

Macroeconomic Populism in Venezuela

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Abstract

Latin America lives in economic cycles; there have been several episodes of economic populism over the last few decades. This analysis places the government of Hugo Chávez, the current President of Venezuela, in a populist context. Chávez's experiment with populism is a case of the "model" presented by Dornbusch and Edwards (1990). A country rich in natural resources, but plagued by poverty and inequality, Venezuela presented all the conditions favorable for a populist leader to emerge. If Chávez continues using expansive fiscal policies to accelerate growth and redistribute income, while disregarding general macroeconomic equilibrium, a final collapse is highly probable.

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“Venezuelan politics cannot be understood unless two opposite facts are taken into consideration: the country’s economy grew more than any other economy in the world between 1920 and 1980, and there is no other nation, outside of Africa, that has declined so much economically in the past 20 years. Plus, one has to consider another problem: the wealth implied in oil, whose owner is the State, makes the population grow up thinking they are rich, when in reality they are getting poorer. This contradiction creates frustration, resentment and the search for a panacea. People think that if oil belongs to everyone and if they do not receive their share it is because somebody is stealing, it is because of corruption. This is the context in which Hugo Chávez arises.”

- Moisés Naim (quoted in Prados, *El País*, February 20th, 2002)

(Venezuelan ex-Minister of Industry and Commerce and Director of Foreign Policy Magazine)

Introduction

This is a story that can apply to most Latin American countries. Venezuela is an extreme case because it has large supplies of oil; other countries have minerals, fertile land, abundant labor, and/or vast water supplies. The central idea is that there is wealth implied in these resources and the reason that countries do not see this wealth is because of corruption. Most Latin Americans not only learn this story when they are young, but it is indoctrinated in them, which in turn generates frustration and disappointment. This situation creates the context for a particular kind of leader to emerge, one who appeals to the needs of the population and promises to attack corruption and redistribute the wealth that is rightfully theirs.

Latin American countries present a vast range of differences. Paradoxically, they are united by similarities in culture, religion, and language. At the same time, they are also plagued by high income inequality: the poor are very poor and the few wealthy are very wealthy. A report by the Inter-American Development Bank indicates that “by any standard of measure, Latin America stands out as the most inequitable region in the

world...Income distribution has not improved in the 1990s and remains below levels of two decades ago” (quoted in Gaudin, 1999). Consequently, many governments have attempted to pursue political and economic policies aimed at redistributing income and ameliorating the conditions of the poorest sectors in society. Unfortunately, the region’s economies have not achieved their goals. In fact, many are characterized by macroeconomic instability. The modern economic history of the region has been dominated by inflation outbursts, balance of payments crises, and in the end, painful stabilization attempts. Most Latin American countries have experimented with a wide range of economic policies and political systems, including military regimes, democracies, and populist governments.

Logically, with such a wide range of economic policies and political systems, there have been several episodes of economic populism in the continent. Even though each country has specific characteristics and circumstances that shape its experience, there are many common factors. All episodes tried to deal with the problem of income inequality and relied on: (1) the use of overly expansive fiscal policies, including deficit financing; and (2) the use of controls and a disregard for general macroeconomic equilibrium. Unfortunately, they resulted in major macroeconomic crises, where in the end, it is the poor sectors that are affected the most.

Presently, in the political and economic realm, there is a general trend towards democracy and neo-liberal policies. Obviously, the global trend does not guarantee that populist leaders will not emerge. On the contrary, Latin America lives in economic cycles, where concurring episodes tend to repeat themselves. What is particularly

frightening is the repeated use of populist macroeconomic policies to cure the ills of income inequality, albeit abundant historical evidence on their harmful consequences.

Populism in Latin America is not a rare phenomenon. In fact, in the last few decades, there have been many populist regimes in the region, some even in the same country. Every time, each leader and each experience claim to be different; nevertheless, they all result in economic collapse. As a result, there is no evidence or precedent that indicates that a populist government will be successful. Unfortunately, a new populist regime has emerged in Venezuela. This thesis strives to place the government of Hugo Chávez in a populist context and predicts that it will collapse mainly due to macroeconomic imbalances. Several journalists and politicians have been analyzing the current situation in Venezuela from a social and/or political point of view. Curiously, they are failing to see the macroeconomics behind it all. My hypothesis is that Chávez's experiment with populism is a textbook case of the model presented by Rudiger Dornbusch and Sebastian Edwards (1990). The model is not formal, but it is based on sound macroeconomic analysis and fundamentals. Applying the model to Chávez's government is a non-trivial task; many people, including one of the model's authors, believe macroeconomic populism is dead in Latin America: "I believe that macroeconomic populism, even in countries like Venezuela, is dead," said Edwards (Smith 2002, *The Nando Times*). Even though the author has changed his mind about the applicability of his model, I have not. The purpose of this thesis is to show how closely Chávez's government follows Dornbusch and Edwards' model. If Chávez maintains his current economic policies, while disregarding general macroeconomic equilibrium, the final collapse is foreseeable.

My analysis is divided into 5 sections. Section 2 defines populism and the difference that exists between economic populism and other forms of populism. Section 3 describes Dornbusch and Edwards' model. It begins by illustrating the characteristics of a populist leader and the most important features of a populist regime. It continues by explaining the model's four phases of a populist regime. It also presents several case studies of other countries that have had populist episodes, which have also been analyzed using Dornbusch and Edward's model. Section 4 presents the Venezuelan case. First, it illustrates the country's social and economic panorama that created the environment for a populist leader to emerge. Second, it gives a brief description of Venezuela's political past and the events that lead up to Chávez's election as President. Third, it places Hugo Chávez's government in the populist model. It describes Chávez's policies and traces their effects on the economy. Finally, this section attempts to place Chávez's government in one of the four phases of the populist model.

2. Defining Populism

Populist has become a common word to describe specific governments; however, it is difficult to set a precise definition for this term. Although populism is difficult to define, it is easy to describe and characterize: you know it when you see it. Several scholars have diverged over its specific attributes as well as its definition in political, social or economic terms. Due to these conceptual disagreements, a wide range of leaders, governments, policies, and political movements have been labeled populist. For the purpose of this thesis, I am interested in the concept of macroeconomic populism. Defining it results imperative to understanding the difference between economic

populism and other forms of populism. Below I describe other definitions of populism, which include a political definition, classical populism and neopopulism.

Meny and Surel (2002) stress the difficulty of defining populism. They see this concept as “an empty shell which can be filled and made meaningful by whatever is poured into it” (2002, p. 6). Paul Taggart emphasizes that “populism has an essential chameleonic quality that means it always takes on the hue of the environment in which it occurs” (2000, p. 4). Consequently, while in the past populism was used almost exclusively to characterize developing countries governed by charismatic leaders, the term has increasingly been applied to policies in Western Europe. In fact, populism has become a catchword, especially in the media, to “designate the newborn political or social movements which challenge the entrenched values, rules and institutions of democratic orthodoxy” (Meny and Surel 2002, p. 3). Hence, populism is defined as “the pathology of democracy” (Meny and Surel 2002, p. 3). The preceding interpretation sees populism as an ideological corruption of democracy, due to the fact that democracy is founded upon transmissible principles: the willingness to educate and teach the people rather than to seduce them (Taguieff 1997).

A political definition of populism is given by Weyland (2001) who believes that it is preferable because it captures best the basic goal of populist leaders: to win and exercise power, while using economic and social policy as an instrument for this purpose. This conceptualization situates populism “in the sphere of domination, not distribution. Populism first and foremost shapes patterns of political rule, not the allocation of socioeconomic benefits or losses” (Weyland 2001, p. 11). Under this definition, a populist leader seeks or exercises power based on support from large number of

followers. The populist leader mobilizes and demonstrates distinctive power capability through instruments such as elections, mass demonstrations, referendums and opinion polls (Weyland 2001). The leader is charismatic and wins broad and intense support from a largely unorganized mass by “representing people who feel excluded or marginalized from national political life and by promising to rescue them from crises, threats, and enemies” (Weyland 2001, p. 14).

A different definition for populism is classical populism. It refers to the classical populists of the 1930s through the 1960s. This concept stresses charismatic leadership and cross-class alliances. As defined by Cardoso and Helwege (1999), classical populism “represented an urban political movement that opposed the primary product, export-oriented status quo of the nineteenth century and endorsed accelerated industrial development” (Cardoso and Helwege 1999, p. 204). Policies were designed in a way that economic growth was achieved based on industrialization as the path to sustained employment; interclass antagonisms were minimized through the propagation of a broadly nationalist ideology. Classical populism is often associated with the policies pursued by Perón in Argentina from 1946 to 1949, Getulio Vargas in Brazil after 1945, and by Juan Velasco in Peru between 1968 and 1975.

Neopopulism has been used to describe the rise and decline of populist leaders in the 1980s and 1990s, such as Alan García in Peru and Fernando Collor in Brazil. According to Weyland (2001), neopopulism is less institutional than classical populism: “it adopts a more antiorganizational stance, reaches followers in the private sphere, and depends on the confidential responses of individual citizens, not on collective manifestations by the people in the public sphere” (Weyland 2001, p. 16). Therefore,

neopopulism mobilizes less people and is less transformatory and redemptive than classical populism. However, by appealing to the whole population, and by determining the will of the people through votes and poll responses, neopopulism is more representative than classical populism and more compatible with liberal democracy (Weyland 2001).

Finally, there exists an economic definition of populism, which also incorporates social and political characteristics. Dornbusch and Edwards (1990) coined the term “macroeconomic populism” to describe the policies of countries, like Chile under Allende or Peru under García, in which governments attempted to respond to pressures for income redistribution through macroeconomic means. These countries all bore the trademark of economic populism: hyperinflation caused by budget deficits and balance of payment crises. Economic populism stresses the repeated willingness of governments to push demand beyond economic bounds (Cardoso and Helwege 1999). These policies, which relied on deficit financing, generalized controls, and a disregard for the equilibrating mechanisms of free markets, ultimately resulted in major macroeconomic crises negatively affecting the same ones they were intended to help. The economic policies usually ended when “foreign exchange constraints and extreme inflation forced a program of real wage cuts that ended in massive political instability, violence, and in the case of Chile, even in a coup” (Dornbusch and Edwards 1990, p. 248).

3. Dornbusch and Edwards' Stylized Model

3.1 Description of the Model

As previously stated, the purpose of this thesis is to characterize Chávez's regime in Venezuela, using Dornbusch and Edwards' (1990) stylized model. Now that macroeconomic populism has been briefly defined, it is time to describe the model itself.

With their model, Dornbusch and Edwards provide a set of characteristics to define populism and describe a common process that occurs when all the characteristics are present. The model also provides a link between the behavior of a populist leader and its effects on the macroeconomy. Populist leaders present a pattern of behavior that emerges from their belief in the need for redistributing income. They emerge in societies plagued by high income inequality and much of their actions are geared towards alleviating this reality. A great avenue for further research is to try to explain populists' behavior. While Dornbusch and Edwards' model does not endeavor to explain why the populist leaders behave the way they do, it presents a link that is based on formal, well-accepted macroeconomic modeling. It provides a setting in which to examine the decisions populists make and how these decisions affect the macroeconomy.

3.2 Defining the Economics of Populism

When defining the economics of populism, one has to consider two things: the characteristics of the leaders and features of the regime. In this section, I describe both.

3.2.1 Characteristics of a Populist Leader

Fundamentally, populist leaders differ from each other. At the same time they share similar characteristics. First, populist leaders exhibit charisma, that is, unique personal abilities and qualities in the eyes of the followers, which empowers them to

defend the needs of the majority of the population and to support national pride (Conniff 1999). Second, populists promise to reform their societies and to improve the lives of the masses. Third, they appeal to the poor and working classes and to the common men and women for votes and legitimacy. Finally, to gain acceptance, they use elements of folklore to demonstrate their proximity to the masses. For example, Perón and Vargas evoked the ethos of the gaucho; Jorge Gaitan and Leonel Brizola in Brazil, stressed their own poverty as youths to explain their identification with the poor (Conniff 1999).

A populist leader tends to design a set of economic policies to achieve specific political goals that include:

(a) *Organizing support with lower-middle class groups and organized labor.* These groups tend to suffer from the high income inequality and are easily attracted to a leader that promises to ameliorate the situation. They represent the regime's primary support.

(b) *Acquiring complementary support from domestically oriented business.* This sector plays an important role in the reactivation of the nation's economy, which in turn helps promote growth, further contributing to the regime's redistribution goals.

(c) *Politically isolating the rural oligarchy, foreign enterprise, and large-scale domestic industrial elite.* These groups are often referred to as the enemy. Previously, they dominated national politics. Their interests tend to conflict with the redistributive goals of a populist regime.

To reach these goals, there are sets of economic policies that include:

(a) *Budget deficits to stimulate domestic demand.* A populist leader seeks economic growth, implementing a set of expansive policies to stimulate domestic demand, which in turn create budget deficits.

(b) *Nominal wage increases plus price controls to affect income redistribution.* The wage increases are designed to produce redistributive effects, while the price controls are implemented to keep inflation under control.

(c) *Exchange-rate control or appreciation to cut inflation and to raise wages and profits in nontraded-goods sectors.* There is a rejection of devaluation even when inflationary pressures develop, because there is a belief that it will reduce living standards and further increase inflation.

3.2.2 Features of the Populist Regime

The most important features of the populist regime¹ are: (1) They ignore macroeconomic constraints as long as possible, and (2) Their plan includes reactivation, redistribution of income, and restructuring the economy. Both features are described below.

(1) *No constraints:* One of the biggest problems with populist governments is that they ignore macroeconomic constraints as long as possible. Policymakers tend to see idle capacity as a possibility for expansion. As long as there is no devaluation, they do not see expansion as inflationary, because they perceive that spare capacity and decreasing long-term costs contain cost pressures; however there is always possibility for the use of price controls. In addition, the accumulated international reserves and the ability to ration foreign exchange create additional room for expansive policies without the risk of running into external constraints. Furthermore, the risks associated with deficit financing are portrayed as exaggerated or altogether unfounded.

¹ The features of the populist regime and the description of the four phases are drawn directly from Dornbusch and Edwards' *Macroeconomic Populism in Latin America* (1990). For a more complete analysis please refer to this text.

(2) *Populist prescriptions*: Populist governments generally have three elements in their plan: reactivation, redistribution of income, and restructuring the economy. The first step is to reactivate the economy. Populist leaders typically face a situation where the nation's economy has not performed as expected, with moderate growth, stagnation, or even depression. Once the economy is reactivated, it is possible to achieve the two other objectives: redistributing income and restructuring the economy. They typically redistribute income through large real-wage increases, but avoid higher prices. However, even if inflationary pressures do develop, populist policymakers reject devaluation. They firmly believe that devaluation reduces living standards and, in the end, it will create further inflationary pressures without having positive effects on the external sector. In terms of restructuring the economy, they try to save on foreign exchange, which in turn supports higher levels of real wages and higher growth.

3.3 Phases of Populist Economies

Dornbusch and Edwards argue that given the characteristics of the leader and the regime described above, we can distinguish four phases of populist governments. This section describes the initial conditions and the four phases of a populist regime. Not all examples follow these phases, but they present a structural framework in which to examine a populist regime. The authors state that even though each populist episode has its own characteristics and the politics differ greatly, the macroeconomics of several experiences are quite similar. Thus, it is possible to distinguish four phases common to most of them (Dornbusch and Edwards 1990).

Before the populist phases can begin, a set of initial conditions is necessary. First, there tends to be dissatisfaction with the economy's performance; many believe things could be better. Typically, the country has experienced very moderate growth, stagnation, or outright depression as a result of previous stabilization attempts. The IMF has usually guided this stabilization program, but it has resulted in reduced growth and lower living standards for the population. Second, people are ready for a radically different economic program because they are tired of the highly uneven income distribution. Third, even though the preceding stabilization plan tends to be harsh, it generally improves the budget and the external balance, through the accumulation of international reserves. The increased international reserves and the improved budget create the room to maneuver, that is, they provide space for a highly expansionary policy. Without the room to maneuver, the populist regime cannot begin. Once the initial conditions are in place, however, the first phase of a populist government can commence.

During **Phase One**, the initial results of the macroeconomic policies are quite successful on the one hand: there is growth of output and both real wages and employment are high. Inflation is not a problem in this stage because the use of price controls and imports alleviates shortages. The reason these policies are initially successful is because there is money to be spent, which has positive effects on the economy. On the other hand, the use of price controls and increased imports creates problems. The run-down of inventories and the availability of imports are financed with the use of reserves or the suspension of external payments. The level of government spending is not sustainable in the long run if government receipts do not increase at the same rate.

In **Phase Two**, the economy runs into bottlenecks, that is, when certain sectors of the economy do not grow as quickly as others or as demand does. This is partly due to the growing shortage of foreign exchange and the price controls that began in Phase One. Where in the first stage the run-down of inventory was essential, it now becomes a source of problems. It is now necessary to introduce industry protection, devalue the currency, realign prices, or establish exchange control. Inflation increases significantly, but wages rise accordingly. Finally, the budget deficit worsens tremendously as a result of persistent subsidies.

Phase Three is characterized by pervasive shortages, extreme increase of the rate of inflation, as well as a large foreign exchange gap. All these variables lead to capital flight and demonetization of the economy. Due to the sharp decline in tax collection and the increasing costs of subsidies, the budget deficit deteriorates. As a result, the government attempts to stabilize by cutting subsidies and by a real depreciation. Economic policies become unsustainable and real wages fall massively. Clearly, at the end of this stage, the government is in a desperate situation.

Phase Four is the final phase. It involves the collapse of the populist government. A new government takes over and implements an orthodox stabilization plan. It is common that an IMF program is enacted. Once the new government has taken over, it becomes obvious that real wages have decreased to a level significantly lower than prior to the populist government. The problem lies in the fact that the politics and economics of this movement caused capital flight and depressed investment. As a result, wages are kept low for a while.

3.4 Case Studies of Populism

There have been several episodes of economic populism in Latin America over the last few decades. In *The Macroeconomics of Populism in Latin America* (1991), Dornbusch and Edwards present several case studies that use their populist model as a point of departure to analyze regimes in certain Latin American countries. Federico Sturzenegger (1991) examines the Argentine experience between 1973 and 1976. Between these years, four different Presidents held office: Hector Campora, Raul Lastiri, Juan Domingo Perón, and Isabel Perón. What is most interesting is that the initial economic policy remained unchanged through all of them, even though they represented different sides of the political spectrum. It was only during the government of Isabel Perón that the situation deteriorated to the point that radical changes could not be avoided.

The initial conditions in Argentina were different from those laid out by the Dornbusch and Edwards' model: Argentina was not experiencing a recession prior to the implementation of the economic program. The economy was experiencing a period of high growth of GNP and unemployment was at its natural rate. The situation in the external front was excellent: high international prices for Argentine exports plus abundant international reserves in the Central Bank.

One of the objectives of Campora's administration was that of social justice, which was defined as a fair distribution of income with special concern for eliminating extreme levels of poverty and unemployment. As a result, The Concertation Act was drafted, a stabilization plan that aimed at attacking the economy's most compelling problem: the extreme rate of inflation (Phase 1). The Act was successful in achieving

high growth, complete price stabilization, progressive redistribution of income, and an increase in the reserves held by the Central Bank. Unfortunately, problems began to emerge after approximately eighteen months (Phase 2). The price freeze created shortages and the terms of trade began to worsen. The economic problems started to get out of hand, which forced the government to make an adjustment of the economy (Phase 3). Real wages fell, inflation exploded, and a recession ensued. The regime finally collapsed in March 1976, with a military coup and the implementation of strict orthodox policies. In the end, all the initial objectives of stability, growth, investment, redistribution of income and increased standard of living were not only not achieved, but they appeared even more distant in 1976 than they were in 1973.

The Argentinean case is not unique. Other authors have studied the phenomenon using Dornbusch and Edwards' model as well (see i.e. Rabello de Castro and Ronci 1991 and Bazdresch and Levy 1991). Checchi (1996) investigates the reasons for the recurrence of populist governments. He argues that the root of populist experiences lies in the absence of free access to market opportunities within a regime where there is free access to vote. He examines the case of Alan García's government in Peru from 1985 to 1990. He finds that by appealing to excluded sectors of society with promises of immediately improving their living standards, a populist candidate can gain office, even when these promises seem inconsistent with macroeconomic constraints.

Even before Chávez, Venezuela has already had its own experience with populism. Hausmann (1995) argues that the Venezuelan experience during the 1980s followed the path of a populist regime, as described by Dornbusch and Edwards. The difference lies in the fact that it stopped at Phase 2. After the 1983-85 stabilization

attempt, the government decided to adopt an expansionary policy in 1986, in spite of a major adverse external shock caused by a decline in oil prices. The economy experienced vigorous growth. Unfortunately, it was accompanied by increasing external problems that were addressed through devaluation and exchange, price, and interest rate controls. Instead of dragging the economy down in Phase 3, Carlos Andrés Pérez's government (the newly-elected President) decided to "quit populism cold turkey: it unified and floated the exchange rate, freed prices and interest rates, reduced drastically the fiscal deficit, and embarked on a major trade reform" (Hausmann 1995, p. 253). While the reforms were necessary, the effects were more painful than expected. The author argues it was mainly due to the government's inability to communicate clearly with the population. The lack of a clear message made it difficult to maintain support, which in the end contributed to two attempted military coups.

Even though each country has specific characteristics and circumstances that shape the populist experience, there exists a common theme: all episodes have tried to deal with the problem of income inequality through the use of overly expansive fiscal policies. Each attempt ended in a major macroeconomic crisis. Recent events in Venezuela provide a new opportunity to understand the forces and consequences of economic populism. What I am attempting to do, to a certain extent, is to add a chapter to Dornbusch and Edwards' book.

4. The Venezuelan Case

Here, I analyze the new Venezuelan experience with populism. I begin with a brief description of the country's social and economic panorama that created the environment for a populist leader to emerge. Second, I give a short account of the

political past and the events that lead to Hugo Chávez's election as President. Third, I describe how, once elected, Chávez pursued and achieved his political goals of generating loyalty in one group of society while isolating the other. I explain how in this process he was able to centralize power and gain a loyal base of support. Once these characteristics are described, I move on to place Chávez in the populist model and portray the policies he has taken and their consequences for the nation.

4.1 Social and Economic Conditions in Venezuela prior to Chávez's election

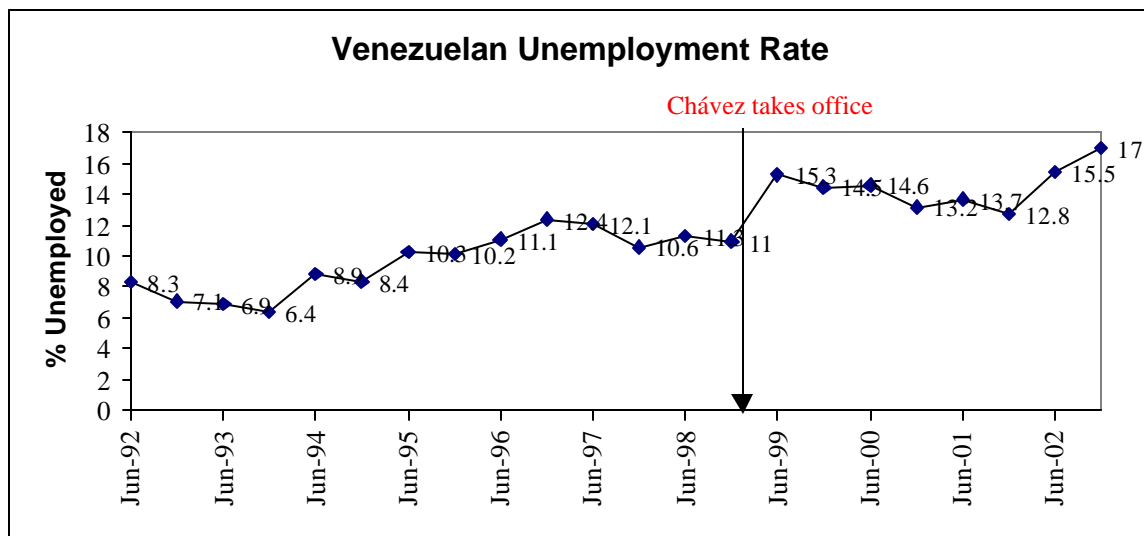
Venezuela is a country rich in natural resources. Unfortunately, poor economic policies over the past two decades have led to disappointing economic performance, a highly unequal income distribution and poor social indicators. A 2001 survey found that 85% of the Venezuelan population believes that the country is one of the richest countries in the world (Keller 2002). It is indeed an ironic statistic, especially when one considers that an estimated 86% of the population lives in poverty, with a 51% increase in the last ten years. Moreover, an estimated 20.7% live in extreme poverty, lacking the basic necessities (The Economist Intelligence Unit 2001). Between 1975 and 2000, the number of poor doubled, while the number of those living in extreme poverty tripled (Riutort 2002). In terms of income distribution, the top quintile received 84% of household income, while the lowest quintile received 3% in 1998 (IMF 1999). If the preceding statistic seemed overly negative, consider the one below.

An employment study conducted by Fundacredesa² found that 50% of the labor force worked in an unstable and precarious way in the informal sector. 20% were

² Fundacredesa is part of the Venezuelan Ministry of Health. It is a research and teaching center focused on the growth and development of all Venezuelans.

unemployed and only 30% were working in the formal sector, even though their wages were not high enough to cover half of the basic food basket. The average annual unemployment rate in 1994 was 8.7% and this increased to 11% in 1998 (see Figure 1). In terms of land distribution, the top 3% of owners owned 76.5% of the land, while the bottom 42.9% of owners only owned 1%. Income inequality in 1996, as measured by the Gini Coefficient was 48.8 (Dominguez 1999).

Figure 1



Source: Banco Central de Venezuela 2003

4.2 The Emergence of Hugo Chávez

Two compelling reasons lead me to believe that Venezuela is a fertile ground for populism. The first one is the acute income inequality. The second one refers to Moisés Naim’s quote in the introduction, which relates to the story that is indoctrinated in the population when they are young. In the words of Rogelio Pérez Perdomo, a specialist on Venezuela and the rule of law, the story of Venezuela is a story

“About a mythical rich country ruled by a king who makes disappear the value of everything he sees or touches outside his palace. Except for those who live in the palace, his subjects become increasingly poor and

wretched. The curse that has fallen upon this Midas-in-reverse and this country is called ‘corruption’” (Pérez Perdomo 1995, p. 2).

Venezuela’s wealth comes from oil and the reason most Venezuelans do not see this wealth is because of corruption. These are the conditions that lead to the emergence of Hugo Chávez and the most important stated reason for the attempted coup on February 4, 1992.

Unlike other countries in the region, Venezuela has had a stable political history; it has been a democratic country for the past 44 years. Unfortunately, while its leaders have been democratically elected, achieving a relative sense of political stability, the system has been plagued by political corruption. 66% of the Venezuelan population believes that they will be rich again once corruption is eliminated from the system (Keller 2002). The difficult austerity program adopted by Pérez in 1989 as part of the effort to reform Venezuela’s economic system required sacrifices from all citizens. However, people were no longer willing to sacrifice themselves for a system that had been unable to improve their living conditions, increase employment or lessen the gap between rich and poor. Sirowy and Inkeles (1990) argue that in any democracy, deepening economic crises that sharpen existing social inequalities may also provide a backdrop for abrupt political change. Hugo Chávez emerged in the midst of a population that was ready to break with the past. They were ready for Chávez, someone who promised them a deep structural change that would allow the wealth from petroleum to benefit the majority. Psychiatrist Pedro Delgado, a specialist on the appeal of Chávez, insightfully summarizes Venezuela’s relation with Chávez. He considered Venezuela to be

“a country in the throes of adolescence that made an immature decision to elect Chávez, but a decision that was part of its identity-formation process, like trying drugs. Chávez was an experiment for a society looking for a

way out of the old, corrupt order of things. He is a great seducer, and he bewitched the electorate. We have a hard time resisting strongmen who say they will solve all our problems. We want to believe in them passionately, blindly” (quoted in Sontag, 2002).

These were the circumstances that led to the emergence of Hugo Chávez. He used populist and extreme nationalist rhetoric, repeatedly lamenting the hunger and poverty that so many Venezuelans were suffering (Coppedge 1999). He pledged to eliminate the corruption and inefficiency of past political parties and to create new opportunities, greater equality and prosperity.

Timeline of Events

1989	Feb 1992	Nov 1992	1994	1998
Carlos Andrés Pérez announces new economic plan	1 st attempted coup	2 nd attempted coup	Pres. Caldera releases Chávez from prison	Hugo Chávez wins elections

Brief Account of Political Events

1989-1992: Pérez’s failed reforms
 When Carlos Andrés Pérez took office in 1989, the economic reality facing his government was worse than expected. Emergency measures were required. The government was forced to seek assistance from the International Monetary Fund, which also meant immediate and harsh economic austerity. Pérez planned to restructure the economy on neo-liberal lines; he announced a new economic plan in mid-February 1989, which included a major devaluation of the currency, extensive increases in the price of gasoline and transportation, and the elimination of subsidies for most food items (Martz 1995). The shock was immediate and had a dramatic impact on the middle class and the poor. In 1989, GDP contracted by 8%. From 1980 to 1992, average Venezuelans lost over half of their purchasing power in real terms. From the late 1970s to the early 1990s individual daily caloric intake dropped 50%, from 2,651 to 1,350; the portion of the population below the poverty line grew to 64%. The efforts of the Pérez government to privatize certain industries and reduce government participation in the market created the foundation for enormous growth in the Venezuelan economy. However, by February 1992, the benefits of this new economic policy had not yet trickled down to the average Venezuelan. Consumers saw their purchasing power decline, the gap between rich and poor widened, and the elites (businesspeople, politicians, journalists, and public officials) continued to maintain their luxurious lifestyles. More and more, Venezuelans were asking themselves where the billions of petrodollars had gone. The perception of corruption in government became a dominant theme in popular press.

1992: Coup attempts

On February 4th, 1992, Chávez led a group of mid-ranking military officers in an attempt to overthrow Perez, promising to restore patriotism and defend the interests of common Venezuelans. Before beginning the uprising, Chávez wrote his mother that he was willing to risk his life in order to free the nation of corruption. Later, to justify the coup, he cited Article 250 of the constitution, which he claimed “provides for the correction of violations of the Constitution specifically where...corruption is concerned” (Burgraaff and Millett 1995, p. 66). The group called itself the Simón Bolívar Revolutionary Movement. They invoked military symbols and 3 historical figures in particular: Simón Bolívar, Simón Rodríguez (Bolívar’s mentor and teacher), and Ezequiel Zamora (a nineteenth-century general who had favored distribution of land to soldiers). As a 38-year old military officer, Chávez emerged as a national hero who promised to put an end to corrupt politicians, improve the conditions of the poor and move the country onto a fresh course. The movement attempted another coup in November of the same year. Although both coups failed, they succeeded in unleashing social and political forces that dramatically and irreversibly changed the country’s political, institutional, and economic landscape.

1994-1998: Chávez’s rise to power

In 1994, after two years in prison, President Caldera pardoned all the military and the civilians who had taken part in the two failed coups. Hugo Chávez ran as the presidential candidate in 1998, winning the election in December with 56.2% of the vote (3,673,685 votes) (Dominguez 1999). Unlike his electoral rivals, Chávez sharply criticized massive privatization, and raised the banner of the struggle against corruption, even in the armed forces. Chávez was now the dominant personality in Venezuela; within four years he had come from prison to the gates of the presidential palace. He named his new organization the Movimiento Quinta República (MVR), the Fifth Republic Movement. He said Venezuela needed to create a new republic, and the new movement’s name was designed to indicate a complete break with the past (Gott 2000).

4.3 Chávez achieves his political goals

As stated earlier a populist leader has several political goals: (1) Building support from lower-middle class groups and organized labor; (2) Creating complementary support from domestically oriented business; and (3) Politically isolating rural oligarchy, foreign enterprise and large-scale domestic industrial elite. In this section, I illustrate

how Chávez's words and actions divided society into two sections: the small elite and the masses. According to Chávez, the lower sphere (the pueblo), represents goodness, while those on top, the elites and private enterprise, represent perversion. This separation of good and bad allowed him not only to create a large base of support, it also allowed him to justify actions that punished one group and contributed in the centralization of power.

The governments prior to Chávez referred to the deficient politics of earlier governments or external circumstances (such as the price of oil) as the causes of poverty. Chávez's government on the other hand blamed the elites, denouncing their deliberate purpose to enrich themselves at the expense of the majority:

“We have lived in a sea of oil, in a sea of all kinds of riches, with great navigable rivers, vast quantities of fertile land for agriculture and the production of food, with large reserves of iron, aluminum, gold (...); how is it possible for a perverse group of politicians to have taken the Venezuelan population to an unexplainable historic level of 80% poverty, living over a sea of riches; unexplainable but true.”

(Hugo Chávez, Palacio de Miraflores, February 4, 2002)

Chávez located the political enemy in the elite, and called it the oligarchy, which is a group of perverse people who have exploited the country and have illicitly taken over the riches, with no regards to everybody else's rights (Chávez 2002). The high contrast between opulence and poverty, as well as the distance that was created from the beginning of Chávez's government with employers, created an element of attack against private enterprise. They became the enemy to blame for the country's and the poor's problems. The pueblo (the people) were those who followed Chávez. The rest who criticized and opposed him were considered part of the “corrupt oligarchy, the privileged, those linked to interests banished by the revolution” (Blanco 2002, p. 362). In this way,

the opposition was created by the regime itself, beginning with the group of enemies that it decided on.

Apart from the wealthy classes, Chávez also managed to progressively alienate the media, the private sector, the Roman Catholic Church, landowners, and the unions. He referred to the Church hierarchy as “devils in vestments” and to those who disagree with him as “counterrevolutionaries.” Chávez made an enemy of the leading labor union federation (Confederación de Trabajadores de Venezuela) by trying and failing to eliminate it. In doing so, he fostered an unlikely collaboration between union leaders and industrialists who opposed him. These groups would later play central roles in opposing the administration and organizing methods in which to display their disapproval. Importantly, the middle class was fairly divided, yet he had the backing of important sectors of the armed forces.

Chávez’s locus of support was the marginal class and unorganized workers. Consistent with populist rhetoric, Chávez focused his attention on the poor, the nonprivileged sectors of society. To improve the conditions of the underprivileged sectors of society, it was necessary for the State to assume the role of providing them with the necessary resources. As stated by Chávez,

“(…) there wasn’t anyone to protect the people and now usury is condemned to death, usury is now condemned to disappear because now the people have a government that pays attention to them, a government that belongs to the people, for the people.” (Chávez, *Venezolana de Televisión*, January 13, 2002)

Chávez recognized the existence of several problems in society: poverty, hunger, lack of land, etc.—problems faced by the majority of the population. Thus, tolerance for crime, land invasions and several actions that violate the notion of private property were

protected by the state as an attempt to repair previous injustices. On August 4, 2001, on his program *Aló Presidente*, Chávez said “private property is not sacred” and defending the “Ley de Tierras” of November 2001, he said “the government can confiscate lands that are not being used for what they should be used” (Chávez 2001). On several occasions, the President justified why a person can rob to satisfy his/her child’s hunger or can take over someone else’s piece of land if he/she has no place to cultivate. For Chávez, crime is only crime if it is committed by certain sectors of society and with certain intentions that are attributed by the regime (Blanco 2002). Crime is seen in a different light if those behaviors are caused by need, desperation, poverty or social injustice (Blanco 2002).

In sum, Chávez achieved his political goals by acquiring support from the masses, while isolating other sectors of society. An essential element in his strategy was oil. Because oil was the most important element in the Venezuelan economy, it also became the medium through which Chávez could appeal to the majority’s needs, redistribute income and improve the existing inequality. A significant consequence of this strategy is the reinforcement of the State’s role as benefactor and redistributor in exchange for political loyalty.

4.4 Chávez’s rhetoric makes him stronger

As many other populist leaders, Chávez’s discourse was radical. The most common theme was the division between friends and foes of “the Revolution.” You were either with the Revolution, or against it; there was no middle ground. The administration’s main goal was the strengthening of the State to prevent the institutions

from being at the service of private, political, or economic interests. Strengthening the State was seen as a practical way to repair injustices because it served as a means to gather and distribute resources and to assure that the government's social function was being achieved. In this way, the State was the only instrument capable of having a vision and a practice that would direct its efforts towards the most needy.

Fundamentally, Chávez centralized power through a succession of elections/referendums after the 1998 presidential election. Upon assuming the presidency, Chávez decreed a referendum for a constituent assembly to be held in April 1999. The assembly would be used as a vehicle for “overhauling the nation’s neocorporatist political system” (Ellner 2001, p.5). Chávez proposed the model be replaced with one of direct popular participation in decision-making at the local level. However, this led in the direction of having a powerful leader whose authority would be largely unchecked by the nation’s institutions. Overwhelmingly, 88% of the voters approved the convocation of the assembly, and 82% accepted that the body defines the limits of its own powers, as Chávez proposed. In the July election, Chávez’s Polo Patriótico alliance won almost all of the 131 seats of the National Assembly (Ellner 2001). In total there were three referendums in 1999 and two elections in 2000.

The series of elections served several functions. First, they became instruments with which Chávez gained direct power over several branches of the government: he dominated the National Assembly, along with 15 out of the 23 governors who were from his party (Blanco 2002). Second, the elections created a new sort of legitimacy based on popular support. Third, they kept society focused on the destruction of the previous political system. This quasi-permanent mobilization contributed to strengthening the

leader-masses relationship, to orienting the society towards a common goal and to filling the political scene with governmental propositions.

The centralization of power led to a privileged role for Chávez and it created an environment to worship his personality. The poor who feel embraced by Chávez saw him as their redeemer: “Hugo the Messiah!” (quoted in Sontag, 2002). Jorge Olavarría, an independent politician and one of Chávez’s critics, stated:

“We must recognize that he is a bold and clever man, with great personal charisma. He is a serpent charmer. I think he is the most powerful and convincing demagogue of Venezuela in the 20th century.” (Olavarría, *El Nacional*, January 21, 2002).

The president started to have different virtues, special intelligence, strategic vision and extraordinary charisma. His decisions became the last word, his points of view the lines of action (Blanco 2002). The repeated use of Simón Bolívar as a symbol of his Revolution served as a mechanism to imply that specific values did not have to be approved, because they are what Bolívar (“the first Venezuelan”) said, thought, would have wanted, or felt.

4.5 Phases of the Populist Regime

4.5.1 Venezuela’s Initial Conditions

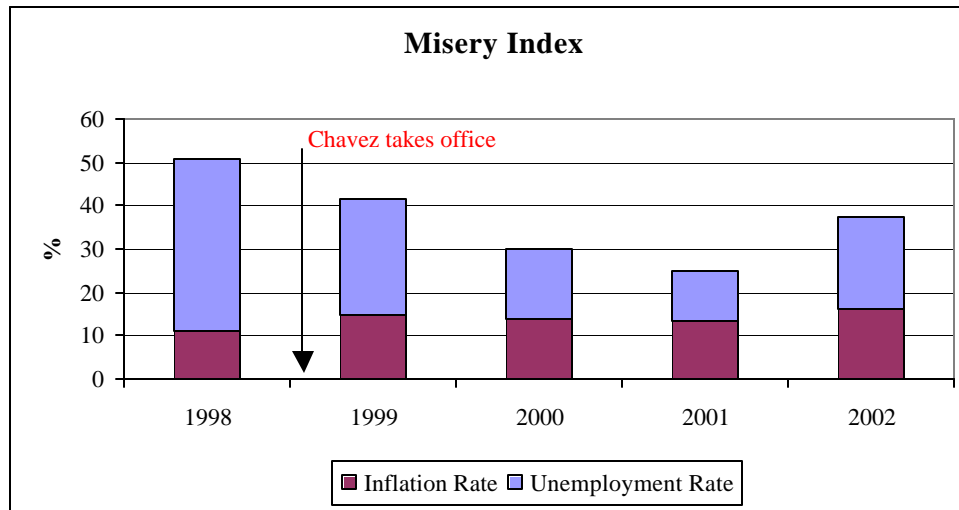
According to the model, a set of initial conditions is necessary before the populist phases can begin. In this section, I describe the conditions that allowed Chávez to embark on his populist path. I then move on to place Chávez’s government in a specific phase and illustrate the policies he took to get there.

Venezuela’s social panorama coincided with Dornbusch and Edwards’ initial conditions for the emergence of a populist leader. People were unhappy with the highly

uneven income distribution and there was a general belief that things could be better.

The Misery Index³ for 1998 was 51% (see Figure 2). Chávez made the levels of poverty and inequality the center of his discourse. In this way, he became “the voice of the poor.”

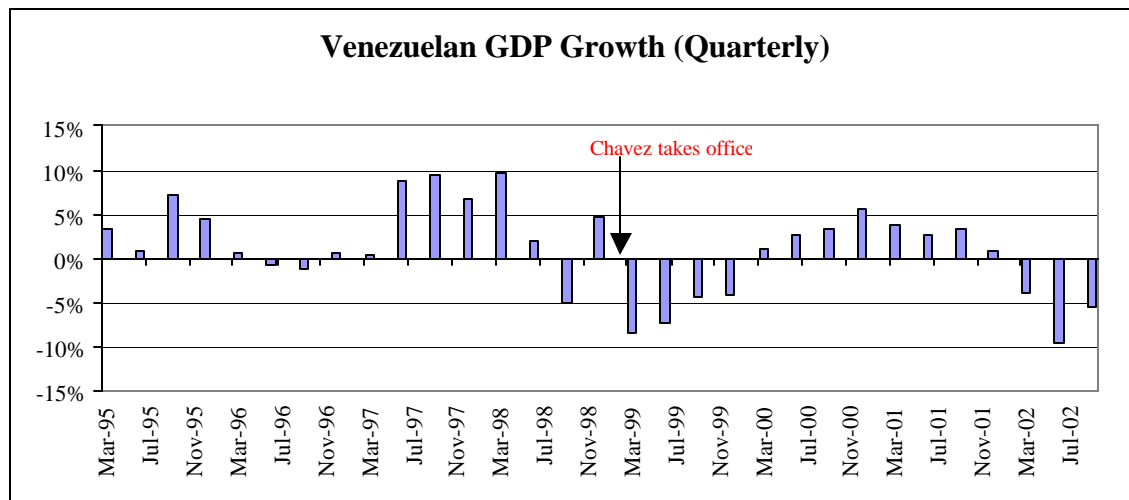
Figure 2



In the economic sphere, the conditions also held true for the most part. First, unemployment was at 11% in September 1998 (see Figure 1), which helps explain why people were unhappy with the circumstances they were living in. Second, growth had come down from high levels. As stated in Dornbusch and Edwards’ model, a populist leader typically faces a situation where the nation’s economy has not performed as expected. Venezuela experienced slower and at times negative growth in the months before Chávez began his Presidency (see Figure 3). As previously stated, the populist will attempt to reactivate the economy to achieve its two other objectives: redistributing income and restructuring the economy.

³ The Misery Index is an index that combines the inflation rate and the unemployment rate. It is used to measure the political significance of the condition of the economy, as well as consumer confidence.

Figure 3

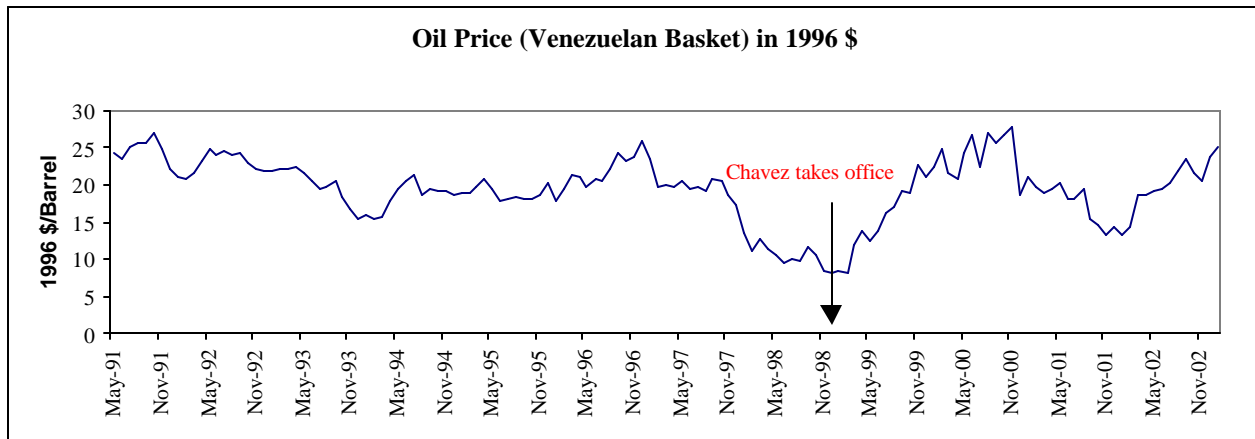


Source: Bloomberg 2002

The conditions were ready for a break with the past and people were ready for a change. This is how Chávez emerged. However, there is one important exception to the model: Chávez could not instantly deliver what he promised because the “room to maneuver” or the space for a highly expansionary policy was non-existent.

The key to comprehending Venezuela’s economy is to understand its reliance on oil. For Venezuela, the oil industry represents 80% of incoming capital, and close to 50% of fiscal revenues, while directly or indirectly generating 40% of national economic activity (Blanco, 2002). Venezuela’s dependence on oil export revenue has made the country vulnerable to fluctuations in oil demand, hence price of this commodity. In other words, the government’s “room to maneuver” is given by the price of oil. Chávez became president at a time when oil prices were at their 30-year low: at \$8/ barrel in January 1999 (See Figure 4). He grasped the importance of the Organization of Petroleum Exporting Countries (OPEC). During the first quarter of 1999, in order to raise the price of oil, a multilateral effort was made to put an end to the generalized violation of quotas by OPEC members.

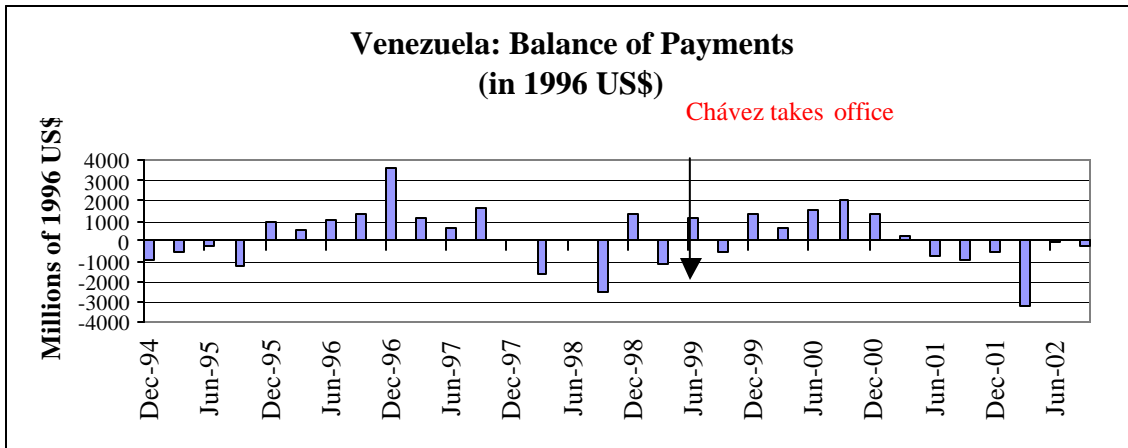
Figure 4



Source: Bloomberg 2002

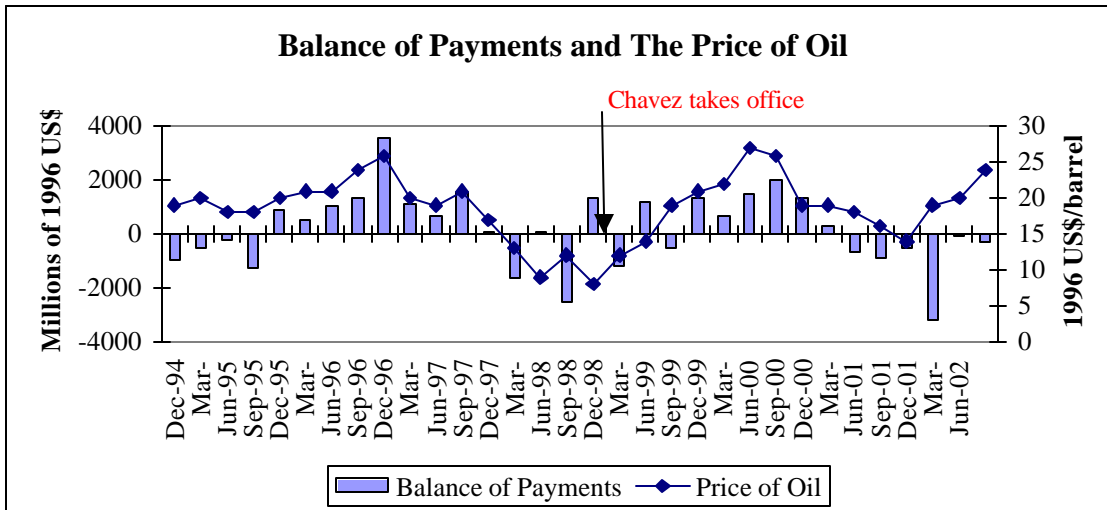
The country's dependence on the oil industry is also evident on the balance of payments, the international reserves, and the public sector balance. These three elements of the economy were affected negatively by the low price of oil during the year preceding Chávez's election as President. As stated above, oil prices were low in 1998, which helps explain why the balance of payments was not entirely healthy during that year, exhibiting a deficit of -\$2,556 million (in 1996 US\$) (see Figure 5). The relationship between the price of oil and the Venezuela's balance of payments is clear: as the price of oil decreases, the country exhibits decreasing surpluses or deficits; as the price of oil increases, the deficits decrease and at most times the country achieves surpluses (see Figure 6). The exception to this trend begins in 2002, when the price of oil is rising and the country still exhibits deficits in the balance of payments. The explanation rests in the government's populist policies, which will be explained below.

Figure 5



Source: Bloomberg 2002

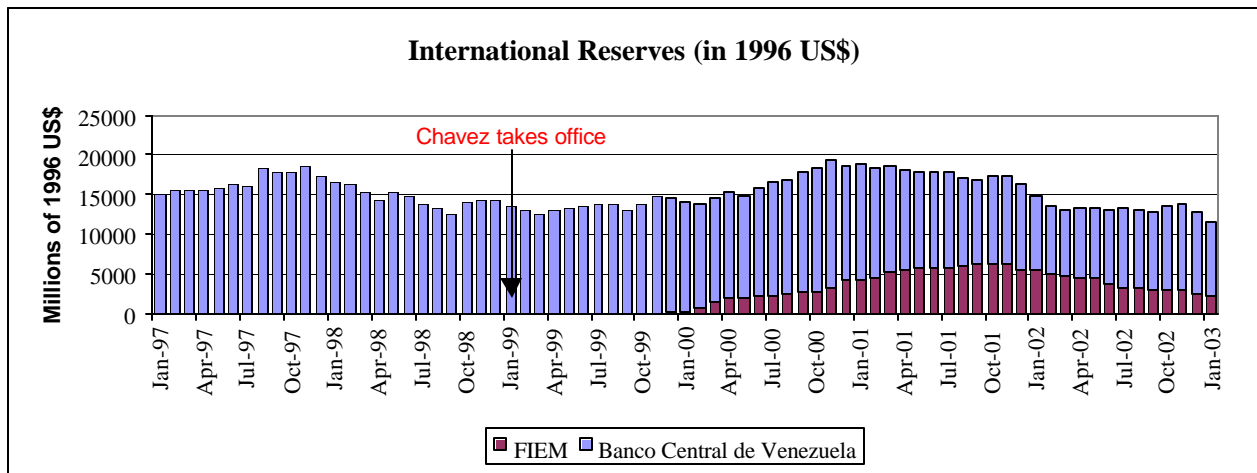
Figure 6



Venezuela’s international reserves were also affected by the low price of oil: in 1999 they were at lower levels than those in 1997 (see Figure 7). Once oil prices began to rise, international reserves increased as well (see Figure 8). In February 1999, international reserves were at \$13,048 million and a barrel of Venezuelan oil was selling for \$8. Seventeen months later, in July 2000, international reserves were at \$16,458, representing a 20.7% increase. Oil prices were at \$22 per barrel.

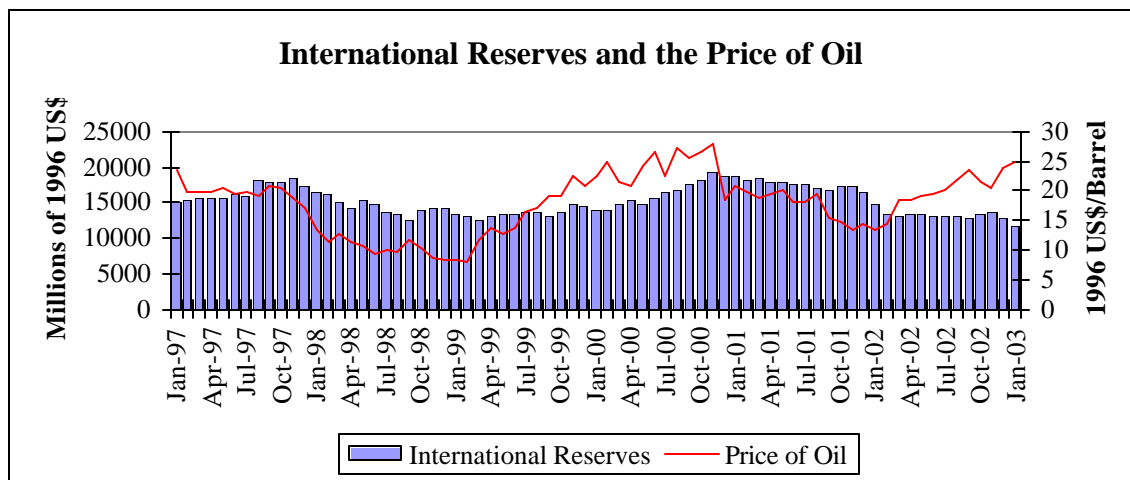
Venezuelan international reserves have two components: those held by the Central Bank (Banco Central de Venezuela) and those held in the Investment Fund for Macroeconomic Stabilization (FIEM). The FIEM was created in 1998 with the purpose of avoiding dangerous instability. During every oil boom, the revenue above the average oil income of the preceding five years would be saved in this fund. This revenue would be exclusively used to compensate any fall in oil income below the average of the previous five years. The rule was clear and not subject to the discretion of any government.

Figure 7



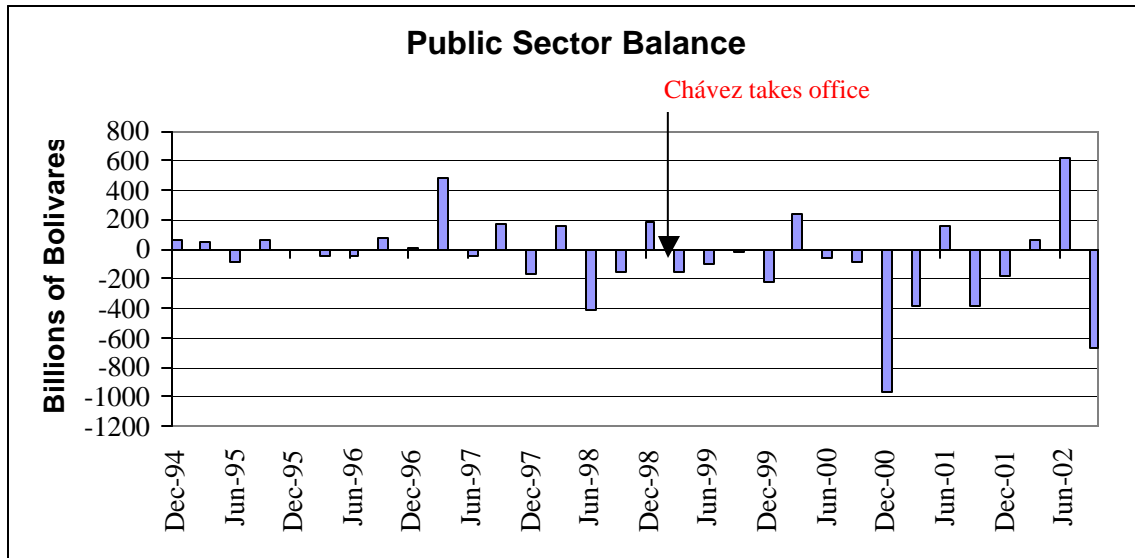
Source: Banco Central de Venezuela 2003

Figure 8



The low oil prices also affected Venezuela’s public sector balance (see Figure 9). Oil revenues represent a source of public finance for the government. As a result, when oil prices are low, the government must either reduce spending or spend at the risk of a deficit.

Figure 9



Source: Bloomberg 2002

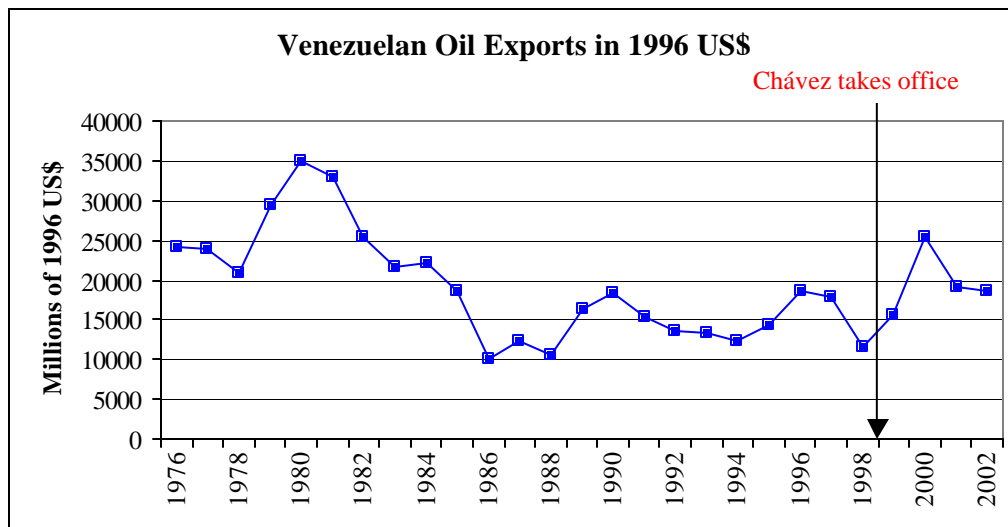
The Venezuelan economy was not in a good state when Chávez began his Presidency. It took two years before the initial conditions were in place for the populist episode to enter Phase 1. In a July 2, 1998 article, *The Economist* sums up the economic situation by saying

“Mr. Chávez’s ‘time for a change’ message is winning support as the economy falters, hit hard by the collapse of oil prices. GDP may grow by only 1% this year, as against an earlier projection of 6%.” (*The Economist*, July 4, 1998)

The missing element was the international reserves needed to fund a populist set of economic goals. This was not possible until the price of oil rebounded; it was not until the year 2000 that Chávez had anything to work with. During this year, oil prices

quadrupled, reaching a high of \$28 per barrel in November 2000 (see Figure 4). The level of oil exports in real dollars in 2000, when the Venezuelan basket was around \$26 per barrel, constituted the highest level of earnings in the country's recent history, surpassed only by the real income obtained in 1974 and the 1979-1981 period (see Figure 10).

Figure 10



Source: Banco Central de Venezuela 2003

The increase in the price of oil finally completed all the initial conditions for the populist episode to begin. In fact, it was in this year, on September 15, when Chávez revealed a plan to use the oil money for a “hundred day” program of social welfare schemes, housing, school building, and other public works (*The Economist*, September 30, 2000). Two years after Chávez had been elected, Phase 1 was ready to begin.

4.5.2 The Price of Oil Allows Chávez to Implement Populist Policies

In this section I first describe Chávez's policies and trace their macroeconomic effects. In doing so, I describe each phase and attempt to place Venezuela in one of them.

4.5.3 Phase 1

An economic policy will be socially efficient if it allows the economy to develop in a way that it can remunerate workers above the level of inflation. If the population's real income or purchasing power decreases, then by definition their living standards will decrease as well. There were three elements to Chávez's populist plan: reactivation, redistribution of income, and restructuring of the economy. In this light, it is logical that Chávez's economic policies were oriented towards controlling inflation. Maintaining low levels of inflation, accompanied by increases in the real wage, are ways to guarantee that the poorest sectors of society are better off.

As stated earlier, the low prices of oil constrained the government during its first year. GDP experienced negative growth at -6.1% in 1999. However, oil prices exhibited a rising trend beginning at \$8 per barrel in January 1998 and reaching a high of \$28 per barrel in November 2000. International reserves reached a high of \$19,271 million in November 2000. It is precisely during this year when Phase 1 of the populist regime begins.

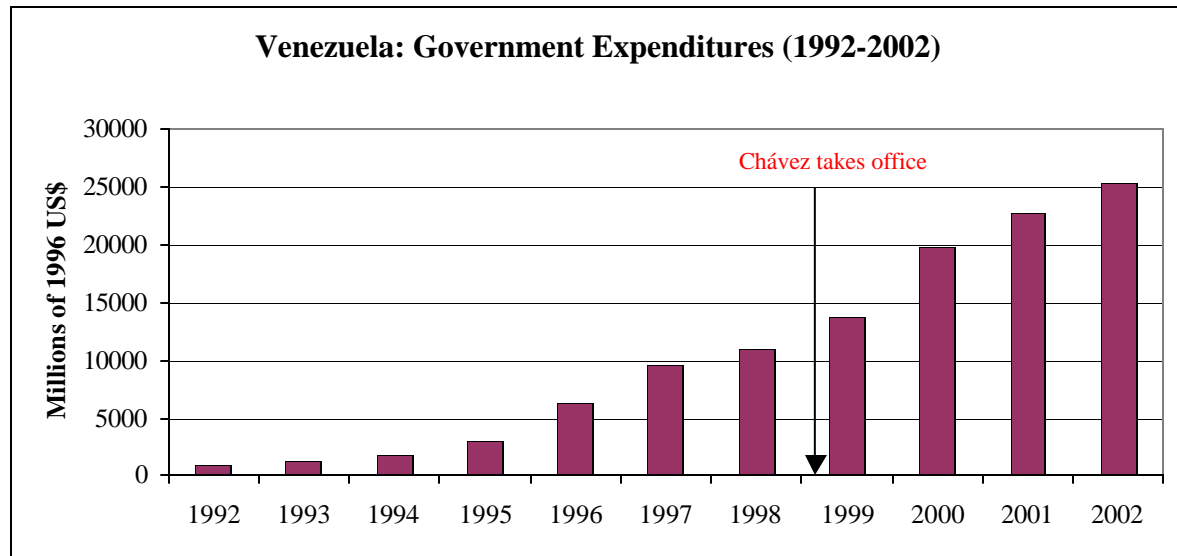
In 2000, Chávez began expansionary measures aimed at accelerating economic recovery. With the quadrupling of oil prices in 2000, government expenditures increased 30% in real terms (see Table 1). Between 1998 and 2001, the central government increased its spending by 52% in real terms, by moving from \$10,957 million to \$22,710 (see Figure 11). Under normal circumstances this level of expansion would create higher rates of inflation. Consistent with the populist model, however, economists sympathetic to the government were quoted as saying: "there is little threat of inflation because the economy has lots of idle plants and jobless workers" (*The Economist*, September 30,

2000). This is an example of ignoring constraints; the administration disregarded the consequences of the expansionary measures.

Table 1
Venezuelan Government Spending

Year	% Increase in Real Terms
1998	12%
1999	26%
2000	30%
2001	13%
2002	10%

Figure 11



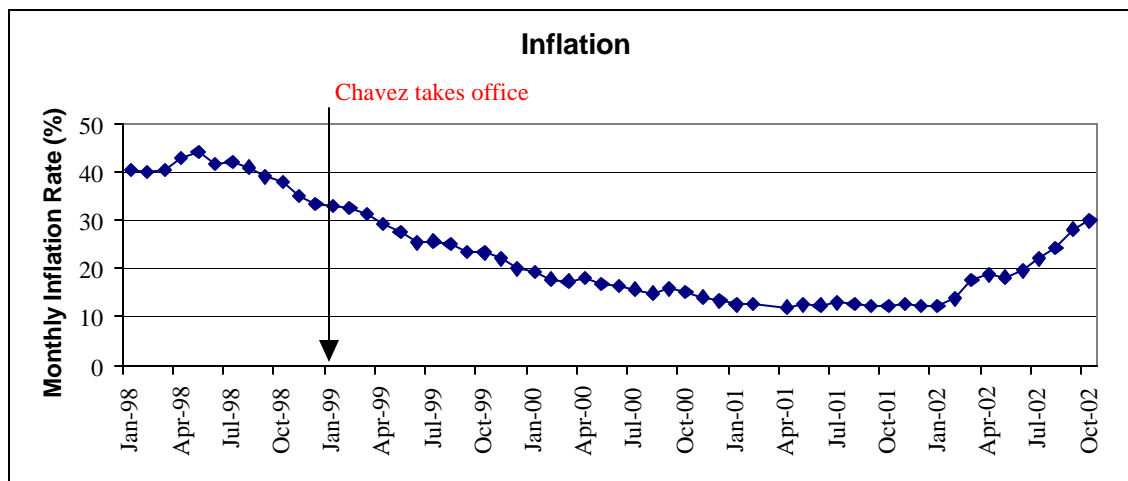
Source: Banco Central de Venezuela 2003

Along with the increased spending, the State took on a more active role in the economy by gathering resources, distributing them, and assuring the social function was completed. The resources came from the oil revenue. The social function was fighting poverty. Distribution was done through social programs and wage increases. On May 5, 1999 Chávez signed six decrees that ordered a 20% increase in the minimum wage for public administration employees (Globovisión 1999). At the end of April 2000, the

President announced a 20% wage increase and made it official on May 1st. For 2001, wage increase was 10% (Globovisión 2001).

The higher oil prices and the increase in public spending had positive effects on the economy. First, GDP began to exhibit positive growth. In 2000, GDP grew 3.2% and in 2001, it grew 2.7% (see Figure 3). Second, unemployment decreased 2 percentage points (see Figure 1). The Misery Index improved by decreasing to 30.2% in 2000 and 24.8% in 2001 (see Figure 2). In June 1999, unemployment was at 15.3% and it decreased to 13.2% in December 2000. Third, the balance of payments exhibited surpluses throughout the year 2000 (see Figure 5). Finally, one major success during the first three years of Chávez's government is the control of inflation. The average inflation rate for 1998, the year before Chávez began his Presidency, was 40% (see Figure 12). In 1999, 2000 and 2001, inflation was 26.5%, 16.3% and 11.5% respectively.

Figure 12



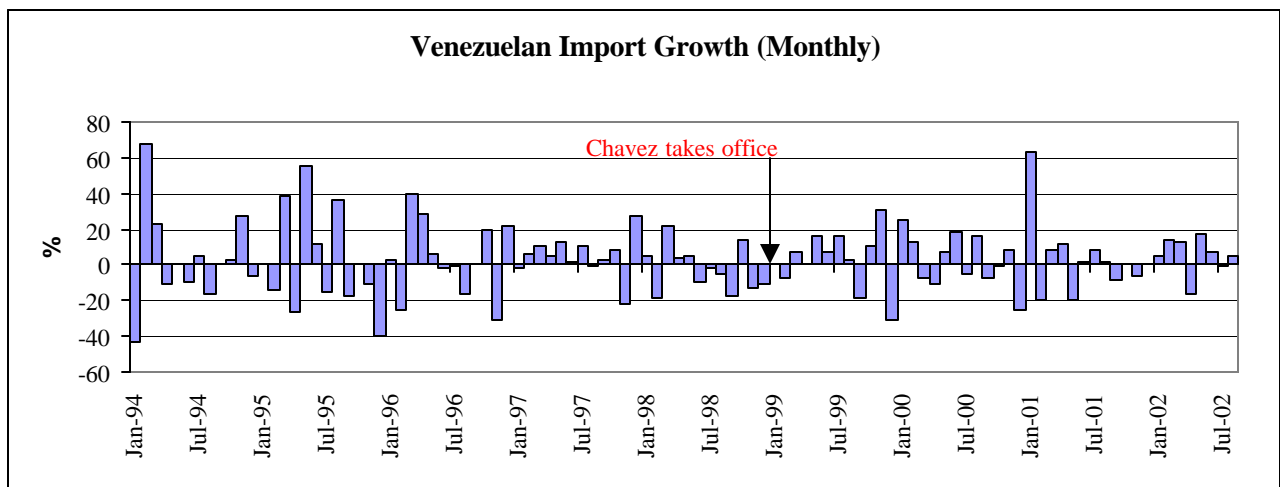
Source: Banco Central de Venezuela 2003

Under normal circumstances, a large increase in public spending would lead to higher levels of inflation. However, under Chávez the control of the inflation rate was possible due to the use of the exchange rate as a nominal price anchor. The controlled

exchange rate established an anchor on the price of imported goods, while the price of domestic goods increased. It became cheaper to consume imported goods than those produced domestically, a phenomenon that had two important consequences: (1) Imports increased, which has no adverse effects as long as the oil boom continues and there are enough dollars (international reserves) to finance them; and (2) Domestic production is negatively affected by the appreciation of the exchange rate, which in turn diminishes the economy's capacity to grow.

The country had to maintain adequate reserves to finance the increased level of imports. Imports increased 34% in 2000 and 43% in 2001 (see Figure 13). The level of international reserves depended on the price of oil. Oil prices began to decrease in December 2000 and so did international reserves (see Figure 8). The price of oil was no longer high enough to finance the increased government spending and the level of imports. The imbalance between oil prices and government spending leads me to believe that Venezuela entered Phase 2 of the populist model.

Figure 13



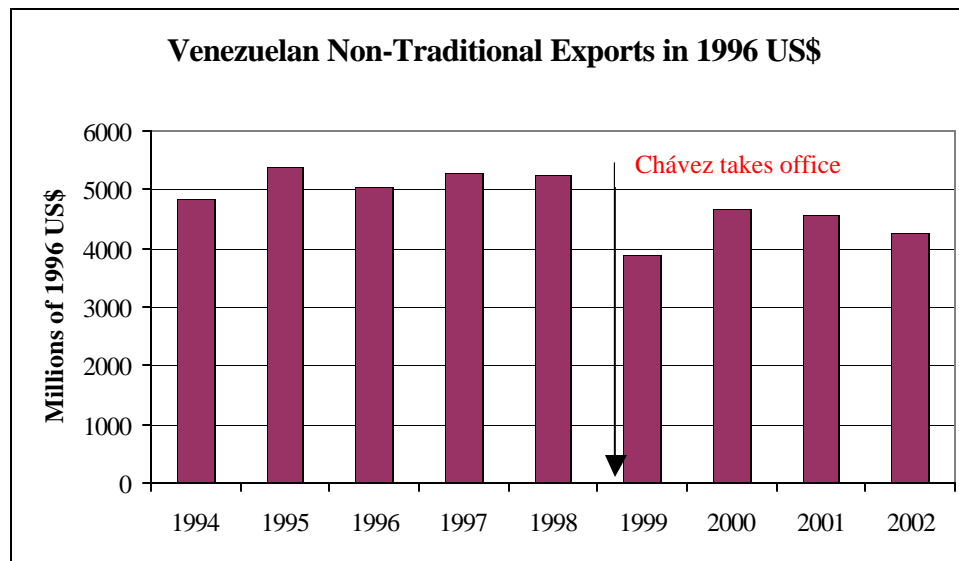
4.5.4 Phase 2

Logically, the increase in government spending coupled with the decrease in the price of oil at the end of the year 2000 worsened the public deficit. Consequently, in December 2000, the public sector deficit was -962 billion bolívares (equal to \$1.4 billion dollars). Coincidentally, in 2001, the public sector also exhibited a deficit, this time equal to -781 billion bolívares (equal to \$1.08 billion dollars).

The overvalued exchange rate boosted imports. As stated earlier, imports increased 34% in 2000 and 43% in 2001. Once the price of oil (the source of finance for these imports) began to decrease, the international reserves began decreasing as well, which is not surprising considering they were used to finance the imports. In November 2000 and November 2001, international reserves were at \$21,160 million dollars and \$19,583 million dollars respectively, representing a 10% decrease in real terms. By February 2002, international reserves were at \$15,468 million dollars. This represents a 29% decrease in real terms in three months.

Interestingly, the overvalued exchange rate had a second effect: it hurt domestic production. Non-traditional exports (exports not including oil) experienced a 25% reduction in real terms in 1999 when compared to the previous five-year average (see Figure 14). Beginning in 2000, non-traditional exports also exhibited a decreasing trend, although the change is not as significant. In 2000, 2001 and 2002, non-traditional exports represented \$4,658, \$4,563, and \$4,272 million dollars respectively. From these numbers one can safely deduct that domestic industry was becoming less competitive.

Figure 14



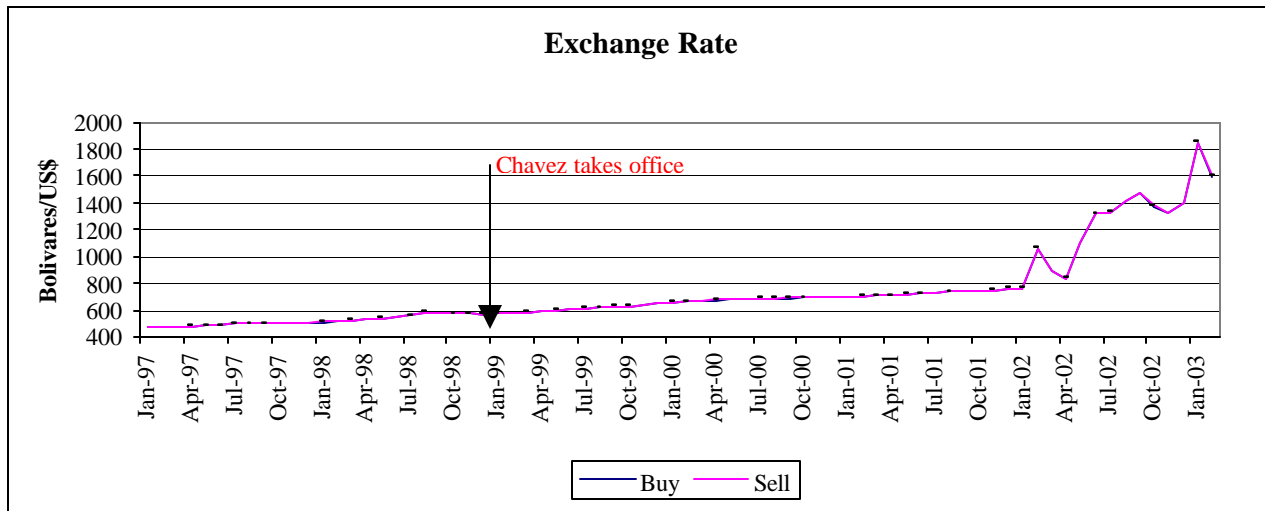
Source: Banco Central de Venezuela 2003

The deficits in the balance of payments and the decreasing international reserves led the government to announce its first adjustment plan on February 12, 2002. This adjustment plan had three main parts: (1) Decreasing government spending; (2) Re-introduction of the tax on bank debits (IDB⁴); and (3) Free floating exchange rate (García 2002).

The average exchange rate for January 2002 was 764 bolívares per US\$. The average for February 2002 was 1060 bolívares/ US\$, which represented a 28% depreciation (see Figure 15). The floating of the currency brought the country three immediate benefits. First, it gave the export sector and domestic industry much-needed relief from the uncompetitive exchange rate. Second, it moved the economy off the road to currency collapse paved by overvaluation and reserve losses. Third, it reduced public sector borrowing requirements by increasing government oil revenues in bolívares.

⁴ The tax on bank debits (IDB) was applied to all withdrawals from checking accounts, savings accounts, and in any other deposit accounts.

Figure 15



According to Dornbusch and Edwards' model, price controls are established to control inflation. During the first and second phases of Chávez's populist regime, however, no price controls were declared. Instead, the government threatened different sectors of the economy with establishing controls. The interest rate was not regulated, but bankers were threatened and accused of being greedy:

“Chávez accused a group of bankers of resisting to decrease the interest rates, and threatened with ‘taking measures’ to begin their decrease. ‘The banks’ interest rates, through which they lend the people, the middle class, the small and medium producers, must come down and will come down, declared Chávez.’” (quoted in Armas, *El Universal*, May 6, 2001)

Capital mobility was not prevented, but those who took their money out of the country were denigrated:

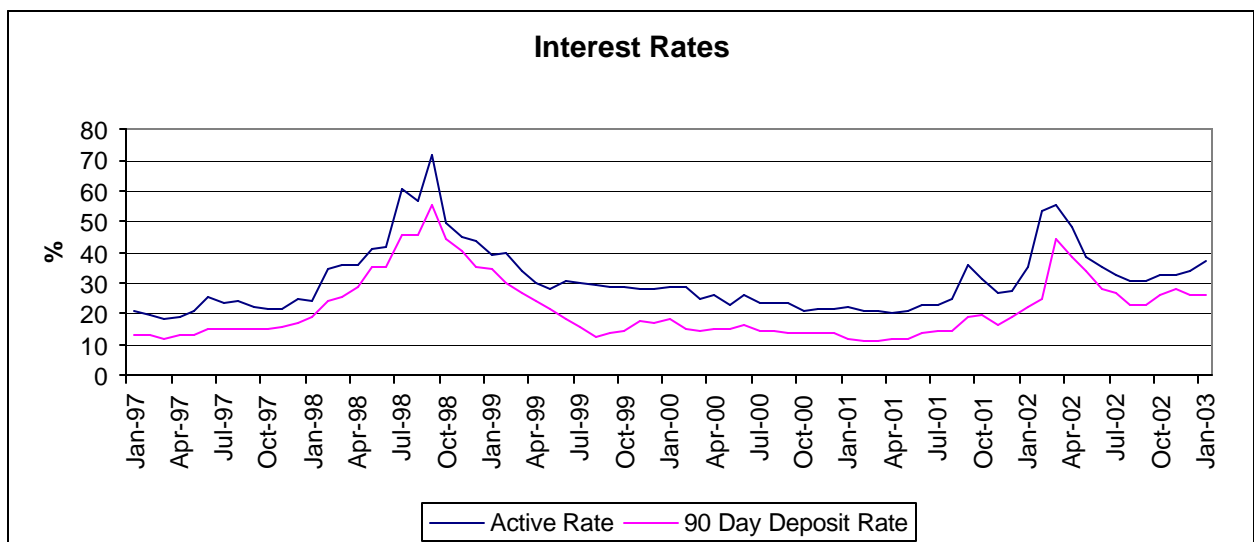
“We are making efforts to maintain the price of oil and a group of Venezuelans who have a lot take it all out to gain more interest. It is the devil inside of them, the country's misery does not hurt them at all.” (quoted in Duran Santamaría, *Últimas Noticias*, August 1, 2001)

Prices were not controlled, but supposed speculators were threatened:

“Chávez arranged for authorities to employ a strategy to detect and punish the businessmen who raised the prices of their products. Those who transgress the measures will go to prison, he warned.” (Terra, February 2002)

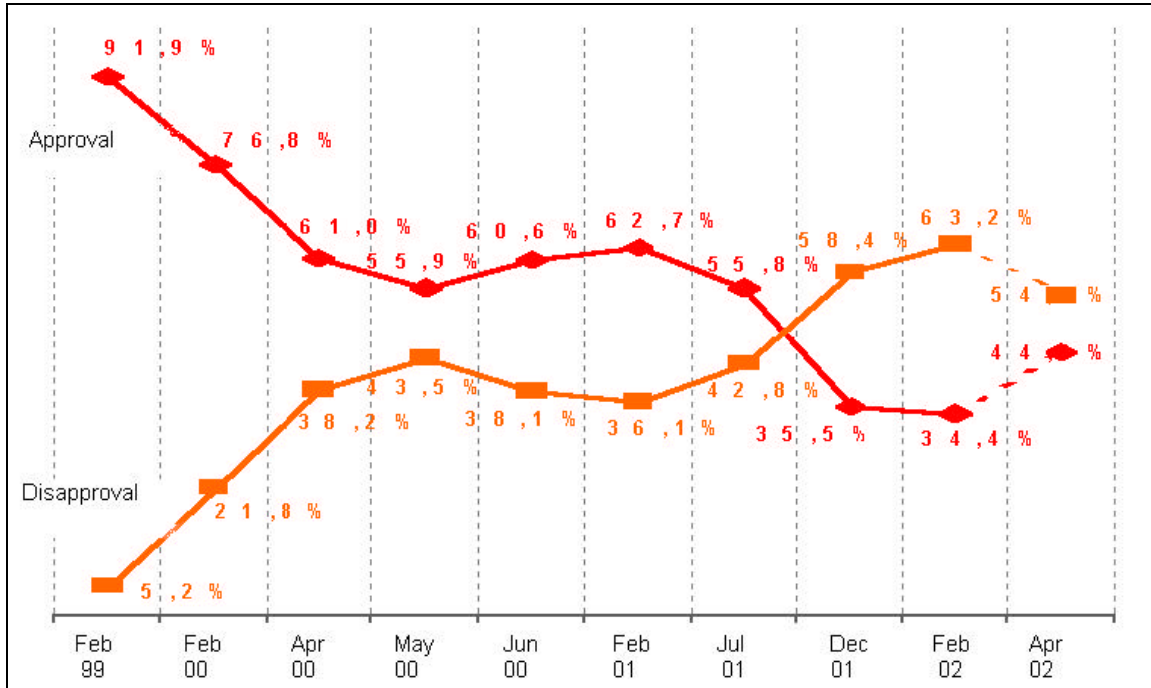
Contrary to the beginning of Chávez’s government, there was no longer inflation targeting. On the one hand, the exchange rate was no longer used as an anchor for prices, thus inflation increased. Beginning in March 2002, inflation began an upward trend (see Figure 12). In April 2002, inflation was at 18%, a much higher level than April 2001. On the other hand, the interest rate was being used as an instrument to defend the floating currency. A positive consequence develops as interest rates increase: there is less demand for foreign currency to invest in foreign banks. Conversely, a negative consequence develops as well: the rise in interest rates makes it extremely difficult for people to borrow money and make new investments, as well as pay back their debts, a cycle that in turn halts growth in the economy.

Figure 16



Apart from the economic policies pursued by a populist leader, there exists other essential elements that influence the life of a regime. One important piece in the life of a populist regime is that the leader maintains the followers' allegiance. As stated earlier, Chávez managed to alienate diverse groups within Venezuela, including the media, the private sector, the Roman Catholic Church, landowners and the union movement. Due to the centralization of power around Chávez, these groups were unable to lobby him or to influence policy changes. As a result, these groups took their protests outside established political channels and into the streets for the first time during his government. Opposition to Chávez among military and armed forces officers grew as well. Through his actions and populist rhetoric, Chávez fostered an unlikely collaboration between union leaders and industrialists who opposed him. Since he was elected in 1998, Chávez's popularity ratings decreased substantially (see Figure 17) (Datanálisis, 2002). Beginning in December 2001, the country was seriously disrupted by work stoppages and protest marches, leading to an attempted coup on April 11, 2002. The deteriorating economic situation coupled with growing political opposition lead me to believe Venezuela entered Phase 3.

Figure 17



Source: Datanálisis 2002

4.5.5 Phase 3

The attempted coup on April 11, 2002, represents growing political discontent about the country’s economic reality. However, it came too early; Chávez was reinstated in power after two days. He still enjoyed support from certain sectors of society and the country was not in an acute crisis yet. The failed coup helped to: (1) Strengthen Chávez as he eliminated all those that opposed him from important political and military positions, and (2) Further separate those that supported and opposed him. The situation in Venezuela reached the point where almost everyone was

“Either passionately for Chávez or against him, a Chavista or an anti-Chavista. The poor who feel embraced by Chávez worship the Venezuelan president as their redeemer: ‘Hugo the Messiah!’ His equally zealous foes see him as Hurricane Hugo, with the power to transform Venezuela into a Communist backwater like Cuba or, alternatively, a violent republic like Colombia” (quoted in Sontag, 2002).

In the midst of the political turmoil, Chávez declared a second economic adjustment plan in April 2002. It consisted of increasing the tax on bank debits from 0.75% to 1% and increasing the sales tax (IVA) from 14.5% to 15.5%. Furthermore, he announced cuts in government spending and “more flexibility in the exchange regime” (García 2002).

The cuts in government spending and the increase in tax rates were not enough to ameliorate the budget deficit. In March 2002, when the price of oil was rising, Venezuela exhibited a deficit of \$3221 million dollars in its balance of payments (see Figure 6), the worst deficit in eight years, which persisted throughout the year 2002. In terms of growth rates, the country experienced negative growth at 10% by June 2002.

“More flexibility in the exchange regime” translated into real depreciation of the currency. In May 2002, the currency begins to depreciate (see Figure 15). By August 2002, it depreciated 22% compared to the May rate. By January 2003, it depreciated 41%. The currency’s real depreciation was accompanied by the acceleration of inflation (see Figure 12). The average inflation for 2001 was 11.5%. By June 2002, inflation was 19.6%. The average inflation for 2002 was 31.2%.

The country’s deteriorating economic situation affected the average citizen. Unemployment began to increase, reaching a high of 17% in December 2002 (see Figure 1). However, there also existed a large percentage of the population that worked in the informal sector⁵. The Venezuelan National Institute of Statistics (INE) estimated that by June 2002, 51.2% of the working population was in the informal sector. Others estimated

⁵ The Venezuelan National Institute of Statistics (INE) defines the workers of the informal sector as “people who work in businesses with less than five employees (including the owner), domestic servants, self-employed non-professionals (such as artisans, painters, carpenters and peddlers) and family helpers who are not compensated and work for 15 or more hours per week.”

informality around 60% (Blanco 2002). The large percentage of workers in the informal sector exacerbated the situation because it meant that approximately 70% of the Venezuelan population did not have a formal job. In addition, the misery index increased to 37.5%; the index does not include the informal sector of the economy.

Undoubtedly, government policies are to blame for the large percentage of people in the informal sector. First, the government took a more central role in the economy and promised to redistribute oil revenue. Second, Chávez's anti-industrial policies made it impossible to create micro enterprises capable of creating capital. Instead, the result was informality and the creation of eternal clients of the state, as people became dependant on the government for income redistribution. It was in the industrial sector where the economic groups that best represented the oligarchy were concentrated. As stated above, part of the administration's political goals was isolating the elites because they were seen as the enemy. The idea was to stimulate small and medium-sized businesses, as well as farm production to promote ample participation in the economy (Blanco 2002). One problem with the economic policies is that the government required the destruction of large businesses, a policy that worked against exports and with a strong tendency towards paralyzing investment in non-oil sectors. The result was the creation of income through low productive jobs or the informal sector, instead of through productive employment.

Poverty increased in Venezuela at the same time the country's oil income was the highest since the 1980's. Riutort (2002) finds that the situation during Chávez's first three years in government can be summarized in the following:

- (1) The regime, which conceived itself as the voice and representation of the poor, achieved the growth in the number of poor in almost two million people-- almost 8% of the population joining poverty.
- (2) Even though there was a reduction in poverty in 1999 and 2000, there was no general improvement in poor households, since those households with lower incomes were relatively poorer than in 1998.

Currently, only 6.5% of Venezuelan households (294,616 out of the 5,261,000 households that are registered in the Census) can afford the basic family basket⁶ (which comprises food and services), according to Omar Meza, ex-president of the Center of Documentation and Analysis for Workers (quoted in Martínez 2003, *El Universal*). Furthermore, a month's minimum wage is only enough to acquire 59% of essential foods. These statistics further demonstrates the deteriorating economic situation faced by Venezuelans.

By December 2002, political opposition was at its highest. A national strike began on December 2, demanding Chávez's resignation before the end of his mandate in 2006 or call for new elections. The strike was organized by the labor unions. The country's most important sectors joined the strike, including the oil sector, seaports, schools, and shopping centers. Oil exports were cut by about 90%, representing a significant fall in government revenues. Most people believed that by eliminating a large part of government revenues Chávez would resign or negotiate with the opposition.

⁶ The Basic Family Basket (Canasta Básica Familiar) is a basket comprised of the basic foods (cereals, meats, milk products, fruits and vegetables, sugar and others) and services (water, electricity and telephone). Its cost is calculated based on an average family size of 5 as a way of tracing the costs of living.

However, Chávez was firm in his position and declared he would only renounce power through the Constitution, that is, through elections. The strike lasted almost two months.

The political and economic crisis that took place in Venezuela during the strike created a large demand for foreign currency. Between 1999 and 2001, \$26,200 million dollars fled the country, a value equal to 40% of oil exports during the same period (Blanco, 2002). Reserves were run-down. By January 2003, international reserves were at \$13,656 million dollars, representing a 19% decrease in real terms compared to the November 2002 value. This situation lasted until January 21, 2003, when the market was closed until February 5, 2003. On February 5, the President declared a new decree on price controls.⁷ The products that were subject to price controls included basic foods (rice, bread, sugar, eggs, etc.), medicines, cleaning products (toothpaste, shampoo, detergent, etc.) and services (water, electricity, gas, telephone, rents, etc.) (Globovisión 2003).

Based on the description of the four phases of a populist episode, and given the current political and economic crisis in Venezuela, it is safe to conclude that the country is at the end of Phase 3. However, politics, not economics, will play the decisive role in determining the final outcome. The country is currently living through one of its worst recessions-- negative growth, large budget deficits, increasing inflation, and high unemployment. After four years of Chávez, Venezuela ended up with more poor people, more unemployed and more financial and economic vulnerability. The attempted coup, the repeated marches and the two-month long strike proved to be insufficient in toppling

⁷ Price controls are an official intervention in the market to fix certain values to products, according to the opinion that official powers have. Price controls are generally established to avoid inflation or increasing costs of living. (Sabino 2003, *Diccionario de Economía y Finanzas*)

Chávez's regime. The final outcome will be determined by politics, as the first referendum allowed by the Constitution is scheduled for August 19, 2003.

5. Conclusions

I have established that Chávez is a populist and fits into the populist model. He has embraced economic programs that relied heavily on the use of expansive fiscal and credit policies and overvalued currency to accelerate growth and redistribute income. Unfortunately, the situation in Venezuela did not improve. On the contrary, the country is presently going through one of its worst economic recessions, with a depreciated currency and a high inflation rate. Furthermore, Chávez managed to dissolve the largest political support any leader or government has had in Venezuelan history.

Chávez offered the Venezuelan population an alternative to the corrupt system that governed Venezuela during its 44 years of democracy. The social and economic circumstances in the country presented the opportunity for a populist leader to emerge, one that promised economic growth and income redistribution. It took two years after Chávez's election to accumulate the international reserves needed to fund a populist set of economic goals. This was possible due to the increase in the price of oil in the year 2000. It was precisely during this year when Phase 1 of Chávez's populist regime began. Government spending increased substantially, GDP exhibited positive growth and unemployment decreased. The inflation rate was controlled through the use of the exchange rate as an anchor for prices. As a result, imports increased and international reserves began to decrease.

Venezuela entered Phase 2 once the price of oil began to decrease and the level of government spending was no longer sustainable. The budget deficit worsened and the overvalued exchange rate increased imports and hurt domestic production. The first adjustment plan declared on February 12, 2002, allowed the currency to float freely. No price controls were established during this time. Freeing the exchange rate meant that it was no longer used as an anchor for prices. Consequently, inflation began an upward trend. The deteriorating economic situation coupled with growing political opposition lead Venezuela into Phase 3. Chávez declared the second economic adjustment plan in April after a failed attempted coup. The budget deficit continued to deteriorate and the currency suffered a real depreciation. Not only did inflation increase, but unemployment and the number of people working in the informal sector increased as well.

After four years Chávez's policies did not produce the promised social revolution. On the contrary, Venezuela now has more poor people, more unemployed and a deteriorated economy. Venezuela is currently at the end of Phase 3 of the populist regime. Political opposition is at its highest and strongest. After a two-month long national strike, during which government revenues decreased substantially, Chávez still remains in power. This leads me to believe that the final collapse of his government will be through political means.

Now the question is how is it going to end. The political context will influence the final economic outcome. If Chávez has the political power and will to take the necessary economic measures to repair the country's problems, Venezuela can be saved from a complete collapse. In this case, Chávez departs from the populist model. However, if policies are not changed and Chávez loses power through elections, a

referendum, or through a coup, one aspect that remains constant is the fact that both the economy and the people who were supposed to benefit from the populist policies will end up worse off. All countries that have experienced economic populist regimes have ended up with the disastrous effects on their economies. If there was not a complete collapse, there were devastating consequences for the groups who were supposed to be the beneficiaries of the policies. It is difficult to not wonder why leaders keep repeating the mistakes of past populist regimes.

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