

# Effect of hugo rafael chávez frías' regime on the economy



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## Introduction

Venezuela is located in the upper corner of South America and neighbors with Colombia, Brazil, and Guyana. It has been nearly 200 years since Venezuela first gained its independence from Spain (1811). From 1830 onwards, when Venezuela split from the Bolivarian Colombia (1819-1830), the country was governed mostly by military and despotic regimes. That military period lasted until 1958 when the current democratic spell started following the ousting of General Marcos Pérez Jiménez's dictatorship.

[1]Despite that long period of military dictatorships, the Venezuelan economy is considered to be a mixed economy where there is a mixture of command and free market elements[2]. These will be discussed in greater depth in the following text.

Venezuela had until the 1980's a series of successful periods of economic growth[3]. The country had from there on and until 1999 a succession of economic and political crises. The government previous to the election of Hugo Chávez headed by Rafael Caldera was in power from 1994 to 1999. During this time in office he had to deal with high inflation rates and a financial crisis. Due to these severe problems, Caldera was forced to impose an exchange control in mid-1994. This was shortly followed by more stabilization actions that were enforced by the International Monetary Fund agreement. Due to these severe actions taken by the Caldera's government (Convergencia) he became severely unpopular among the electorate. This did not help him win his reelection and set the stage for Hugo Chávez[4].

The purpose of this essay is to discuss whether or not Hugo Rafael Chávez Frías' regime is moving towards a planned economy due his anti- American stance. Moises Naim states that “ the rise to power of Venezuelan president Hugo Chavez is often seen as evidence of an impending backlash against globalization, American-style capitalism.”[5]This statement reflects the change in the government's policies on the Venezuelan economic system. To further explain this transformation it is vital to define what a free market economy and planned economy are.

## **Theoretical Background & Hypotheses**

If the Venezuelan government is moving from a free market economy to a planned economy, one would expect to find evidence of this transition economy. Definitions are needed to be known before explanation of results. A free market economy refers to an economy in which markets, in other words the interaction of buyers and producers, determine price and output. [6]In addition, this economic system “[relies] on free markets which permit people to engage in economic activities largely free from government control.”[7]In other words the government must have a hands-off policy in regards to the economy. Therefore, all production is in private hands and companies are able to adjust their wages and prices according to the demand and supply curve. Furthermore individuals are able to make independent decisions regarding the price of products, amount of production, and retailing. The free market economy is one that allows for the best interests of both consumers and producers to be met[8].

Advantages of the free market economy include: “ resources are allocated by market forces and price mechanisms,”[9]and the motivation of profits “  
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provides an incentive to reduce costs and be innovative.”[10]As William Baumol points out, to some extent, innovation in the economy is important as it indicates the expansion of people’s creativities in businesses and therefore fosters ‘ productivity’ growth in the economy.[11]What this makes clear once again is that a lot of the power and decision making lie within companies and the market. Disadvantages can include resources being “ used up too quickly... as firms seek to make high profits and to minimize costs.”[12]Additionally, large firms can expand and dominate a particular industry; leading to higher prices, and results in excessive power.

A planned economy is defined as an economy where “ decisions are made by the government on the behalf of the people, and in theory, in their best interests.”[13]This indicates that the state has great ownership of resources in the economy and through this provides social welfare to the people. In this economy the government sets the price of resources. There are thought to be several advantages and disadvantages in a planned economy. The advantages are that the government can directly “ influence the distribution of income to make it more equal”[14]. In addition the government determines “ which [types of goods] are to be supplied”[15]. This necessarily gives the government the power to decide what goods are considered to be ‘ important’ in the society. A disadvantage of this economy is the “ government [’ s dominance which] may lead to a loss of personal freedom of choice”[16]. Unlike the free market economy there is “ no incentive for individuals or firms to be innovative... goods are often of poor quality and usually a limited choice.”[17]No competition in the economy and low profit (or absence of profit altogether) can lead to inefficiencies of resources. In

short, it is the government, and not the consumers, who make all the decisions. A planned economy is an ideology often used by governments in communist states. Countries like Cuba and North Korea are currently using a planned economy system.

An important concept of economic theory in describing a planned economy and free market economy is the understanding of economic growth.

Economic growth is defined as an “improvement in the standard of living (that) typically occurs when an economy increases its output of goods and services during an expansion”[18]. This leads to economic development which “refers to an improvement in living standards in an economy encompassing material consumption, education, health, and environmental concerns.”[19] Therefore the use of a production possibility curve (PPC) is implemented to determine economic growth.

Looking at the graph below (figure 1), one can see the theoretical downfall of the total goods and services (GDP) as the market moves from free market to planned economy. The PPC1 curve shifts downwards to PPC2 a level where planned economy would function. In moving from a free economy to a more planned economy orientated structure (transition economy), theoretically the output of the country's total goods and services would decrease because of the inefficiencies. Overall the economic growth diminishes as the government's dominance in the economy increases.

Figure 1

The PPC can also be used to better understand the change in government spending in a planned economy. This curve demonstrates the shifting of the <https://assignbuster.com/effect-of-hugo-rafael-chvez-fras-regime-on-the-economy/>

government spending. The graph below (figure 2) presents public sector production and private sector production. The PPC curve represents the maximum amount of output possible given the available resources.[20].

At point A, there is an equal amount of production from the public and private sector. The total production at point A is on the PPC curve meaning that the maximum level of production is obtained[21]. As the government moves closer to a fully planned economy and it begins to invest in the public sector which include schools, health programs, housing, and so forth bureaucracy and inefficiencies increase and production moves to point B. [22]As we can see in figure 2, point B is no longer on the PPC curve but below it, signaling that the maximum level of output is not being achieved.

Figure 2

## **Methodology**

Departing from the following hypothesis “ If the Venezuelan government is moving from a free market economy to a planned economy, one would expect to find evidence of this transition economy”. This evidence would be found in several areas. One would expect to find more government bureaucracy and interferences in private enterprises. This could take the form of increased unjustified fines, paper work, restriction of all kinds, and control, which all result in reduction of business. One would also expect to find an increase in the nationalization of private companies; this could take the form of expropriation of private lands by the government. Further evidence of a movement towards a planned economy would be greater spending on social welfare. This would be clear in areas such as health,

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education, and housing. Finally, one would expect to find evidence of more interference in the economic structure exemplified by manipulation of currency exchange rates. To prove my hypothesis, this evidence should be demonstrated as actually present in order to confirm the transition of Venezuela's economy.

To prove or disprove my hypothesis I relied both on primary and secondary sources. In investigating primary sources, I met with two local business men[23]and one professor[24]in Venezuela. I then asked them specific questions[25]regarding their businesses in this transition economy.

Furthermore, in October 2010 on a visit to Venezuela, I was able to make my own observations of the state of the country. In investigating secondary sources, I researched articles and books written by authors and journalists. In addition, I looked for statistics that represent the movement from a free-market to a planned economy.

## Results & Analysis & Evaluation

### **More government interference on businesses**

When Hugo Chavez's government got into office in 1999, the government slowly imposed new regulations on all sizes of businesses. This policy mainly impacted negatively small businesses and employment. I interviewed one business man, Otto Horn, regarding the increased bureaucracy that his firm, Floritec[26], encounters. In this interview he stated that " It is harder to import and export raw materials and finished products abroad"[27]. Many businesses are required to fill in extra custom paper work for SENIAT (the government's tax collection entity)[28]and face crippling fines for even a

minor inconsistency in the eyes of custom agents. It gets harder by the day to keep small enterprises in business. This has led to higher cost for businesses as these bureaucratic obstacles force the firms to hire more labor to deal with these issues. As well, it is noticed that waiting for approvals from the government in so many newly imposed demands on small enterprises means loss of time and money which impacts the efficiency of these businesses. To put an example, the government has begun charging firms for the use of their own company logo on their own trucks. Otto Horn stated, " If you want to put a company logo, you need to buy a license from the government and this raises costs." [29] These examples point to an increased level of government interference. Small businesses are mostly affected by these measures as they don't have enough capital to cover these new expenses.

Big businesses have also been affected by these government interferences and even though they are better prepared to cope with it the uncertainty leads to less investment and further instability in the economy as a whole. In early 2009, the economy encountered high inflation [30]. This caused a surge in the prices of all products. The Venezuelan government, under Chavez, made several attempts in reducing this high inflation. One of the actions taken was imposing price controls on certain staple foods in an effort to make them more affordable to everyone. However, this action did not have the best outcome, "[the] government [ `s] attempts to impose price control has had limited effect as big food producers have cut back on production, food distributors have decreased shipments and even hoarded essential goods and retail sellers have traded on the black market" [31] This control



further damaged the food producers by cutting their profit which forced them to reduce the costs, which in one example was achieved by reducing the number of employees. Furthermore, Luis Carmona of Polar states, “ Forcing companies to produce rice at a loss will not resolve the situation, [and] simply makes it worse.”[32]In addition, fewer goods could be established on the market.

These price controls largely affects food producers and many food processing companies became bankrupt. Hugo Chavez and his government decided to sue or even nationalize dysfunctional companies if they do not follow the government’s rules[33]. Hugo Chavez said he would take over the control of the food processing industries, as he said in one of his statements, “ I will expropriate them, I have no problem with that, and I’ll pay them with bonds. Don’t count on me paying with hard cash”[34]. This suggests that the government is serious about making food available to the poor but on the other hand, private firms cannot cope with the price changes unless it cuts down on costs. This is all evidence of a planned economy.

Government interference was evident in the conversation with another business man named Jorge Redmond, CEO of Chocolates El Rey[35]. Mr. Redmond initially wanted to merge his company with the world renowned company, Nestlé. He wanted to merge the company to avoid suffocating levels of governmental interference and bureaucratic hurdles brought upon the firm affecting its products exports mainly to its U. S customers. However the government blocked the deal between the potential mergers, as the government did not want more foreign presence in Venezuela[36]. The government’s move against expansion of global assets limits the choices of <https://assignbuster.com/effect-of-hugo-rafael-chvez-fras-regime-on-the-economy/>

private firms. This emphasizes the government's bureaucracy and interference on businesses.

## **Government Nationalization**

Growing bureaucracy and government interference have led to a failure of private companies as they cannot maintain healthy profitability levels. This has given the government an excuse to nationalize private firms. Common examples are CA Nacional Telefonos de Venezuela (CANTV), the country's telephone company and Electricidad de Caracas, the largest electric company in Venezuela[37]. These nationalizations were linked by Chavez to his pursuit of XXI century Socialism[38]. In July 2007, at the start of the high fuel prices, the government nationalized key infrastructures of the Venezuelan economy in an attempt to reach the goals of the government. [39]

Also in 2007, the government stripped assets from two U. S. oil companies Exxon Mobil Corp. and ConocoPhillips.[40]The government seized control of the profits of both companies. In the following year, 2008, Hugo Chavez and his government ordered the nationalization of the cement industry, Cemex, [41]a Mexican owned company. Chavez's rationale was to prepare for future building in the housing sector. In addition, in 2008, the Venezuelan steel mill, Siderúrgica del Orinoco SIDOR, was nationalized. Chavez "complained the companies do not put a high enough priority on supplying the domestic market"[42]. In 2009, the government for the first time ordered the Venezuelan armed forces to take over a business, in this case a rice processing plant[43]. In October 2010 the government nationalized

AGROISLENA, the country's largest producer of goods and services for the agricultural sector[44].

According to The Economist, since Hugo Chavez got into power in 1999, "almost 400 companies have been nationalized, the vast majority in the past two years." [45] This shows the government's movement to take over major industries in order to fix the prices of the goods.

All the above actions taken by the government have been sweeping reforms throughout the nation with the aim of reducing the prices of products which would result in massive consumption of the products by the local economy. The nationalization of firms by the government points to evidence of a planned economy as the government begins to de-privatize companies, moving towards a greater control of how the economy functions.

### **More Social Welfare Spending**

Hugo Chavez came to power by promising the people a reduction in poverty and an increase in quality of life for the masses. This spending was fueled by high oil prices in July 2007, "crude had reached the remarkable world market price of \$US 147 per barrel." [46]

This increased spending in the public sector gives more evidence of the move to a planned economy. The graph (figure 3) below shows the statistics of government public expenditure [47]. The current regime under Hugo Chavez has increased public spending by a factor of 13 between 1999 (the year Chavez entered office) to 2008.

Figure 3

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The government has spent money on the educational, health, and housing sectors. With the increase profits from the oil rents and productions, the Ministry of Education has introduced 'mission' programs, "Robinson I and II are mission[s] focusing on literacy and primary education for adults, Ribas and Sucre target secondary and university education for individuals who never had the opportunity to attend or those who dropped out." [48] These 'missions' are examples of increased spending on the public sector.

Hugo Chavez's government has increased public spending on the health sector of the economy. The government has created new 'mission' programs such as, "Barrio Adentro [which] provides free health care to the poor through the assistance of tens of thousands of Cuban doctors" [49] Internet correspondence with Guillermo Buhrkohl [50], a political professor from Venezuela, confirms this in the following, "The health programs known as Mission Barrio Adentro and Mission Miracle, are programs... aiming [at]... providing primary medical attention to the shantytown population"; however the professor confirms "the government is literally asphyxiating both health care provided by private hospitals and the traditional public health system, paradoxically the latter is the place where the poor go when a very limited Barrio Adentro cannot cope." This proves that there has been an increase in government spending on healthcare which could be seen as detrimental to both private and public sectors.

The government promised the masses to increase the public social welfare to all. This would also include the construction of close to free housing for each family. From my own personal observation while visiting the country in October 2010, the use of the billboards to promote housing plans was clearly <https://assignbuster.com/effect-of-hugo-rafael-chvez-fras-regime-on-the-economy/>

evident everywhere[51]. This evidence of increased spending in the public sector mostly for political purposes adds up to the motive of the planned economy.

## **Manipulation of currency**

Hugo Chavez's government has interfered deeply into the currency market. The government has made severe adjustments to currency, starting with the introduction of strict exchange rate controls by pegging the exchange rate to the American dollar in 2005. In 2008, the government changed the numerical currency making 1, 000 Bolivars equal to the value of one Bolivar Fuerte (strong Bolivar)[52]. This measure could be seen to minimize the "perceived" inflation due to government action. However, it does not address the inflation that the country faces. In January 8th 2010, the government announced the "devaluing of the currency by up to 50%"[53]. The government believed that the devaluation of the Bolivar would trigger an 'export boom' as Venezuela's exports would become more competitive. In reality, the devaluation had little to no effect on the country's exports, as can be seen in Figure 4[54].

### Figure 4

As mentioned above, in 2005, Hugo Chavez's administration made extreme adjustments to the Venezuelan financial system. The government's control over the currency exchange rates is shown in a statement, "The introduction of the exchange controls has meant that companies and individuals have to apply to the Comision de Administracion de Divisas (Cadivi, the official foreign exchange agency)."[55]This is where the government fixed the

currency rate at 2.15 to the dollar. This triggered an increase in imports from 2005 which can be seen on the graph above (Fig. 3)[56].

On January 8, 2010, the devaluation has occurred; “ from 2.15 bolivars to the [US] dollar to 4.3 bolivars to the [US] dollar”[57] explained above caused higher consumer inflation on goods thus affecting the total spending on imported goods like televisions. The devaluation of the currency and exchange controls has led the Venezuelan economy to have extremely high inflation. Consumption in the Venezuelan economy has decreased and business production has lowered to meet their expenditures.

For example, “ Movistar, [in Venezuela] a mobile phone company owned by Spain’s Telefonica, last month [August 2010] ... suspended roaming agreements in 13 countries.”[58] This indicated that the dollar squeeze is affecting the Venezuelan economy deeply. On the other hand, high inflation means that the government gets more Bolivars from a quick recovery of oil prices, and exporting oil to United States. This money allows the government to satisfy the needs of the Venezuelans to the best interests of the government, and this brings the role of the government into everyday lives as, “ that gives Mr. Chavez the chance to throw money around: pay rises for the army for example.”[59] This manipulation of the currency gives solid evidence of interferences in economy by Hugo Chavez’s government which adds a new element that confirms the hypothesis of a transition towards a planned economy in Venezuela.

## Conclusions

In this investigation, I found information that supports the transformation to a planned economy from a free market economy in Venezuela. The evidence included: increased government bureaucracy, nationalization of the private sector, increased government spending in social welfare, and increased manipulation of the currency. This has led Hugo Chavez's government to gain greater control of the Venezuelan economic system since his election in 1998. The government is able to decide which goods and services are considered to be important for society. Such examples are the heavily subsidized food distribution firms (MERCAL and PDVAL) created by the government[60].

In this investigation, there are a number of difficulties that hinder the gathering of evidence. First, it was hard to gain true statistics regarding the economy. For example, the unemployment rate is hard to determine due to the fact that workers in the informal sector of the economy are included in the statistics which constitutes half of the country's total workforce[61]. It was difficult to find statistical data to support the losses of business budget. Despite my attempts to access this information through internet sources, I was unsuccessful. Secondly there has been a strong political bias in many articles, books, and interviews. These biases affected my research and influenced me deeply, though I made every attempt to remain objective. In addition, it was often hard to separate politics from economics where both are closely linked together.

These shortcomings together with a lack of time beg for further and more in depth research to formalize conclusions. Specifically, I would wish to focus <https://assignbuster.com/effect-of-hugo-rafael-chvez-fras-regime-on-the-economy/>

on a significant number of concrete business cases where the government's interference in the economy has greatly affected their profitability. I would be interested in confirming the statistical data to support the hypothesis presented. However, the evidence and research presented here demonstrate that there are elements to sustain my hypothesis. It is clear that the government is seriously attempting to impose upon the country a planned economy of the Venezuela. Whether the government is able to complete a transition to a fully planned economy or not, this conclusion stands regardless.

In my opinion, the move to the planned economy under Hugo Chavez can have a negative impact on Venezuela as it has negatively limited the freedom of Venezuelan businesses and increased government interference in the economy. Evidence can be found in articles discussing the current brain drain[62]; the educated Venezuelans are more likely to leave the country. Many of these educated people whom are students, professors, doctors, business owners and so forth have either moved to Colombia or to the United States.

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