is increasingly scarce. A World Bank analysis posits that there are only six countries in the world where it is worse to do business.<sup>29</sup> In fact, Venezuela is ranked one of the top two worst places in the world to get credit, pay taxes, or receive investor protection.<sup>30</sup> Furthermore, many international investors have refrained from entering the Venezuelan market due to Chavez's unpredictable nature. Since his first election in 1999, Chavez has nationalized part or all of the oil, cement, steel, gold, and rice industries. The result of these nationalizations remains largely a mystery, as the government routinely releases economic data with little transparency. Overall, the country's economy is beginning to feel the crunch of economic mismanagement. Since 2007, direct foreign investment in Venezuela has decreased from \$44 billion to \$37.6 billion, a 14.5 percent drop.<sup>31</sup> As Chavez continues to nationalize industries and the government maintains intrusive policies, foreign investment in Venezuela will continue to languish.

While many resource-rich nations have turned to sovereign wealth funds (SWFs) to help manage their resource rents, Venezuela has largely turned a blind eye to the economic precaution. SWFs help prevent the local currency from appreciating and act as a "rainy day fund" to help bolster the economy of a resource-rich country when commodity prices are low. Oil is responsible for nearly 95 percent of Venezuela's export revenue, which between 1999 and 2010 totaled over \$510 billion. Despite this great number, the country's SWF is valued at less than 1 percent of this total, at a mere \$800 million. This pales in comparison to Norway, who has put over \$560 billion in an SWF fund thanks to nearly \$1 trillion worth of exports over the same time period. According to the Sovereign Wealth Fund Institute, Chavez has nearly complete control over his country's SWF, as he appoints the SWF's leadership and the country's legislature has "limited involvement with any decision-making regarding the fund, nor does it have an oversight role."<sup>32</sup> Over the last decade, Venezuela has become a heavily statist regime with severe regulatory restrictions and little history of private sector growth. The petroleum monoculture exacerbated the country's economic woes when facing the 2008 global financial crisis. As a result of the crisis, Venezuela witnessed local debts rise, inflation, exchange rate distortions, consumer good shortages, and the flight of foreign direct investment.<sup>33</sup> The Chavez government failed to pass any serious austerity measures, as spending cuts would adversely impact his vital support base, the country's lowest classes.

### *Political Instability*

Venezuela is not politically instable in the traditional sense. The country has regular elections that are contested by various political parties. However, the structure is currently one of political asymmetry that encourages either co-option or incendiary political rhetoric.

Various indices rate the country among the world's worst in terms of political freedoms. The *Economist Intelligence Unit's (EIU) 2011 Democracy Index* ranks Venezuela 97th after taking into account factors such as the electoral process, political participation, and civil liberties. EIU also rates Venezuela "the worst offender" after Cuba in terms of freedom of the media.<sup>34</sup> *Reporters Without Borders* backs up this sentiment, ranking Venezuela 117th in the world in their *2011/2012 Press Freedoms Index*. Tied with Venezuela are a handful of other nations rarely lauded for their freedoms: Cambodia, Fiji, Oman, and Zimbabwe. Nearly every index shows that political freedoms in Venezuela have declined over the past decade. Freedom House's *Freedom in the World 2012* is just another example: Venezuela scores a 5 in both political rights and civil liberties. This ranking is down from 1999, when it scored a 4 in both categories.<sup>35, 36</sup> Though Freedom House may have designated Venezuela "partly free" before Chavez entered office, the historical rankings show that the country has slipped even further during his presidency. Lastly, and perhaps most stark, is Transparency International's Corruption Perceptions Index, which measures the "perceived levels of public sector corruption." In 2011, Venezuela ranked 172nd, with only nine nations designated as more corrupt.<sup>37</sup>

The Chavez Administration is best described as a hybrid regime, a "political system in which the mechanism for determining access to state office combines both democratic and autocratic practices."<sup>38</sup> A hybrid regime is one in which the government rarely negotiates with opposition forces, the State undermines the autonomy of civic institutions, and loyalists of the government are put in the highest offices, helping to undermine the system of checks and balances. Chavez came to power following an era of extremely uneven growth in Venezuela. In the decade before his presidency, Venezuela experienced a growth rate of less than 1 percent six times.<sup>39</sup> Chavez was able to capitalize off the anti-establishment sentiments caused by the country's poor economic performance and created a "hyper presidential" constitution. He was able to manipulate the electoral process to "enable the government, with only 53 percent of the votes, to

obtain control of 93 percent of the seats."<sup>40</sup> Lastly, Chavez altered the structure of the country's Supreme Court, ensuring that the judiciary would make *chavismo*-inspired rulings by adding twelve of his close allies to the bench. Overall, since Chavez has come to power the political atmosphere in Venezuela has transformed from one of "heightened power competition to...power asymmetry."<sup>41</sup>

The various measures that Chavez took to secure power and stack the government with allies greatly alienated the opposition and caused his political enemies to become more extreme in the eyes of the people. Political losses have forced the opposition to become even more polarized. In the face of increasingly undemocratic political moves, opposition parties boycotted legislative and presidential elections. Unfortunately, this worked to their own detriment, as Chavez and his party, Partido Socialista Unido de Venezuela (PSUV), were able to secure more power.

One way that Chavez maintains such great control over his country is through the utilization of resource rents for personal and political gain. A key aspect to *chavismo* is "placing state resources and security services at the disposal of the ruling party while denying them to its rivals."<sup>42</sup> Opposition members who have grown tired of fighting the status quo have been co-opted by the government. Furthermore, Venezuela has become an increasingly undemocratic state: The government has shut down opposition media, jailed opposition leaders and been charged with election tampering on numerous occasions. Unfortunately for the people of Venezuela, today's majority coalition is not motivated by democratic gains but rather personal power and economic benefit.

## The Stagnation of PDVSA

Venezuela has benefited in some ways over the past few years from booming oil prices. From 2004–2011, the lowest annual price of oil was still higher than that of the previous twenty years. Despite these high prices, the country remains weak across various political, economic, and social indicators. The stagnation of the parastatal oil company, PDVSA, is partially responsible for the country's woes. PDVSA has been poorly managed, both in terms of who it employs and its relationship with the Chavez administration. Had it been under better care for the past decade, the company would not currently face the strain of weakened infrastructure. This would have led to greater oil revenues that could have been used to weather unfavorable economic conditions that may arise in the future.

### *Oil Strike of 2002–2003*

In December 2002, mid- and high-level managers, operational staff, and shipping captains in PDVSA brought the company to a standstill in a movement against Hugo Chavez. The economic effects of the strike were grave. In the first quarter of 2003, the country's GDP contracted by 27 percent. Venezuela was forced to import oil to meet domestic demand and unemployment increased by a third, growing to 20.3 percent.<sup>43</sup> When the strike eventually ended, Chavez replaced the company's board of directors with political allies and merged the company with the Ministry of Energy and Petroleum, which assured the President would have a hands-on relationship with the national oil company. He then fired nearly 18,000 employees in a wide-ranging move: Exploration and well engineers, human resources staff, and members of finance, maintenance, and marketing.<sup>44</sup> This move would cause a "brain drain" in PDVSA for years to come. The company suffered a "loss of human capital that was seen as the best trained and most experienced staff of any oil company in a developing country."<sup>45</sup>

### *Social Investment*

PDVSA, despite the mass firings, still manages to bring in hundreds of billions of dollars in revenue due to high oil prices and the country's vast reserves. Much of these revenues, however, have not gone towards reinvestment in PDVSA but rather toward social programs such as Fonden, Fondespa, and *misiones*. All of these initiatives, integral parts of Chavez's "Bolivarian Revolution," provide aid to the country's lower class via infrastructure projects, agricultural activities, health care and education. From 2003–2008, PDVSA spent more than \$23 billion on these social programs.<sup>46</sup> Social indicators in Venezuela have improved since PDVSA began to focus on social investment. The number of households living in poverty has nearly halved to 29 percent and social spending per capita has tripled. The social programs have been criticized as being too short-term and for not addressing the structural inequalities that are an intrinsic problem within the country. Although the people of Venezuela have benefited from oil revenues, it is impossible to predict what progress could have been made had Chavez chosen not to fire 40% of PDVSA's employees. Had they remained with the company, it may have been able to avoid the stagnation it faces today and bring in billions of dollars more.

In spite of some of the progress made as a result of oil revenues, Venezuela faces a number of social issues including violence, energy insecurity, and food shortages. Over the past decade, homicides in Venezuela have quadrupled. Caracas has a higher murder rate than any other city in the

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Western Hemisphere other than Ciudad Juarez. Worldwide, the country has the fourth highest murder rate; nearly two people are killed every hour.<sup>47</sup>

Despite the country's massive reserves of oil, Venezuela gets 72.8 percent of its domestic electricity generation from hydropower.<sup>48</sup> Hydropower provides many advantages, including clean and generally competitive energy prices. However, relying so heavily on this source of electricity has greatly hampered Venezuela. Climate change has caused prolonged droughts in the region and brought Venezuela's dams to dangerously low levels. Over the past few years the government has instituted rolling blackouts in order to conserve power. This policy has hurt small and large businesses alike. On numerous occasions PDVSA's oil refineries have lost power and been forced to shut down. Even temporary hiccups such as this can seriously hamper a national economy that is so dependent on one good.

In response to inflated consumer prices, Caracas installed price ceilings on thousands of different goods. Price ceilings typically cause shortages in two ways. With limited room for profit, producers will begin to make less of that product, prompting a supply shortage. Furthermore, artificially low prices often prompt hoarding and create parallel black markets. Venezuela has not been able to escape from the negative impacts of price ceilings. The country is currently experiencing food shortages and is in the midst of what many would consider to be a state of emergency: "Soldiers have been deployed to raid private homes for food stores. Long lines regularly form on streets for basic commodities."<sup>49</sup>

### *Debt and Inefficiency*

One of the largest problems associated with PDVSA's social agenda is that the company has failed to invest in its own future. Despite a massive oil boom from 2004–2008 in which Venezuela exported nearly three billion barrels, PDVSA's debt increased from \$3.7 billion to \$19 billion dollars. Between 2010–2011, operating costs rose from \$11.8 billion to \$15.3 billion in the face of declining infrastructure.<sup>50</sup> The total cost for each barrel has more than doubled, going from \$13 in 2001 to \$29 in 2008.<sup>51</sup> Furthermore, "analysts say PDVSA's debt profile is worrying given upcoming maturing bonds and the need for multibillion dollars of investments in the extra heavy crude Orinoco Belt to boost national production in coming years."<sup>52</sup> Debt aside, another sign of growing inefficiency has been the rise of employees despite decreasing production. Since Chavez fired 18,000 employees in 2003, the official payroll of the company has

increased from 30,000 to 80,000 employees.<sup>53</sup> However, during this time oil production has gone from 2.85 to 2.47 million barrels per day, a 13 percent decline.<sup>54</sup>

Another financial issue that plagues PDVSA is Venezuela's trade policy. Nearly 300,000 barrels a day, well over 10 percent of total production, are sold to Caribbean and Central American nations at a discount in order to secure political backing. These discounts, as well as a subsidy on domestic gas that allows the fuel to be sold for six cents/gallon, have significantly blunted the growth of the company's coffers.<sup>55</sup> Venezuela will need to begin pumping heavy crude from the Orinoco Tar Sands in the coming years if it wishes to maintain its current output. This will require billions of dollars in infrastructure investment and a great deal of technical know-how, neither of which the company currently possesses, and it will need to look for abroad in an environment not entirely eager to invest in Venezuela.

While Chavez has made it clear that he wishes to diversify oil exports and decrease the role that the United States has as a trade partner, he has yet to come up with a serious alternative. The Venezuelan President has repeatedly said that he wishes to increase oil trade with China, but this appears an unrealistic venture. China has limited refinery capacity, limited access to petroleum due to its proximity to Russia and Central Asia, and brings with it prohibitively high transportation costs of moving oil around the Strait of Magellan or Cape Horn.

High oil prices actually threaten to hurt Venezuela's market share in the global oil industry. These high prices allow for petroleum to be produced from sources once considered financially prohibitive. Canadian tar sands and Brazilian offshore pre-salt oil deposits were once thought too costly to make exploration and production worthwhile. However, oil prices hovering near \$100 per barrel make these operations economically viable and may hurt Venezuela in the long run.

## Conclusion

This article has dispelled the traditional economic theory that frames the resource curse as the primary cause of instability in Venezuela. The resource curse is not the cause of instability, but rather it is a result of structural problems within the nation. These problems include the misguided economic and political policies of the Chavez government as well as the deterioration of the state oil company.

Theorists such as Pauline Jones Luong and Erika Weinthal have shown through their research on CIS nations that ownership structure plays a significant role in the health of resource-dependent nations. CIS states that relied on a public ownership composition resulted in inefficient oil sector as well as zealous spending programs and the inability to weather commodity price swings. Venezuela, home to a state-owned oil sector, displays many of the problematic traits that Luong and Weinthal outline.

Ill-advised economic and political policies have left Venezuela in a precarious position. High commodity prices resulted in currency appreciation and the subsequent corrosion of the country's non-oil industries. What was once a nation that relied on manufactured and agricultural goods for export revenue is now forced to import most of its finished goods and food as a result of Dutch Disease. This could have been avoided had the Chavez regime used prudent economic policies, most notably a sovereign wealth fund. Chavez has chosen to freely use resource rents rather than use SWFs and other pragmatic economic solutions. This has spawned an asymmetrical political system in which the president and his party have an unfair advantage over the opposition. Chavez uses oil revenues to campaign for office and promote cronyism. If his opponents wish to enjoy the spoils of the oil revenues, these groups are forced to join his political movement or remain on the political fringe with the rest of the Chavez opposition.

The deterioration of PDVSA has played an equally important role in the instability witnessed today in Venezuela. The oil company has experienced a vast "drain brain" and is being forced to spend revenues on social programs rather than reinvestment into company infrastructure. These social programs show some gains, though critics claim that these gains are merely superficial and fail to address the structural inequalities within the nation. Unfortunately, PDVSA's rising inefficiency and debt threaten to permanently cripple Venezuela's oil economy. Without this commodity, the country has little to fall back on and what little gains were made during the Chavez Administration will become undone.

The findings in this article will be applicable in future analyses of resource-reliant countries. Governments play an incredibly important role in a country's response to resource wealth. A political system with adequate checks, balances, and transparency helps ensure that resource wealth is appropriately handled. Alternatively, resource abundance in a country with an asymmetrical power distribution often begets the misappropriation of wealth and the rise of cronyism. Hopefully, resource rich



nations can learn from the mistake of Venezuela in order to help mitigate the role that the poor economic policies and misguided individual leaders can play when it comes to a country's resource wealth.

## About the Author

Mr. Kott is a recent graduate of New York University, where he received his Master of Science in Global Affairs with a dual concentration in Energy & the Environment and International Business. Prior to this, Mr. Kott received his Bachelor of Arts in International Affairs from The George Washington University in May 2009. His research interests include energy security, project finance, and emerging markets. His writing has been featured by the Center for International Relations and Council on Hemispheric Affairs as well as an upcoming publication by the Tanenbaum Center.

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