

ISSUE BRIEF

No. 3911 | APRIL 15, 2013

Venezuela: U.S. Should Push President Maduro Toward Economic Freedom

By James M. Roberts and Sergio Daga

Hugo Chavez's hand-picked successor, former trade union boss Nicolás Maduro, appears to have defeated Governor Henrique Capriles by a narrow margin in a contentious and hard-fought special election on April 14. Venezuela is in such shambles after 14 years of seat-of-the-pants mismanagement that Maduro—assuming his victory is confirmed—may ultimately be forced to pursue more moderate policies and seek help from the U.S. to restore stability.

The Obama Administration and Congress should exploit this opening by using U.S. leverage to push Venezuela to turn from Chavez's failed experiment in oil-cursed¹ "21st-century socialism" toward economic freedom.

An Economy in Ruins. The foundations of economic freedom in Venezuela have crumbled. When Chavez took office in 1999, Venezuela scored 54 out of 100 possible points in The Heritage Foundation/*Wall Street Journal's* annual *Index of Economic Freedom*. Today, however, after 14 years of Chavez's soft authoritarian populism, Venezuela merits a score of just 36 points. This nearly 20-point plunge is among the most severe ever recorded by a country

in the history of the *Index*. Its 2013 rank—174th out of 179 countries—places Venezuela among the most repressed nations in the world.²

Venezuela's dismal economic freedom score is reflected in statistics that translate into real-time hardship for Venezuelans, who must spend more of their incomes on higher prices for necessities—if they can find them on empty store shelves. There are scarcities of nearly all staple food and fuel products. In fact, according to the Banco Central of Venezuela's (BCV) shortages index, Venezuela faces the most severe food shortages in four years.³ And what food is available comes at a price: Mary O'Grady reports in *The Wall Street Journal* that "over the past 10 years inflation in food and nonalcoholic beverages is 1,284%."⁴

Financial disequilibrium in Venezuela is the result of a sharply widening fiscal deficit that reached almost 15 percent of gross domestic product (GDP) last year.⁵ Government control of the formerly independent BCV also contributed to a massive expansion of the money supply. There are anecdotal reports in Caracas of people paying as much as 23 *bolívares* for one U.S. dollar in the black market as of early April. The official rate is just 6.3 *bolívares* per dollar—and that is after a significant 32 percent devaluation in February.⁶

These problems were aggravated by Chavez's foreign adventurism—which drained billions of petrodollars from the economy to keep afloat the failed economy in Fidel Castro's Cuba—as well as generous subsidies to his *Chavista* cronies in the region through such schemes as ALBA and PetroCaribe.

Corruption and Weak Rule of Law. As reported in the *Index*, political interference in Venezuela's

This paper, in its entirety, can be found at
<http://report.heritage.org/ib3911>

Produced by the Center for International Trade and Economics (CITE)

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judicial system has become routine, and corruption is rampant. The landscape in Caracas and elsewhere in the country is littered with half-finished, publicly funded infrastructure and housing projects. The government funds needed to complete them often disappear.

As government expanded under Chavez, corruption became institutionalized. Chavez doubled the size of the public sector, many of whose 2.4 million⁷ employees have no real job other than to work to keep the regime in power. A World Economic Forum (WEF) survey found little trust among businesses, politicians, the judicial system, and the police in Venezuela.⁸ The tragic result is that Venezuela is now one of the most dangerous countries of the world. According to the Venezuelan Violence Observatory, in 2012 nearly 22,000 people were murdered.⁹

An inefficient and non-transparent regulatory environment that is hostile to private foreign direct investment obstructs long-term development and hampers entrepreneurial growth. The investment regime is tightly controlled by the state and favors investors from China, Russia, Iran, and other

democracy-challenged countries.¹⁰ Investor protection in Venezuela is ranked at 140 out of 144 countries, according to the WEF report.¹¹ In 1998, before Chavez took power, there were more than 14,000 private industrial companies in Venezuela; in 2011, after 13 years of extensive nationalizations and expropriations, only about 9,000 remained.¹²

The Chavez government did make one product very inexpensive for Venezuelans: Generous energy subsidies mean a car can be filled up with 15 gallons of gasoline for less than one U.S. dollar.¹³ Although that might buy short-term political advantage for the *Chavista* government, in the long term these energy subsidies are very destructive to future economic growth, since Venezuelan companies have a distorted cost base and thus cannot compete globally. Operations of the state oil company, PDVSA, have also deteriorated significantly under Chavez. When he took office, PDVSA was producing 3.5 million barrels per day (bbl/d); today, it is down to 2.5 bbl/d.¹⁴

Social Programs and Inequality. Ironically, Chavez's years in power did not result in much reduction of poverty and inequality. Although some

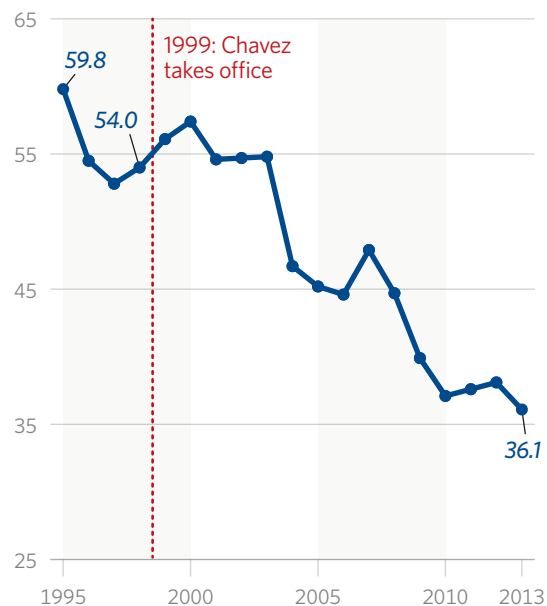
1. For more on the "oil curse," see James M. Roberts and John A. Robinson, "Property Rights Can Solve the Resource Curse," in Terry Miller, Kim R. Holmes, and Edwin J. Feulner, *2013 Index of Economic Freedom: Promoting Economic Opportunity and Prosperity* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2013), Chapter 5, <http://www.heritage.org/index/book/chapter-5>.
2. Miller, Holmes, and Feulner, *2013 Index of Economic Freedom*.
3. Lissy De Abreu, "Venezuela Is Struggling with a Historic Food Shortage," *Business Insider*, January 25, 2013, <http://www.businessinsider.com/venezuela-food-shortage-2013-1> (accessed March 18, 2013).
4. Mary Anastasia O'Grady, "Chávez, The Redeemer," *The Wall Street Journal*, March 11, 2013, <http://online.wsj.com/article/SB10001424127887324128504578348444202586314.html> (accessed April 9, 2013).
5. Economist Intelligence Unit, "Venezuela's Economic Outlook Post-Presidential Election," September 8, 2012, <http://country.eiu.com/article.aspx?articleid=1249568109&Country=Venezuela&topic=Economy> (accessed March 23, 2013).
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7. *The Economist*, "Now for the Reckoning," March 9, 2013, <http://www.economist.com/news/briefing/21573095-after-14-years-oil-fuelled-autocracy-hugo-ch%C3%A1vezs-successors-will-struggle-keep> (accessed April 12, 2013).
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9. Nick Allen, "Venezuela Murder Rate Soars," *The Telegraph*, December 28, 2012, <http://www.telegraph.co.uk/news/worldnews/southamerica/venezuela/9769897/Venezuela-murder-rate-soars.html> (accessed April 15, 2013).
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11. World Economic Forum, "The Global Competitiveness Report 2012-2013."
12. Stephen Keppel, "5 Ways Hugo Chavez Destroyed the Venezuelan Economy," ABCNews.com, January 17, 2013, http://abcnews.go.com/ABC_Univision/News/ways-chavez-destroyed-venezuelan-economy/story?id=18239956#.UWww7JPFXTo (accessed April 15, 2013).
13. Ernesto J. Tovar, "Gasoline Price in Venezuela Down to USD 0.01 upon Devaluation," *El Universal*, February 15, 2013, <http://www.eluniversal.com/economia/130215/gasoline-price-in-venezuela-down-to-usd-001-upon-devaluation> (accessed April 4, 2013).
14. U.S. Department of Energy, Energy Information Administration, "Venezuela Country Report," updated October 3, 2012, <http://www.eia.gov/countries/cab.cfm?fips=VE> (accessed April 12, 2013).

CHART 1

Economic Freedom in Venezuela Plummeted Under Chavez

Prior to 1999, when Hugo Chavez took office, Venezuela scored a 54 in the Index of Economic Freedom. Today, the nation scores only 36.1—fourth-worst in the world.

OVERALL SCORE IN THE INDEX OF ECONOMIC FREEDOM



Source: Terry Miller, Kim R. Holmes, and Edwin J. Feulner, 2013 *Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2013), <http://www.heritage.org/index>.

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measures of income inequality (such as the Gini coefficient) did improve under Chavez,¹⁵ according to a recently published research paper by Darryl McLeod and Nora Lustig¹⁶ that used data for 18 Latin American countries, market democracies such as Chile and Brazil were far more successful at reducing inequality and poverty than the populist *Chavista* regimes.

Despite its vast oil wealth, Venezuela's economic growth performance has also been poor. Between 1999 and 2012, average annual per capita growth was just 1.1 percent, while in the top four Latin American countries (Panama, Peru, the Dominican Republic, and Chile) the rate was 3.6 percent.¹⁷ Not surprisingly, the rate of private investment in Venezuela—under 5 percent—is also one of the lowest in the region. In Peru and Chile, it is almost 20 percent.¹⁸

U.S. Policy Toward the New Maduro Government. Washington should insist on strict conditionality before sending a new U.S. ambassador to Caracas or assenting to any new lending to Venezuela by international financial institutions until the new government:

- Produces a comprehensive plan for reform that reduces the size of the public sector, reverses nationalizations and expropriations of land and enterprises with just compensation to owners, restores the independence of the central bank and judicial institutions, reforms the electoral system, and submits to an internationally supervised audit of the government's books during the Chavez years;
- Takes steps to privatize PDVSA to bring in international equity partners with the expertise and financial capacity to restore PDVSA to the high level of professional operational and managerial expertise for which it was widely respected prior to 1999;
- Immediately stops all subsidies to Cuba and terminates wasteful and economically destabilizing subsidy programs such as PetroCaribe and ALBA;
- Ceases cooperation with international state sponsors of terrorism (such as Iran) and joins the international community's cooperative efforts in the fight against transnational crime, narco-trafficking, and terrorism; and

15. Robert Plummer, "Hugo Chavez Leaves Venezuela in Economic Muddle," BBC News, March 5, 2013, <http://www.bbc.co.uk/news/business-20795781> (accessed April 12, 2013).

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17. International Monetary Fund, "Database October 2012," *World Economic Outlook*.

18. International Monetary Fund, "Bolivia, 2012 Article IV Consultation," <http://www.imf.org/external/pubs/ft/scr/2012/cr12149.pdf> (accessed February 3, 2013).

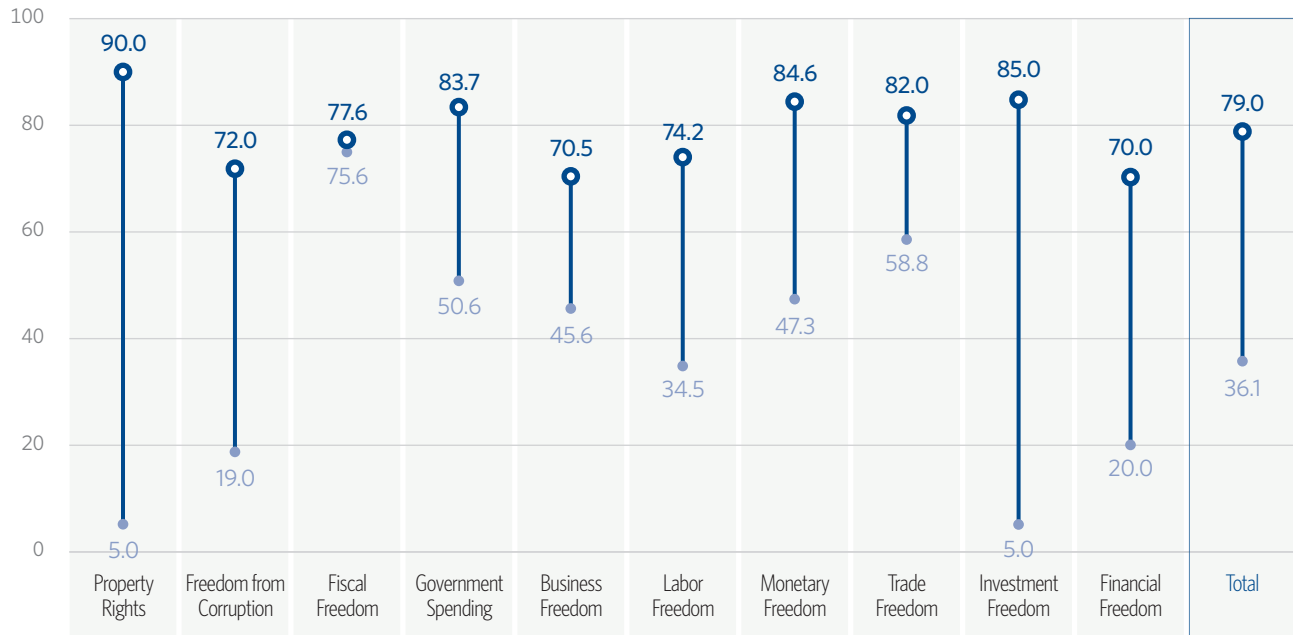
CHART 2

Economic Freedom: Venezuela vs. Chile

In the South and Central America/Caribbean region, Chile has the highest score in the Index of Economic Freedom. Venezuela is second-worst, ahead of only Cuba.

● Chile
 ● Venezuela

2013 ECONOMIC FREEDOM SCORE



Sources: Terry Miller, Kim R. Holmes, and Edwin J. Feulner, *2013 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2013), <http://www.heritage.org/index>.

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- Restores freedom of the press and access to information for all Venezuelans.

Use U.S. Leverage. The foundations of economic freedom in Venezuela were severely weakened during the 14-year misrule by Chavez. Although Chavez's death may aggravate instability and further polarize Venezuela, it need not be that way. Venezuela is in need of immediate and sweeping reforms, but these changes will take time, effort, determination, and, above all, dedicated reformers in Venezuela.

The Obama Administration should step into the breach with active and forward-looking policies to bring Venezuela back into the globalized economic system.

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CHART 3

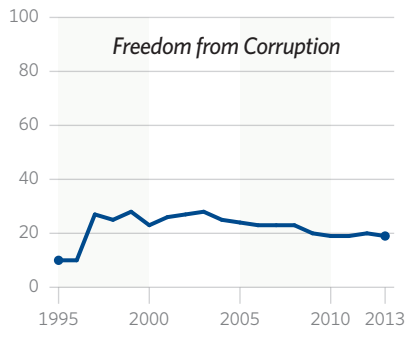
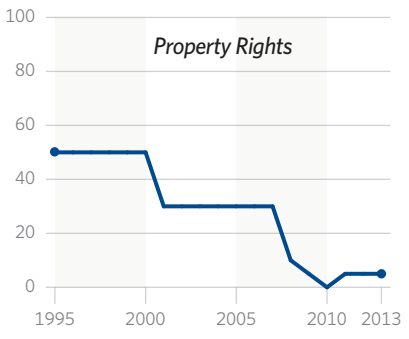
Venezuela's Economic Freedom Scores

Economic freedom in Venezuela has deteriorated steadily—and in some areas, dramatically—since Hugo Chavez became the nation's leader in 1999. In five of the 10 categories in the Index of Economic Freedom, scores dropped by 20 points or more.

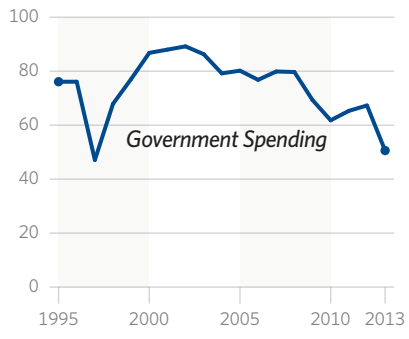
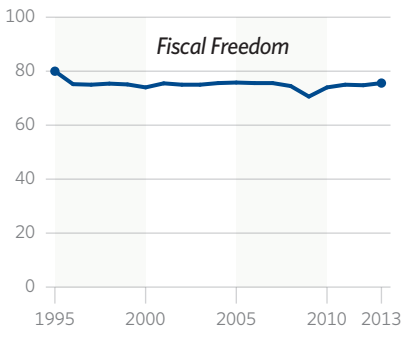
Sources: Terry Miller, Kim R. Holmes, and Edwin J. Feulner, *2013 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2013), <http://www.heritage.org/index>.

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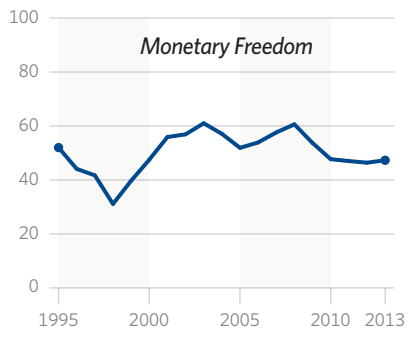
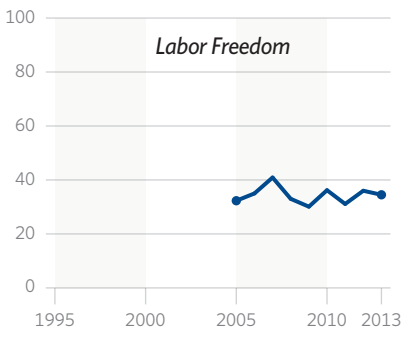
RULE OF LAW



LIMITED GOVERNMENT



REGULATORY EFFICIENCY



OPEN MARKETS

