

The 'Curse' of Venezuela

Since being elected president of Venezuela in 1998, populist Hugo Chavez has evoked strong feelings, many of them negative. Chavez's detractors charge that he has maneuvered the country into autocracy, but instead of waiting to beat him in the next election, they attempted to oust him in a military coup. Since the coup's failure, Venezuela has reeled from economic downturns in the wake of national strikes and, it is widely complained, Chavez's counterproductive meddling in the national oil company. Stories about political stand-offs over recent opposition efforts to organize a recall election fill the country's newspapers.

Most media coverage characterizes Venezuela's political strife as either a situation that would not have materialized had someone other than Chavez been elected or as a struggle between rich and poor. Individual players certainly shape Venezuela's political battles. And struggles between the rich and poor are a crucial issue. However, these factors are symptoms of a larger phenomenon that the technical economics literature calls the "resource curse."

The resource curse literature conflicts with the conventional idea that natural resource wealth contributes to economic expansion. According to this literature, abundant natural resources impose economic and political distortions that retard economic growth in the long run, even though they can produce short-run booms. In Venezuela's case, the resource is oil.

An important observation by resource curse economists is that a positive relationship generally does not exist between a nation's natural resources and other forms of economic wealth. Much more telling, resource-rich countries grow slower on average than resource-poor countries. The term *on average* is a conservative one. In fact, very few resource-rich countries grow as fast as the average resource-poor country.

How It Works

If all this means that a large natural resource base is somehow a curse, how does the curse work? In the simplest, purely economic version of the curse story, a boom in natural resources generates inrushes of financial capital. When the money comes in, prices for nontradable goods and services—ranging from office buildings to farmland to haircuts—go up and stay there.¹

When the prices of these goods and services are bid up beyond a certain point, types of production that use them can no longer compete internationally. Export-based agricultural production falls off. Export-based manufacturing—the growth engine of the Asian tigers—never buds and certainly never blooms. Governments often try to "sow" their oil gains in subsidies to manufacturing and create other market distortions to offset the cost disadvantages infant industries face. The infants never grow up, although with continued government subsidies, they can grow very fat.

Price distortions are not the only deterrents to broad economic development in resource curse countries. Thorvaldur Gylfason, a professor at the University of Iceland, finds that a nation's educational attainment is negatively related to the share of natural resources in national wealth.² Education levels have important implications for future industry mix and so, for growth. Workers with more education learn faster on the job. Education shifts comparative advantage away from resource production, where learning by doing is less important, toward manufacturing and services, where it is very important.

Partly as a result of these factors—the crowding out of nonresource industries, the discouragement of education that could allow advancement in manufacturing and services—players in resource-based countries focus more on fighting over pieces of the nation's economic pie and less on efforts to make the pie bigger.

In a book on Venezuela published before Chavez became president, Stanford University professor Terry Karl argues that "the skewed development produced by petroleum fosters the belief of state managers that market mechanisms do not function in a manner compatible with socially approved goals." This contributes, she says, to a psychology that "admires and rewards those who can 'milk the cow' without effort rather than those...in less remunerative but more productive activities."³

Moreover, the government focuses its tax collection on energy, because such efforts are politically easier and cheaper, rather than on the economy as a whole. So when oil prices fall, significant fiscal problems emerge. When oil prices boom, resource curse countries spend even more than their increased revenues in hopes of establishing a non-oil production base that will save them when the oil runs out.

How Venezuela Stacks Up

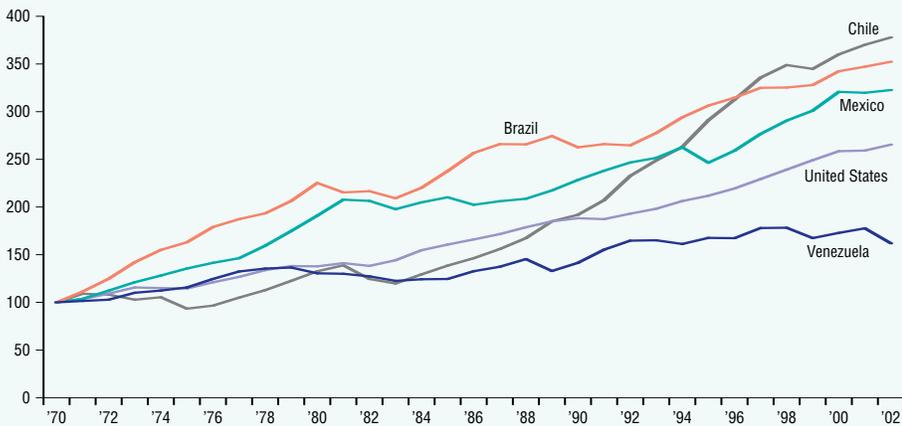
Consistent with the resource curse literature, Venezuela has grown slowly compared with other Western Hemisphere countries. Chart 1 shows indexes of real gross domestic product for Brazil, Chile, Mexico, the United States and Venezuela. Note the uptick in Venezuelan GDP after 1973 with the first major oil price jump under the Organization of the Petroleum Exporting Countries and the brief growth following the 1979 oil price shock.

Notice, however, that over the longer run Venezuela's economy has experienced slower growth than the other economies. Even though Mexico, like Venezuela, is one of the world's 10 largest petroleum exporters, Mexican petroleum exports are typically about two-thirds of Venezuela's. Moreover, Mexico's population is nearly four times Venezuela's, and manufacturing exports have long played a more important role for Mexico.

Chart 1

Venezuela Trails Other Countries in Real GDP Growth

Index, 1970 = 100
(constant local currency units)



SOURCE: World Bank.

While contrasts between Venezuelan and other nations' GDP growth are striking, Venezuela's absolute declines in real GDP per capita are grimmer still (*Chart 2*). Between 1980 and 1999, the year Chavez took office, real income per capita fell about 18 percent. From 1980 to 2002, income per capita dropped 25 percent. In 1988, the percentage of Venezuelans with 12 years of schooling living below the poverty line was 2.4. By 1998, when Chavez was elected president, the percentage had risen to 18.5.

How much was oil to blame for slow Venezuelan growth and declining per capita income? While with the Center for International Development at Harvard University, Jeffrey Sachs and Andrew Warner estimated that during 1970–90, Venezuela's real GDP would have grown an average 0.77 percent faster per year without oil than with it.⁴ By the end of this period, GDP would have been 14 percent higher if Venezuela had not been an oil-exporting country.

Trapped in a Feedback Loop

In sum, Venezuela has been caught in a feedback loop for decades. The economic peculiarities of a natural-resource-based economy—in which not only price relationships but even educational incentives keep the country from moving in a more productive direction—result in a political system that perpetuates the economic system. The political system then feeds back into the resource-based economic focus. Until the late 1990s, revenue and spending were organized to distribute the pie with a minimum of conflict rather than make the overall system ultimately more competitive.

For 40 years, Venezuela's principal political parties had a formal accord—the Plan de Punto Fijo—to share power and economic largesse. As the country's economy worsened and opportunities for accommodation eroded with the decline in per capita income, the old arrangement collapsed. Chavez's election was an important manifestation of this breakdown; he did not run as a candidate of the Plan de Punto Fijo parties.

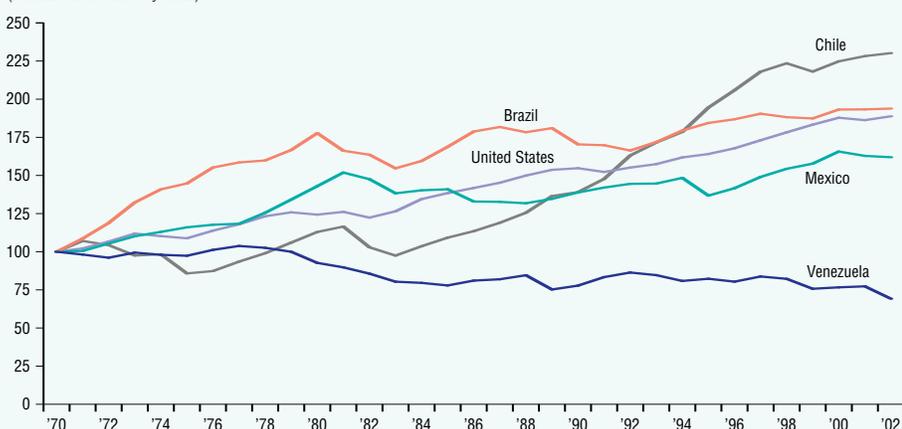
Compromise has been replaced by struggle, but the struggle involves the same issues accommodation did when economic circumstances were better—the same political focus, just new ways of expressing it. The current polarization differs from the old accommodation, but it is the old feedback loop that created it, much more than any one, two or 100 individuals.

—William C. Gruben
Sarah Darley

Chart 2

Growth in Real GDP per Capita Even Worse

Index, 1970 = 100
(constant local currency units)



SOURCE: World Bank.

Gruben is a vice president and senior economist and Darley a research assistant in the Research Department of the Federal Reserve Bank of Dallas.

Notes

- ¹ Jeffrey D. Sachs and Andrew M. Warner provide strong econometric evidence that after adjusting for other relevant factors, prices are significantly higher in resource-dominated economies. See "The Curse of Natural Resources," *European Economic Review*, vol. 45, May 2001, pp. 827–38.
- ² "Natural Resources, Education, and Economic Development," by Thorvaldur Gylfason, *European Economic Review*, vol. 45, May 2001, pp. 847–59.
- ³ *The Paradox of Plenty: Oil Booms and Petro-States*, by Terry Lynn Karl, Berkeley: University of California Press, 1997.
- ⁴ "The Big Push, Natural Resource Booms and Growth," by Sachs and Warner, *Journal of Development Economics*, vol. 59, June 1999, pp. 43–76.