

# **An Empty Revolution**

## **The Unfulfilled Promises of Hugo Chávez**

By Francisco Rodríguez

From *Foreign Affairs*, March/April 2008

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Summary: Even critics of Hugo Chávez tend to concede that he has made helping the poor his top priority. But in fact, Chávez's government has not done any more to fight poverty than past Venezuelan governments, and his much-heralded social programs have had little effect. A close look at the evidence reveals just how much Chávez's "revolution" has hurt Venezuela's economy -- and that the poor are hurting most of all.

*FRANCISCO RODRÍGUEZ, Assistant Professor of Economics and Latin American Studies at Wesleyan University, was Chief Economist of the Venezuelan National Assembly from 2000 to 2004.*

On December 2, when Venezuelans delivered President Hugo Chávez his first electoral defeat in nine years, most analysts were taken by surprise. According to official results, 50.7 percent of voters rejected Chávez's proposed constitutional reform, which would have expanded executive power, gotten rid of presidential term limits, and paved the way for the construction of a "socialist" economy. It was a major reversal for a president who just a year earlier had won a second six-year term with 62.8 percent of the vote, and commentators scrambled to piece together an explanation. They pointed to idiosyncratic factors, such as the birth of a new student movement and the defection of powerful groups from Chávez's coalition. But few went so far as to challenge the conventional wisdom about how Chávez has managed to stay in power for so long.

Although opinions differ on whether Chávez's rule should be characterized as authoritarian or democratic, just about everyone appears to agree that, in contrast to his predecessors, Chávez has made the welfare of the Venezuelan poor his top priority. His government, the thinking goes, has provided subsidized food to low-income families, redistributed land and wealth, and poured money from Venezuela's booming oil industry into health and education programs. It should not be surprising, then, that in a country where politics was long dominated by rich elites, he has earned the lasting support of the Venezuelan poor.

That story line may be compelling to many who are rightly outraged by Latin America's deep social and economic inequalities. Unfortunately, it is wrong. Neither official statistics nor independent estimates show any evidence that Chávez has reoriented state priorities to benefit the poor. Most health and human development indicators have shown no significant improvement beyond that which is normal in the midst of an oil boom. Indeed, some have deteriorated worryingly, and official estimates indicate that income inequality has increased. The "Chávez is good for the poor" hypothesis is inconsistent with the facts.

My skepticism of this notion began during my tenure as chief economist of the Venezuelan National Assembly. In September 2000, I left American academia to take over a research team with functions broadly similar to those of the U.S. Congressional Budget Office. I had high expectations for Chávez's government and was excited at the possibility of working in an administration that promised to focus on fighting poverty and inequality. But I quickly discovered how large the gap was between the government's rhetoric and the reality of its political priorities.

Soon after joining the National Assembly, I clashed with the administration over underfunding of the Consolidated Social Fund (known by its Spanish acronym FUS), which had been created by Chávez to coordinate the distribution of resources to antipoverty programs. The law establishing the fund included a special provision to ensure that it would benefit from rising oil revenues. But when oil revenues started to go up, the Finance Ministry ignored the provision, allocating to the fund in the 2001 budget only \$295 million -- 15 percent less than the previous year and less than a third of the legally mandated \$1.1 billion. When my office pointed out this inconsistency, the Finance Ministry came up with the creative accounting gimmick of

rearranging the law so that programs not coordinated by the FUS would nevertheless appear to be receiving resources from it. The effect was to direct resources away from the poor even as oil profits were surging. (Hard-liners in the government, incensed by my office's criticisms, immediately called for my ouster. When the last moderates, who understood the need for an independent research team to evaluate policies, left the Chávez camp in 2004, the government finally disbanded our office.)

Chávez's political success does not stem from the achievements of his social programs or from his effectiveness at redistributing wealth. Rather, through a combination of luck and manipulation of the political system, Chávez has faced elections at times of strong economic growth, currently driven by an oil boom bigger than any since the 1970s. Like voters everywhere, Venezuelans tend to vote their pocketbooks, and until recently, this has meant voting for Chávez. But now, his mismanagement of the economy and failure to live up to his pro-poor rhetoric have finally started to catch up with him. With inflation accelerating, basic foodstuffs increasingly scarce, and pervasive chronic failures in the provision of basic public services, Venezuelans are starting to glimpse the consequences of Chávez's economic policies -- and they do not like what they see.

## FAKE LEFT

From the moment he reached office in 1999, Chávez presented his economic and social policies as a left-wing alternative to the so-called Washington consensus and a major departure from the free-market reforms of previous administrations. Although the differences were in fact fairly moderate at first, the pace of change accelerated significantly after the political and economic crisis of 2002-3, which saw a failed coup attempt and a two-month-long national strike. Since then, the Venezuelan economy has undergone a transformation.

The change can be broadly characterized as having four basic dimensions. First, the size of the state has increased dramatically. Government expenditures, which represented only 18.8 percent of GDP in 1999, now account for 29.4 percent of GDP, and the government has nationalized key sectors, such as electricity and telecommunications. Second, the setting of prices and wages has become highly regulated through a web of restrictions in place since 2002 ranging from rigid price and exchange controls to a ban on laying off workers. Third, there has been a significant deterioration in the security of property rights, as the government has moved to expropriate landholdings and private firms on an ad hoc basis, appealing to both political and economic motives. Fourth, the government has carried out a complete overhaul of social policy, replacing existing programs with a set of high-profile initiatives -- known as the *misiones*, or missions -- aimed at specific problems, such as illiteracy or poor health provision, in poor neighborhoods.

Views differ on how desirable the consequences of many of these reforms are, but a broad consensus appears to have emerged around the idea that they have at least brought about a significant redistribution of the country's wealth to its poor majority. The claim that Chávez has brought tangible benefits to the Venezuelan poor has indeed by now become commonplace, even among his critics. In a letter addressed to President George W. Bush on the eve of the 2006 Venezuelan presidential elections, Jesse Jackson, Cornel West, Dolores Huerta, and Tom Hayden wrote, "Since 1999, the citizens of Venezuela have repeatedly voted for a government that -- unlike others in the past -- would share their country's oil wealth with millions of poor Venezuelans." The Nobel laureate economist Joseph Stiglitz has noted, "Venezuelan President Hugo Chávez seems to have succeeded in bringing education and health services to the barrios of Caracas, which previously had seen little of the benefits of that country's rich endowment of oil." Even *The Economist* has written that "Chávez's brand of revolution has delivered some social gains."

One would expect such a consensus to be backed up by an impressive array of evidence. But in fact, there is remarkably little data supporting the claim that the Chávez administration has acted any differently from previous Venezuelan governments -- or, for that matter, from those of other developing and Latin American nations -- in redistributing the gains from economic growth to the poor. One oft-cited statistic is the decline in poverty from a peak of 54 percent at the height of the national strike in 2003 to 27.5 percent in the first half of 2007. Although this decline may appear impressive, it is also known that poverty reduction is strongly

associated with economic growth and that Venezuela's per capita GDP grew by nearly 50 percent during the same time period -- thanks in great part to a tripling of oil prices. The real question is thus not whether poverty has fallen but whether the Chávez government has been particularly effective at converting this period of economic growth into poverty reduction. One way to evaluate this is by calculating the reduction in poverty for every percentage point increase in per capita income -- in economists' lingo, the income elasticity of poverty reduction. This calculation shows an average reduction of one percentage point in poverty for every percentage point in per capita GDP growth during this recovery, a ratio that compares unfavorably with those of many other developing countries, for which studies tend to put the figure at around two percentage points. Similarly, one would expect pro-poor growth to be accompanied by a marked decrease in income inequality. But according to the Venezuelan Central Bank, inequality has actually increased during the Chávez administration, with the Gini coefficient (a measure of economic inequality, with zero indicating perfect equality and one indicating perfect inequality) increasing from 0.44 to 0.48 between 2000 and 2005.

Poverty and inequality statistics, of course, tell only part of the story. There are many aspects of the well-being of the poor not captured by measures of money income, and this is where Chávez's supporters claim that the government has made the most progress -- through its misiones, which have concentrated on the direct provision of health, education, and other basic public services to poor communities. But again, official statistics show no signs of a substantial improvement in the well-being of ordinary Venezuelans, and in many cases there have been worrying deteriorations. The percentage of underweight babies, for example, increased from 8.4 percent to 9.1 percent between 1999 and 2006. During the same period, the percentage of households without access to running water rose from 7.2 percent to 9.4 percent, and the percentage of families living in dwellings with earthen floors multiplied almost threefold, from 2.5 percent to 6.8 percent. In Venezuela, one can see the misiones everywhere: in government posters lining the streets of Caracas, in the ubiquitous red shirts issued to program participants and worn by government supporters at Chávez rallies, in the bloated government budget allocations. The only place where one will be hard-pressed to find them is in the human development statistics.

Remarkably, given Chávez's rhetoric and reputation, official figures show no significant change in the priority given to social spending during his administration. The average share of the budget devoted to health, education, and housing under Chávez in his first eight years in office was 25.12 percent, essentially identical to the average share (25.08 percent) in the previous eight years. And it is lower today than it was in 1992, the last year in office of the "neoliberal" administration of Carlos Andrés Pérez -- the leader whom Chávez, then a lieutenant colonel in the Venezuelan army, tried to overthrow in a coup, purportedly on behalf of Venezuela's neglected poor majority.

In a number of recent studies, I have worked with colleagues to look more systematically at the results of Chávez's health and education misiones. Our findings confirm that Chávez has in fact done little for the poor. For example, his government often claims that the influx of Cuban doctors under the Barrio Adentro health program is responsible for a decline in infant mortality in Venezuela. In fact, a careful analysis of trends in infant and neonatal mortality shows that the rate of decline is not significantly different from that of the pre-Chávez period, nor from the rate of decline in other Latin American countries. Since 1999, the infant mortality rate in Venezuela has declined at an annual rate of 3.4 percent, essentially identical to the 3.3 percent rate at which it had declined during the previous nine-year period and lower than the rates of decline for the same period in Argentina (5.5 percent), Chile (5.3 percent), and Mexico (5.2 percent).

Even more disappointing are the results of the government's Robinson literacy program. On October 28, 2005, Chávez declared Venezuela "illiteracy-free territory." His national literacy campaign, he announced, had taught 1.5 million people how to read and write, and the education minister stated that residual illiteracy stood at less than 0.1 percent of the population. The achievement received considerable international recognition and was taken at face value by many specialists as well as by casual observers. A recent article in the San Francisco Chronicle, for example, reported that "illiteracy, formerly at 10 percent of the population, has been completely eliminated." Spanish President José Luis Rodríguez Zapatero and UNESCO's general director, Koichiro Matsuura, sent the Venezuelan government public letters of congratulation for the achievement. (After

Matsuura's statement, the Chávez's administration claimed that its eradication of illiteracy had been "UNESCO-verified.")

But along with Daniel Ortega of Venezuela's IESA business school, I looked at trends in illiteracy rates based on responses to the Venezuelan National Institute of Statistics' household surveys. (A full presentation of our study will appear in the October 2008 issue of the journal *Economic Development and Cultural Change*.) In contrast to the government's claim, we found that there were more than one million illiterate Venezuelans by the end of 2005, barely down from the 1.1 million illiterate persons recorded in the first half of 2003, before the start of the Robinson program. Even this small reduction, moreover, is accounted for by demographic trends rather than the program itself. In a battery of statistical tests, we found little evidence that the program had had any statistically distinguishable effect on Venezuelan illiteracy. We also found numerous inconsistencies in the government's story. For example, it claims to have employed 210,410 trainers in the anti-illiteracy effort (approximately two percent of the Venezuelan labor force), but there is no evidence in the public employment data that these people were ever hired or evidence in the government budget statistics that they were ever paid.

#### THE ECONOMIC CONSEQUENCES OF MR. Chávez

In fact, even as the conventional wisdom has taken hold outside of Venezuela, most Venezuelans, according to opinion surveys, have long been aware that Chávez's social policies are inadequate and ineffective. To be sure, Venezuelans would like the government's programs -- particularly the sale of subsidized food -- to remain in place, but that is a far cry from believing that they have reasonably addressed the nation's poverty problem. A survey taken by the Venezuelan polling firm Alfredo Keller y Asociados in September 2007 showed that only 22 percent of Venezuelans think poverty has improved under Chávez, while 50 percent think it has worsened and 27 percent think it has stayed the same.

At the same time, however, Venezuelan voters have given Chávez credit for the nation's strong economic growth. In polls, an overwhelming majority have expressed support for Chávez's stewardship of the economy and reported that their personal situation was improving. This is, of course, not surprising: with its economy buoyed by surging oil profits, Venezuela had enjoyed three consecutive years of double-digit growth by 2006.

But by late 2007, Chávez's economic model had begun to unravel. For the first time since early 2004, a majority of voters claimed that both their personal situation and the country's situation had worsened during the preceding year. Scarcities in basic foodstuffs, such as milk, black beans, and sardines, were chronic, and the difference between the official and the black-market exchange rate reached 215 percent. When the Central Bank board received its November price report indicating that monthly inflation had risen to 4.4 percent (equivalent to an annual rate of 67.7 percent), it decided to delay publication of the report until after the vote on the constitutional reform was held.

This growing economic crisis is the predictable result of the gross mismanagement of the economy by Chávez's economic team. During the past five years, the Venezuelan government has pursued strongly expansionary fiscal and economic policies, increasing real spending by 137 percent and real liquidity by 218 percent. This splurge has outstripped even the expansion in oil revenues: the Chávez administration has managed the admirable feat of running a budget deficit in the midst of an oil boom.

Such expansionary policies were appropriate during the deep recession that Venezuela faced in the aftermath of the political and economic crisis of 2002-3. But by continuing the expansion after the recession ended, the government generated an inflationary crisis. The problem has been compounded by efforts to address the resulting imbalances with an increasingly complex web of price and exchange controls coupled with routine threats of expropriation directed at producers and shopkeepers as a warning not to raise prices. Not surprisingly, the response has been a steep drop in food production and widening food scarcity.

A sensible solution to Venezuela's overexpansion would require reining in spending and the growth of the

money supply. But such a solution is anathema to Chávez, who has repeatedly equated any call for spending reductions with neoliberal dogma. Instead, the government has tried to deal with inflation by expanding the supply of foreign currency to domestic firms and consumers and increasing government subsidies. The result is a highly distorted economy in which the government effectively subsidizes two-thirds of the cost of imports and foreign travel for the wealthy while the poor cannot find basic food items on store shelves. The astounding growth of imports, which have nearly tripled since 2002 (imports of such luxury items as Hummers and 15-year-old Scotch have grown even more dramatically), is now threatening to erase the nation's current account surplus.

What is most distressing is how predictable all of this was. Indeed, Cháveznomics is far from unprecedented: the gross contours of this story follow the disastrous experiences of many Latin American countries during the 1970s and 1980s. The economists Rudiger Dornbusch and Sebastian Edwards have characterized such policies as "the macroeconomics of populism." Drawing on the economic experiences of administrations as politically diverse as Juan Perón's in Argentina, Salvador Allende's in Chile, and Alan García's in Peru, they found stark similarities in economic policies and in the resulting economic evolution. Populist macroeconomics is invariably characterized by the use of expansionary fiscal and economic policies and an overvalued currency with the intention of accelerating growth and redistribution. These policies are commonly implemented in the context of a disregard for fiscal and foreign exchange constraints and are accompanied by attempts to control inflationary pressures through price and exchange controls. The result is by now well known to Latin American economists: the emergence of production bottlenecks, the accumulation of severe fiscal and balance-of-payments problems, galloping inflation, and plummeting real wages.

Chávez's behavior is typical of such populist economic experiments. The initial successes tend to embolden policymakers, who increasingly believe that they were right in dismissing the recommendations of most economists. Rational policy formulation becomes increasingly difficult, as leaders become convinced that conventional economic constraints do not apply to them. Corrective measures only start to be taken when the economy has veered out of control. But by then it is far too late.

My experience dealing with the Chávez government confirmed this pattern. In February 2002, for example, I had the opportunity of speaking with Chávez at length about the state of the Venezuelan economy. At that point, the economy had entered into a recession as a result of an unsustainable fiscal expansion carried out during Chávez's first three years in office. Moderates within the government had arranged the meeting with the hope that it would spur changes in the management of the public finances. As a colleague and I explained to Chávez, there was no way to avoid a deepening of the country's macroeconomic crisis without a credible effort to raise revenue and rationalize expenditures. The president listened with interest, taking notes and asking questions over three hours of conversation, and ended our meeting with a request that we speak with his cabinet ministers and schedule future meetings. But as we proceeded to meet with officials, the economic crisis was spilling over into the political arena, with the opposition calling for street demonstrations in response to Chávez's declining poll numbers. Soon, workers at the state oil company, PDVSA, joined the protests.

In the ensuing debate within the government over how to handle the political crisis, the old-guard leftists persuaded Chávez to take a hard line. He dismissed 17,000 workers at PDVSA and sidelined moderates within his government. When I received a call informing me that our future meetings with Chávez had been canceled, I knew that the hard-liners had gained the upper hand. Chávez's handling of the economy and the political crisis had significant costs. Chávez deftly used the mistakes of the opposition (calling for a national strike and attempting a coup) to deflect blame for the recession. But in fact, real GDP contracted by 4.4 percent and the currency had lost more than 40 percent of its value in the first quarter of 2002, before the start of the first PDVSA strike on April 9. As early as January of that year, the Central Bank had already lost more than \$7 billion in a futile attempt to defend the currency. In other words, the economic crisis had started well before the political crisis -- a fact that would be forgotten in the aftermath of the political tumult that followed.

The government's response to the crisis has had further consequences for the Venezuelan economy. The

takeover of PDVSA by Chávez loyalists and the subordination of the firm's decisions to the government's political imperatives have resulted in a dramatic decline in Venezuela's oil-production capacity. Production has been steadily declining since the government consolidated its control of the industry in late 2004. According to OPEC statistics, Venezuela currently produces only three-quarters of its quota of 3.3 million barrels a day. Chávez's government has thus not only squandered Venezuela's largest oil boom since the 1970s; it has also killed the goose that lays the golden egg. Despite rising oil prices, PDVSA is increasingly strained by the combination of rising production costs, caused by the loss of technical capacity and the demands of a growing web of political patronage, and the need to finance numerous projects for the rest of the region, ranging from the rebuilding of Cuban refineries to the provision of cheap fuel to Sandinista-controlled mayoralities in Nicaragua. As a result, the capacity of oil revenues to ease the government's fiscal constraints is becoming more and more limited.

## PLOWING THE SEA

Simón Bolívar, Venezuela's independence leader and Chávez's hero, once said that in order to evaluate revolutions and revolutionaries, one needs to observe them close up but judge them at a distance. Having had the opportunity to do both with Chávez, I have seen to what extent he has failed to live up to his own promises and Venezuelans' expectations. Now, voters are making the same realization -- a realization that will ultimately lead to Chávez's demise. The problems of ensuring a peaceful political transition will be compounded by the fact that over the past nine years Venezuela has become an increasingly violent society. This violence is not only reflected in skyrocketing crime rates; it also affects the way Venezuelans resolve their political conflicts. Whether Chávez is responsible for this or not is beside the point. What is vital is for Venezuelans to find a way to prevent the coming economic crisis from igniting violent political conflict. As Chávez's popularity begins to wane, the opposition will feel increasingly emboldened to take up initiatives to weaken Chávez's movement. The government may become increasingly authoritarian as it starts to understand the very high costs it will pay if it loses power. Unless a framework is forged through which the government and the opposition can reach a settlement, there is a significant risk that one or both sides will resort to force.

Looking back, one persistent question (in itself worthy of a potentially fascinating study in international political economy) will be how the Venezuelan government has been able to convince so many people of the success of its antipoverty efforts despite the complete absence of real evidence of their effectiveness. When such a study is written, it is likely that the Chávez administration's strategy of actively lobbying foreign governments and launching a high-profile public relations campaign -- spearheaded by the Washington-based Venezuela Information Office -- will be found to have played a vital role. The generous disbursement of loans to cash-strapped Latin American and Caribbean nations, the sale of cheap oil and heating gas to support political allies in the developed and developing worlds, and the covert use of political contributions to buy the loyalty of politicians in neighboring countries must surely form part of the explanation as well.

But perhaps an even more important reason for this success is the willingness of intellectuals and politicians in developed countries to buy into a story according to which the dilemmas of Latin American development are explained by the exploitation of the poor masses by wealthy privileged elites. The story of Chávez as a social revolutionary finally redressing the injustices created by centuries of oppression fits nicely into traditional stereotypes of the region, reinforcing the view that Latin American underdevelopment is due to the vices of its predatory governing classes. Once one adopts this view, it is easy to forget about fashioning policy initiatives that could actually help Latin America grow, such as ending the agricultural subsidies that depress the prices of the region's exports or significantly increasing the economic aid given to countries undertaking serious efforts to combat poverty.

The American journalist Sydney Harris once wrote that "we believe what we want to believe, what we like to believe, what suits our prejudices and fuels our passions." The idea that Latin American governments are controlled by economic elites may have been true in the nineteenth century, but is wildly at odds with reality in a world in which every Latin American country except Cuba has regular elections with large levels of popular

participation. Much like governments everywhere, Latin American governments try to balance the desire for wealth redistribution with the need to generate incentives for economic growth, the realities of limited effective state power, and the uncertainties regarding the effectiveness of specific policy initiatives. Ignoring these truths is not only anachronistic and misguided; it also thwarts the design of sensible foreign policies aimed at helping the region's leaders formulate and implement strategies for achieving sustainable and equitable development.

It would be foolhardy to claim that what Latin America must do to lift its population out of poverty is obvious. If there is a lesson to be learned from other countries' experiences, it is that successful development strategies are diverse and that what works in one place may not work elsewhere. Nonetheless, recent experiences in countries such as Brazil and Mexico, where programs skillfully designed to target the weakest groups in society have had a significant effect on their well-being, show that effective solutions are within the reach of pragmatic policymakers willing to implement them. It is the tenacity of these realists -- rather than the audacity of the idealists -- that holds the greatest promise for alleviating the plight of Latin America's poor.

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