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Venezuela: The Latest Victim of the Dutch Disease

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In a recent report released by the International Monetary Fund (IMF), inflation in Venezuela is expected to reach 481 percent in 2016, then 1642 percent in 2017. The IMF also projects that unemployment rate in Venezuela currently stands at 17 percent and will rise to 21 percent in 2017.[i] Symptoms of the crippling economy are visible across the nation, with reports of medicine and food shortages, daily electricity blackouts, and soaring crime rates.[ii] Victor Maldonado, executive director of the Chamber of Commerce, Industry, and Services, predicts that the Venezuelan economy, and by extension, the government, will collapse within one year once the reserves are depleted and the government can no longer pay for its debts or fund basic services.[iii] Counterintuitively, Venezuela's dire situation is not unusual for a country rich in natural resources.

The Resource Curse

According to the Organization of the Petroleum Exporting Countries (OPEC), Venezuela's proven oil reserves surpassed that of Saudi Arabia in 2009, totaling 297 billion barrels as opposed to the latter's 265 billion barrels.[iv] However, in reality, Venezuela is only another country on a long list of nations that have fallen victim to the "Resource Curse." This term, coined by economists in the 1950s, reflects the paradox that countries with abundant natural resources are likely to have stagnant economic growth. Examples of this include African countries such as Nigeria, Sudan, and Angola. According to OPEC, these nations rank eighth, tenth, and eleventh in oil reserves in the world, respectively.[v] Yet all three countries have below average Human Development Index scores, according to the United Nations Development Program.[vi]

Just like Venezuela, these countries have failed to diversify their economies. Reports suggest that oil exports have been responsible for 95 percent of Venezuela's exports earnings and nearly half of government revenue.[vii] Oil prices had been steadily rising from the 1990s up until 2014. The revenue brought in from oil exports over this period helped fund Venezuela's late President, Hugo Chavez's socioeconomic policies. As President of Venezuela from 1999 to 2013, Chavez started the "Bolivarian Revolution", a series of social programs that aimed to provide low cost housing, safe food, and access to education for the impoverished, while at the same time reinforcing indigenous rights and strengthening the military. Data indicates that the Venezuelan economy made significant strides under the presidency of Hugo Chavez, with a population above the poverty line increasing from 50.6 percent in 1999 to 70.5 percent in 2011 and unemployment rate falling from 15 percent in 1999 to 8.6 percent in 2010. [viii]

However, this is the nature of countries that are struck with the Resource Curse: When the industry that is heavily depended on flourishes, the country prospers; when that industry is weak, the overly specialized economy fails to adjust, and the nation falls into deep economic problems. In order to finance his Bolivarian Revolution, Chavez overspent. This means that once oil prices began to drop from $114 USD per barrel in 2014 to $35 USD per barrel at the end of February 2016, the current regime in Venezuela, led by Nicolas Maduro, does not have enough money to provide even the most basic services such as healthcare.

The Dutch Disease

To further complicate matters, Venezuela is plagued by the Dutch Disease — an economic phenomenon associated with the Resource Curse. The Dutch Disease refers to a situation where economic development in one specific industry brings decline in another, due to the fact that high revenue from one industry usually drives up the value of the nation's currency. In the case of Venezuela, the value of the Bolivar had been appreciating as a result of high oil exports and government manipulation. A strong currency was thought to be beneficial because the government could then have a larger foreign reserve and hence higher purchasing power of technological goods needed for its industrialization. However, this strategy soon proved to be problematic because not only did a strong Bolivar make Venezuelan exports less competitive internationally, but it also made imports cheaper, leading to a current account deficit characterized by balance of payments problems. Furthermore, while oil exports have been relatively healthy over the past two decades, all other industries have been falling behind when compared to Venezuela's Latin American peers.

Venezuela's once dominating agricultural sector has since been displaced by the oil sector. For years, the government had been using revenues made from oil exports to buy imported food products in order to make up for the loss. However, this became difficult as oil prices began to fall in 2014, the government started to run out of reserves.

Import Substitution Industrialization

As alluded to earlier, a major contributor to the food shortage crisis in Venezuela is the fact that the nation's domestic agricultural sector has been shrinking for decades. A research study by Monica Arruda de Almeida has shown that this is largely because of the Import Substitution Industrialization (ISI) policy that many Latin American nations, not just Venezuela, adopted from the end of World War II up until the 1980s.

ISI emerged as the dominant economic policy of Latin America in the 1950s as countries in the region looked toward the economic success of the Union of Soviet Socialist Republics at the time. ISI is meant to be a solution to the Dependency Theory, which characterizes underdeveloped countries as "periphery states" and economically developed countries as "core states"; the notion is that periphery states export their primary goods mainly to core states while the latter export their manufactured goods to the periphery states. This process tends to enrich core states at the expense of periphery states because extraction adds less value than manufacturing and raw materials are more susceptible to volatile prices.

To implement ISI, Venezuela imposed high import tariffs on consumer goods and provided cheap credit to industrial firms. The idea was that letting domestic industries produce consumer goods instead of importing them would strengthen the industrial sector; not only speeding up the process of modernization but also initiating a trickle-down effect that would, in theory, benefit all other industries in the economy. The Automobile Policy Law was passed in 1962 as the Venezuelan government decided that a strong automobile manufacturing industry would reduce Venezuela's technological dependence on foreign nations.

However, the attempt to industrialize Venezuela has been fruitless. The exact reasons for this are difficult to pinpoint, as they are multi-folded. Dani Rodrik, a political-economy professor at Harvard University, in his paper "Understanding Economic Policy Reform", suggests that the failure of ISI in not only Venezuela, but Latin America in general, is mainly because of a relatively uneducated workforce and the government's mismanagement of macroeconomic fiscal and monetary policies.[ix] With the automobile manufacturing industry not generating significant export revenue, the Venezuelan government had no choice but to over-rely on oil exports, and displacing the agricultural sector and other industries in the process. This over-reliance and lack of economic diversity ultimately culminated in the current economic crisis, the largest the country has ever faced.

Future Outlook

In the wake of the current economic crisis, hundreds of thousands of Venezuelans are currently marching on the streets across the country demanding a referendum to be held to decide whether Nicolas Maduro should be removed from power before his term officially ends in 2019 [14]. *Partido Socialista Unido de Venezuela*, the political party led by Maduro, already lost its majority to the opposition, *Mesa de la Unidad Democrática*, in the National Assembly after the 2015 parliamentary election. In short, there seems to be lots of uncertainty and instability in Venezuela's political future. And this does not bode well for the country's economic outlook.

Many analysts speculate that Venezuela would continue to seek financial help from China. Venezuela has already borrowed over $50 billion USD from China since 2007 and Chinese officials have insisted that "economic ties (with Venezuela) will be further strengthened" despite Venezuela's struggles.[x] Yet given the latter's political and economic instability, one cannot help but wonder whether China is in fact willing to invest even more in Venezuela's crippled economy.

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