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Logan Gish

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I. Thesis

Since the early twentieth century, Venezuela has relied on its oil industry to maintain a constant national revenue. This dependency on one resource has grown over the decades and even today, Venezuela still has not diversified its industrial base. The increase in oil prices and revenue during the 1970's gave Venezuela and the administration of Carlos Andres Perez the opportunity both to combat poverty and to funnel money into new areas of industry. Instead of exploring new economic investment plans however, the government followed the financial plans of past administrations. The result was that Venezuela increased its dependence on oil revenue, neglected social reform, and borrowed heavily abroad.

Carlos Andres Perez, the president during the oil boom, increasingly isolated himself from Congress, his political party, his advisors, and reality. Although his presidential authority allowed Perez to bypass Congressional oversight of his programs, he unfortunately embarked on a series of unrealistic and poorly researched economic programs. Perez's loyal advisors regularly avoided criticizing his policies despite a need for discussion. Congress failed to provide sufficient oversight. Not only had the Accion Democratica (AD) Party obtained a majority in Congress, but AD also had majorities in the municipal governments. At first Perez ignored his political opposition so they adopted radical positions, which divided the government just when political cooperation was needed.

Problems within the government bureaucracy only added to this economic failure. Venezuelan government departments that dealt with the oil industry, such as the Ministry of Mines and Hydrocarbons, were not unified organizations and often viewed other departments with suspicion and distrust. The refusal to share information among departments was worsened after nationalization when Venezuelans who had worked for foreign oil companies were viewed by government officials as remaining loyal to the foreign companies. Venezuelan officials and executives lacked the experience and
knowledge to effectively budget and invest the massive amount of new revenue the oil boom provided. Patronage and big business concerns frequently controlled most of the new revenues, only to invest them in ventures that did not diversify the industrial base or radically improve social conditions or alleviate poverty. Other problems which hurt business interests were high levels of inflation, government subsidies, overseas borrowing, and government spending. The government needed to control the money supply to create an attractive investment environment. The view that the Perez administration led the Venezuelan economy to disaster by failing to budget effectively is shared by numerous authors.

A complete understanding of Venezuelan development during the 1970's can be discerned from the perspectives of several authors. *The Nationalization of Venezuelan Oil*, published in 1977, and written by Morris Morley, James F. Petras, and Steven Smith, focuses on the rise of nationalism in oil producing countries that have traditionally been categorized as third world countries. The authors analyze the political system and the political parties that formed the Venezuelan political left. The analysis is based on Venezuelan class interactions and how the left wing promoted their political agendas. The Venezuelan political left is described as having to combat a political system that increased the power of the national government and furthered the interests of the private sector, both actions proved negative in the economic long-run.1

Another political-economic perspective is offered by Gustavo Coronel, author of *The Nationalization of the Venezuelan Oil Industry*, published in 1983, which is a case study. He describes experiences and factors of both people and economic entities that influenced or were influenced by the nationalization of the Venezuelan oil industry. He explores the years from 1878 to 1983, focusing on government policy and the degree that private industry was included in the economy after nationalization. He describes a political-industrial structure that did not undergo any major changes and increased tensions between Venezuelan officials, dividing the government.2
Another view on Venezuelan history is offered by Richard A. Haggerty, editor of *Venezuela, a country study*, published in 1993. It is an American federal government study of Venezuela written by a team of social scientists. The focus is on the people of Venezuela and how their opinions, attitudes, and beliefs influenced history. Information is drawn from all available documents such as interviews, newspapers, official reports, and other books. The study is composed of factual information that describes the industrial development and financial policies of the Venezuelan government.3

An in-depth analysis of how oil has influenced Venezuelan economics is described in *The Paradox of Plenty*, by Terry Lynn Karl, published in 1997. Karl analyzes the failure of Venezuela to effectively budget the revenue it received during the 1970’s. Karl specifically analyzes the political-economic structure to interpret how decisions were made based on political preference and economic ability. Venezuela is used as an example of how oil centered nations failed to break from previous economic policies and did not advance any social or economic reforms that drastically changed their nation. He used local studies on Venezuela while comparing those studies to other regional histories. Karl writes how Venezuelan government policies increased the power of the private sector and the government without radically changing social conditions.4

II. Economic Analysis Models

One way of analyzing Venezuela’s problem is through the sectoral approach. According to author Terry Lynn Karl, this analysis begins with an explanation of the leading sector. It then looks at other economic factors, such as taxes, which influence and support the oil industry. It then examines how deeply ingrained and/or reoccurring a specific policy result affects the nation. A central assumption of this approach is that nations with similar economies should have similar development patterns. The specific cause of this “sameness” is the origin of government revenues and how that revenue is used. In contrast to European nations, most periphery and/or developing nations, such as Venezuela, have relied on external sources of revenue. This focus on industrialized
nations is not useful when applied to developing nations. Karl's book attempts to solve this problem by demonstrating how the sources of a nation's revenue influence all levels of its political institutions: the state; the regime; and the government. The state is the permanent structure that implements choices in a nation. The regime is the collection of people, rules, and organizations that determine how changes are made. The government consists of the people that dominate and control a regime. Sources of national revenue influence how a state organizes its political structures and policies. But each political level is affected differently, especially the degree of how far a nation can intervene and/or change its economy.

Another economic approach, used by Karl in his analysis of Venezuela, to analyze the Venezuelan economy is the “mining state” model, meaning nations that rely on a single resource for maintaining their economy and face extreme difficulty in changing economic patterns, one example being the Venezuelan oil industry. Business and government interests resist any change that threatens to deprive them of power. Economic power is held by the government, which controls the industry supplying most of the revenue. The stability of the political structure is dependent on the stability of the economic structure. Oil states can demand high prices for their oil with minimal investment. Government authority is weakened as private and public concerns search for ways to gain a part of the revenue, not plan for the future. The dependence on oil can turn these nations into “petro-states.” When oil revenue dramatically increases, these states see the “boom” as evidence to increase oil operations to gain more revenue despite the fact that larger programs will eventually fail when oil prices drop.5

A variant of the mining state model is the “petro-state.” A petro-state is a nation whose economy is dominated by the oil industry. The World Bank categorizes a petro-state as one in which 10 percent of the Gross Domestic Product (GDP) and 40 percent of total merchandise exports are oil. The subset of countries that includes Venezuela and much of the Middle East are the “capital-deficient oil exporter” nations.
Capital-deficient oil exporter nations usually have a large skilled labor force and a more diversified economy than capital-surplus counterpart nations. They generally absorb all of their revenue and usually are net importers of capital. Capital-deficient nations are highly reliant on oil exports and fear the draining of oil reserves more than an oil market crash. They have an incentive to diversify while large amounts of revenue are available, yet their decisions tend to be short-term ones. They feared that oil reserves would run dry before another opportunity presented itself.

An new type of analysis, described by Karl, is the cross regional comparison, the study of similar circumstances that lead to similar results in different nations, sometimes in different time periods, such as Venezuela and oil in the 1970's or Spain and precious metals in the sixteenth century. This is a combined research design that examines similarities despite contrasting circumstances. New categories are encouraged to account for the different economic levels of developing countries. Cross regional studies also show why oil dependent countries may suffer the same fate despite geographical and political differences.6

III. The Origins of Nationalizing the Oil Industry

The move towards oil nationalization began before the Perez government. His predecessor, Rafael Caldera of the of the Comite de Organizacion Politica Electoral Independiente (COPEI) party, increased government control over oil resources by raising the tax rate on foreign oil companies to 70 percent in 1971. In that same year Caldera decided to support Alvaro Silva Calderon’s Hydrocarbons Reversion Law bill. This legislation sought to solve the question of what would happen to the oil industry when the concessions granted to foreign oil companies expired. The Hydrocarbons Reversion Law had four general provisions: (1) all concessions and other properties owned by the companies would become the property of Venezuela when the concession expired; (2) unexploited concession land would return to government ownership in the three years after the law’s enactment; (3) companies would be required to file a “bond” with the
government totaling 10 percent of the total value of that companies installations, thus maintaining the equipment’s working condition; (4) company operations and plans in Venezuela would require approval of the government and the government would control where oil wells could be drilled. Caldera’s decision to support the bill, despite political opposition, marked the start of the government showing a more nationalistic attitude to the oil industry and questioning the oil company’s descisions.7

Government control over the oil industry was strengthened additionally with decree 832, which in 1971 authorized the National Executive to fix oil export prices unilaterally, replacing a system of reference pricing established in the 1960’s. The government would be able to predict the level of oil production per company and the income tax that the oil company would have to pay for the year. Decree 832 which stated that “exploration, production, refining, and sales programs” of oil companies required the approval of the Ministry of Mines and Hydrocarbons in advance before being implemented in actual practice.8

Debates over the law of reversion foreshadowed the debates over the nationalization of oil. In 1972 the Venezuelan Attorney General, J.G. Andueza, defended the law. The main argument between the oil companies and the government was whether equipment related to the concession, but built outside the concession area, would become the property of the Venezuelan government. The law of reversion and decree 832 were followed by an immediate drop in oil output by ten percent. The Venezuelan Central Bank blamed the drop on lower tanker rates, allowing the Middle East an advantage, while the Ministry of Mines and Hydrocarbons stated that there were no valid reasons for the drop. Politicians, such as F. Faraco, president of the Committee of Mines and Hydrocarbons, blamed the oil companies for shutting down 700 wells in retaliation against government policy. Even after the official nationalization of the oil industry in 1976 this hostility increased and continued. This controversy even pitted Venezuelans against each
other. Government officials viewed themselves as patriots, but they considered
Venezuelans who worked for foreign oil companies untrustworthy opportunists.  

During the "lame-duck" period of the Caldera presidency, 1973-1974, the
problems that Caldera had not solved became increasingly obvious. Political pressure had
increased to nationalize the oil industry and support for nationalization was shown by
other members of the government such as Pedro Pablo Aguilar, secretary general of
COPEI. Pressure came from government officials, political parties, and even from some
oil companies like Shell and Creole, which offered to negotiate for better terms when they
realized that nationalization was inevitable. The Caldera administration had generated
record high deficits in 1970 and 1972, dramatically increasing the public debt. Oil revenue
had not been controlled by the government and the public sector gained more influence in
the national economy.  

During the elections of 1973 for the presidency, National Congress, legislative
assemblies, and the municipal councils, candidates rarely mentioned the oil issue during
their campaigns. They made references to the oil industry only when the campaigns
approached their end. COPEI's candidate, Dr. Lorenzo Fernandez, may have avoided the
oil issue to not embarrass Rafael Caldera of his own party. Fernandez, at the end of his
campaign, claimed he would exploit the Orinoco Tar Strip if elected. The AD party and
its candidate, Carlos Andres Perez, likewise avoided the oil issue until a government study
could be undertaken to help determine the best course for his goal, the nationalization of
the oil industry.  

IV. The OilBoom

In 1973, Venezuela reaped an unprecedented increase in oil revenues. These
profits were a direct result of the Arab-Israeli War that started in 1973 and resulted in the
price of crude oil quadrupling in two months. The reason behind the increase was the oil
embargo that the Organization of Petroleum Exporting Countries (OPEC) imposed on the
United States and Western nations in retaliation for their support of Israel. This price
increase presented the newly elected Carlos Andres Perez, with a unique opportunity. Perez’s campaign, “Democracia con Energía,” Democracy with Energy, suggested innovative ideas. Although the Venezuelan government received more oil revenue in five years than the total revenue collected during all previous administrations since 1917, Perez failed to restructure the economy. He became trapped in the “cages’ of the past,” used by previous governments to manage Venezuela’s oil dominated economy. The movement, and subsequent failure, to diversify the Venezuelan economy was influenced by three factors: the 1973 price increase; Perez’s, and the AD party’s, landslide victory; and the realization that Venezuela could no longer rely solely on oil for the majority of its national revenue.12

Perez did decide to nationalize the Venezuelan oil industry. On January 1, 1976 fourteen foreign oil companies lost their property, they did not strongly oppose the move, however, because the new tax rates had lowered their profits. The companies received only 30 percent of the value of the oil they extracted while the government received 70 percent. Many Venezuelan oil employees actually saw nationalization as a way to organize the inefficient Venezuelan bureaucracy. The Ministry of Mines and Hydrocarbons, which oversaw the operation of foreign oil companies, had never been an unified organization, and the departments (hydrocarbons, reversion, local market, petroleum economics, geology) competed for political power and rarely shared information. The leading friction was between Calderon Berti and Arevalo Reyes, the directors of the reversion and hydrocarbon departments. The two departments did not cooperate and the oil companies had to duplicate thousands of documents for the reversion department because the hydrocarbons department would not share their copies. Nationalization meant avoiding intense bureaucratic pressure and saving thousands of hours used for duplicating documents regarding oil exploration and refining plans.13

Each company received one billion dollars from the Venezuelan government in compensation for the nationalization of their industry, although this amount was far lower
than the total value of their investments, including twelve oil refineries and 12,500 oil wells. The plan re-organized the companies into four government entities and placed them under the supervision of the Petroleos de Venezuela, S. A. (PDVSA), which was directed by the former head of the Corporacion Venezolana de Guayana (CVG), General Rafael Alfonso Ravard. Many of the Venezuelan employees who had worked for the foreign oil companies retained their positions in the new government entities. Some Venezuelan political parties and employees of the original Venezuelan state oil corporation, the Corporacion Venezolana del Petroleo (CVP), believed that the foreign oil companies still retained their influence in Venezuela through their former employees. This lack of trust foreshadowed the political disagreements concerning economic policies.

Perez contributed heavily to this ill-will when he introduced his own nationalization bill to Congress. Perez, in 1974, had created the Presidential Commission on Reversion, consisting of nearly all of the Venezuelan intellectual and economic sectors. The commission had presented Perez with a draft law that only the Fedecamaras did not support. Perez however, supported a different bill, supported only by the AD, which contained Article 5. That article implied that foreign corporations might return as partial owners in the oil industry, and it destroyed any hope of political unity. When the AD ratified the bill, opposition came from COPEI, MAS, MIR, and all the other political parties. COPEI also boycotted the nationalization ceremony. Internal disagreements about economic policies within the AD party resulted in the unwise decision to borrow heavily from foreign banks. The need for foreign financing was founded on the fact that Perez’s social and economic development projects could not be financed solely by oil revenue. 14

PDVSA fell under Article 6 of the nationalization law, otherwise known as the Law Reserving the Production and Marketing of Hydrocarbons to the State. It stated that the “Venezuelan executive would be able to ‘create the enterprises necessary for the regular and efficient development of [all activities relative to the exploration, exploitation,
refining and marketing of hydrocarbons." One of these enterprises would be responsible for "the duties of co-ordination, supervision and control of the activities to be undertaken by the rest of the companies."  

Perez officially created the PDVSA on August 30, 1975, by executive decree 1123, to take over control and supervision duties. When nationalization took place, the concessionaires ceded their places to 13 nationalized operating companies. The nationalized companies were not combined into larger companies and that helped maintain the established ownership and operating structures that were already in place. Allowing the existing structure to continue avoided disruptions to oil productivity until the companies could be merged together without disrupting oil productivity. In July 1976, the five largest companies (Lagoven, Maraven, Meneven, Llanoven, and CVP) formed a plan to divide the nationalized businesses into five groups: companies with large organizations, medium-sized companies, small companies that would be integrated into larger companies in the short-term, marginal companies that would be integrated into larger companies at once, and the original state oil company, the CVP.  

V. Government Economic Policy

The Perez government followed the economic policies of past administrations, the only difference that it implemented them on a larger scale. The result was negative policies were exaggerated and new problems emerged. The government lost political unity, as opposition from the left became more radical. The Venezuelan people believed that the revenue had given Venezuela the ability to finally restructure the nation into the dream of "La Gran Venezuela." Perez envisioned rapidly modernizing an oil centered nation, rather than a more modest change in the country's course. The reality was that "La Gran Venezuela" left little room for real choice, but left a lot of room for contradictory economic policies. Inflation became a major problem. In an attempt to avoid it the government tried to control the money supply. Officials followed previous financial policies and simply enlarged the political battles over who would control the
money supply. Private concerns versus public concerns, labor versus owner, these arguments decreased restraint on government spending. Perez had two choices: save the money for the future or build an industrialized, first world "La Gran Venezuela." Considering the resources, the second route was obvious.16

Perez, in an interview on October 13, 1975 with Business Week magazine, said that Venezuela could no longer afford to have the Western nations dictate the price of Venezuelan oil. The first world and the third world, he argued, had to find ways to exist as equals, rather than continuing a dominant-subordinate relationship. The best thing for Venezuela would be to have free trade regulated by the government. International corporations would maintain ties with Venezuela, but would not control the flow of technology into third world nations. Perez stated that the one thing that had to happen was that import and export prices had to balance out.17

The scope of the revenue increase of 1972-1975 was unprecedented in Venezuelan history. In those years, oil prices rose from $2.10 to $10.90 per barrel, a 419 percent increase. Venezuelan fiscal income more than tripled as international reserves went from 1.7 billion dollars to 8.9 billion dollars, this was nearly 40 percent of the Gross Domestic Product (GDP).

Before 1973, the Venezuelan president had to rely on building political alliances in Congress. This was not the case, however, for the Perez administration because the AD party held majorities in both houses. Perez had received 48.7 percent of the votes for president, and the AD party gained control of 28 out of 49 Senate seats, 102 out of 203 Chamber of Deputy seats, and control of every state government except Zulia. Despite internal disagreements, AD legislators voted the party line, and thus did not exercise fiscal control over the president. This lack of outside scrutiny diminished further as Perez named eight cabinet ministers who were political independents, but were loyal to him. Perez built his own network of supporters when he had helped rebuild the AD party following its defeat in 1968. Lack of legislative and industrial oversight prevented any
effective criticism of Perez’s policies. In 1974, however, few people noticed this and could predict the consequences of nullifying the system of checks and balances on the president.18

Perez’s strategy of decreasing dependence on oil revenue ignored the agricultural sector and concentrated on industrial economic power. Perez, in the wake of the revenue increases of 1972-1975, abandoned his original intention to “manage abundance with the mentality of scarcity” and proceeded to institute plans designed to spread the wealth across all social classes and build “La Gran Venezuela.” Perez’s government subsidized food production, increased foreign imports of luxury goods, cancelled a 350 million dollar debt owed to government agencies by the Venezuelan farming community, and increased working wages. The Law of Unjustified Dismissals, passed in 1974, made it more difficult for employers to fire employees and doubled public employment by 1978. However, while unemployment dropped, more “undesirable” jobs were given to illegal immigrants from Colombia and Brazil. The government’s plan improved the lives of all Venezuelans, but the poor still remained poor alongside the more affluent middle class. One report stated the 40 percent of the Venezuelan public lived in poverty.

Perez’s “La Gran Venezuela” differed only from previous development plans in scope and speed of implementation. Perez’s proposed development projects to diversify the economy and fight poverty, before oil reserves went dry. The core of this plan was the nationalization of steel and oil, taking advantage of Venezuela’s mineral and fuel supplies. By 1976, of the 27.186 billion dollars invested under the Fifth National Plan, a government strategy to direct economic development and investment, 60 percent had been allocated to the mining and oil sectors. Despite the fact that previous plans along similar lines had failed to eliminate poverty, government planners believed that the increase in oil revenue would allow their plan to succeed. Poverty had been the result of the government directing most of its resources towards oil. The additional revenue influx would allow planners to sustain the oil industry while diversifying the economy, thereby creating jobs.
The basis for industrialization was the oil industry, the core of the economy. Venezuelans, not foreigners, would profit from the industry. Venezuelans had to face the fact that no new oil reserves had been discovered since 1958 and existing oil reserves were expected to last only twenty years. Oil production had decreased as foreign companies had prepared for the industry’s nationalization. In addition, the Orinoco Oil Belt, believed to contain 1.8 trillion barrels, required new technology to purify the crude oil reserves of sulfur and metal. The president of Petroleos de Venezuela (PETROVEN), General Alfonzo Ravard, estimated that 1.61 billion dollars would be required to fully utilize the Orinoco’s potential.19 Another reason for Venezuelan worries was that the definition of “recoverable” oil had been changed. In 1973, Venezuelan oil reserves were 13.8 billion barrels, by 1974 reserves totaled 18.6 billion barrels. This increase was the result of government officials declaring marginal oil fields commercially recoverable. The disadvantage was that these reserves were profitable only when oil prices were rising.20

VI. Economic Consequences on the Private Sector

Venezuelan industries received massive government subsidies to build a high-technology infrastructure and large scale industrial projects. The government created new autonomous and semiautonomous industries in shipping, textiles, and hydroelectricity, and gave them massive government funding. By 1978, state-owned industries had a budget that was 50 percent higher than the total federal budget. The premiere investment was the industrial complex at Ciudad Guayana, which was directed by the CVG. This had been started in the 1960’s by the government to decentralize industry away from Caracas and attracted private and public investors including the Siderurgica del Orinoco (Sidor), a CVG subsidiary. The government built aluminum and bauxite refineries along with hydroelectric projects to fully utilize the basin’s potential. SIDOR’s president, Luis Jose Hernandez, stated in 1975 that the industrial expansion would cost more than 2.5 billion dollars.21
Besides aluminum and bauxite, the Fifth National Plan planned for an increase in steel production from 1.2 millions tons to 9.8 million tons in two new plants, SIDOR Plan IV and ZULIA. Under that plan, the government funded construction of the Guri Dam to support efforts to exploit the Orinoco Basin’s hydroelectric potential. Other diversification projects included aircraft manufacturing, paper mills, and nickel mining. However, the Fifth National Plan differed from previous government plans in three areas. First, Perez’s plan called for building twenty years of industrial development in five to ten years. Second, Perez’s plan mandated that large-scale projects receive top priority at the cost of public services. Caldera’s fourth national plan had allocated 35.4 percent of public investment for education and government services. Perez’s fifth national plan allocated only 19.9 percent of public investment for education and government services. Third, the boundaries between private and public enterprises would vanish with nationalization. The public share of gross fixed investment was to be increased from 32 percent to 53.2 percent.

Under Perez’s 5 year plan, the government entered manufacturing sectors that private capital had previously dominated and private capital was limited to 20 percent ownership in basic industries and 40 percent in secondary-stage manufacturing. The government increased its involvement in planning and controlling the Venezuelan economy. No major organization or group voiced strong resistance or debated alternative policies. The reason for this widespread acceptance was that Perez was following the guidelines of previous economic plans, all that changed was the amount of amount of money being spent. Private and government officials offered no alternatives to industrial development. They remained silent on the issue of agricultural neglect and ignored the danger of monetary inflation. They also assumed that labor could quickly learn the needed skills. They failed to question that the government’s plan to deliver “La Gran Venezuela” according to schedule. Critics were ignored or kept silent. Only Juan Pablo Perez Alfonzo, the founder of OPEC, publicly warned that the high oil prices could decline and
advocated the cutting of oil production to effectively deal with the unprecedented revenue influx. However, Alfonzo’s warning was lost in the national rush to build “La Gran Venezuela.”

Following the oil revenue influx was the public fear of inflation destabilizing the economy. Venezuelan citizens wanted a return to the previous 1-2 percent inflation rate and Hector Hurtado, Minister of Finance, warned that the rapid revenue influx “could become a block of ice that would end up melting on us.” Perez, in the first 100 days of his presidency, responded by issuing decrees, resolutions, and/or draft laws at the amazing rate of two per day. The prices of services and goods were frozen for 90 days and this was endorsed by political parties and trade unions. He then asked Congress for approval of the Special Powers Act, which gave him “extraordinary executive authority,” so he could enact an income-tax reform, reorganize public financial institutions, and decree widespread wage increases. Besides raising tax rates on foreign oil companies, Perez sought to nationalize the iron ore and oil industries.

The justification for these measures was to control the radical changes in national living standards. Privately, some cabinet members and chief aides felt that Perez wanted to avoid normal administrative channels and enact policies with a minimum of congressional debate. The response, led by COPEI, centered on the balance of power and the viability of democracy. Nevertheless, on May 31, 1974, Congress granted Perez “extraordinary executive authority.” Support for this measure came from the AD, the Communist Party, the Movimiento al Socialismo (MAS) and the Movimiento de Izquierda Revolucionaria (MIR). Opposition came only from COPEI and the Movimiento Electoral del Pueblo (MEP). The Special Powers Act had two major impacts on Venezuelan politics. First, Perez was now free from even nominal oversight by the AD-controlled Congress. Perez ruled the country by decree from May 31, 1974, to June 1, 1975. Second, COPEI was forced to adopt a more radical political stance.
Deconsolidation happened at the same time the political system faced new responsibilities. Even AD, the party that had founded Venezuelan democracy after the military lost power in 1958, did not analyze the Special Powers Act and yielded to granting Perez's "extraordinary executive authority" request. With the exception of the FIV, every other policy could have been submitted for Congressional approval to avoid confusion. The rewriting of the Civil Service Code allowed more political appointments when the nation needed efficient and experienced officials, and further destabilized the nation when an effective administration was needed to deal with the situation. Perez's reliance on vague economic proposals for industrialization revealed obstacles, such as a lack of clear economic planning. The popular belief among the Perez administration was that difficulties could be solved, technical knowledge could be imported, and oil revenue would continue to rise despite competition from North Sea and Mexican operations. Furthermore, they believed the existing industrial structure could support increased demand, corruption would be controlled, inflation would be not become a danger, and industry was seen as more important than agriculture. Lastly, and most importantly, the belief was the government would maintain a strict budget overseen by numerous and competent officials. In the end, Perez had done nothing more than build an illusion of prosperity. 25

VII. Venezuelan Banks and Labor

Perez wanted to execute the dual goals of ending poverty and controlling the revenue influx. New development plans would benefit all of Venezuelan society. The dream of "politics without limits," of the government spreading money to all social classes, collapsed with the reality of the wealthier classes demanding their traditional government subsidies. Plans to control government spending and "manage abundance with the mentality of scarcity" were replaced with ever increasing development costs. Perez, however, won two victories: first, he reduced oil production from 3.4 million barrels a day in 1973 to 2.3 in 1975; and oil exports dropped from 2.1 million barrels a day
in 1973 to 1.5 million in 1975. Lower oil export amounts meant that less revenue entered the country and slowed the depreciation of industrial equipment, which was operating at the limit under the oil companies disinvestment policies. Venezuela ranked fifth in worldwide total oil output in 1974 with an export of 154 million tons of crude oil. This was 12 percent less than the output of 1973.26

Perez’s second strategy was to establish the Fondo de Inversiones de Venezuela (FIV) to manage the sudden increase of six billion dollars in oil revenue. FIV prevented oil revenue from entering the domestic economy. Revenue was invested overseas until it could be gradually reintroduced to the Venezuelan economy. Another investment was the financing of international cooperation among Central American countries that had suffered under the oil price increase. FIV was initially given 3.23 billion dollars by the government and was supposed to receive half of all income from oil sales during Perez’s five year term in office.

The next step by Perez’s government was a tax reform that formed a “diversified fiscal base” and balanced out the currency restriction. Hector Hurtado, Minister of Finance, envisioned a plan including higher taxes, customs, and levies, and a business and property tax. The goal was to replace oil revenue with tax revenue. The plan ran into widespread protest since the government wanted to raise taxes during a massive inflow of money. Furthermore, since the FIV functioned in the exterior, its income was not subjected to Congressional and Finance Ministry oversight and instead was directly supervised by the president. The FIV was only answerable to the president, not a government ministry.

Perez, intending to eliminate poverty, implemented a series of measures that would increase consumer purchasing power. Perez decreed the first Venezuelan minimum wage and set it at 3.50 dollars per day, this decree did not include domestic workers. Next came a nationwide wage increase that ranged from 5 to 25 percent for employees in the private and public sectors.
Following the wage increase and the revenue influx, Venezuelans embarked on a massive spending spree. Venezuela soon ranked as the world’s leading consumer of whiskey. Venezuelan domestic production increased, but many items, such as whiskey, stereos, clothing, foods, and televisions continued to be imported.

Perez also decreed an increase in jobs. Government, white-collar, fixed-position jobs doubled in five years, and agencies avoid partisan “stacking” with Decree 211, which permitted the government to increase political appointments along with nonclassified public employees. This revision of the Civil Service Law allowed Perez to fire people and then replace them with employees who supported his policies. Personnel expenditures in the national budget almost tripled between 1973 and 1979 in response to increased employee numbers and wages. The Law against Unjustified Dismissals, enacted by Perez to counter the fear of increased firings following wage increases, provoked private business opposition of Perez’s policies because the law made it costly for employers to fire employees. A private business association called Fedecamaras attacked this law as interfering with private enterprise and in threatening a favorable economic situation. These businessman feared that capital would leave the country because investors might interpret this measure as an attack on free enterprise. They demanded clear government policies and predicted a recession would result if they were not reassured that the government knew what it was doing. The dramatic increase in government employees was also the result of slow growth in private industry, the government simply increased its size without altering its traditional reliance on revenue from oil.

These private business demands were soon joined by complaints from barrio (low income sectors) inhabitants, nonunionized workers, others in the popular sector. The increase in consumer purchasing power had not been rationally planned. The industrial structure could not respond to the sudden increase in demand. Capital began a mass exodus from Venezuela as prices soared, investment levels dropped below normal, and a severe food shortage occurred. Perez responded by spreading the wealth to his most
vehement critics in a classical appeasement strategy. On September 15, 1974, Perez proclaimed a shift from his populist policies and instead stated that the government would emphasize productivity by granting tax exemptions to businesses and give them government subsidies. The General Banking Law was modified by Perez so tax deductions, up to 20 percent, could be claimed for investments. The construction industry was granted a tax exemption for ten years and similar exemptions were granted to agriculture, ranching, and forestry. The most important parts of the economic strategy were two credit funds that gave industry and agriculture one billion dollars each over a period of five years along with low-cost, long term loans. The combined net transfer of money was unprecedented. The initial transfer totaled over one billion dollars plus investments from all of Venezuela’s public development agencies. Perez’s surrender to private industry simply encouraged the wealthy class to demand more privileges.

Perez decided to avoid the task of designing a new national financial network to control the money flow and instead relied on existing financial institutions. Private banks received huge subsidies and their earnings rose rapidly. Perez, to appease business interests, then enacted the Law for the Protection of the Consumer which replaced government price controls, and killed an antimonopoly law. This meant the government would only regulate and subsidize foods judged necessary for a basic diet. Other consumer products escaped all but partial regulations. Private businesses were also included in drafting future price-control regulations since their exclusion in 1946. While the Law against Unjustified Dismissals remained in force, business gained influence in making economic policies and received a large share of the oil revenue. Following these actions, business owned newspapers printed stories praising the Venezuelan government. Government spending then spun out of control just when the government need to control oil revenue. In the year of the Special Power Act, government expenditures tripled without any plan or any definable relationship to productivity. As a consequence, living
standards rose and the domestic economy experienced a "boom" effect that left some Venezuelans believing that the prosperity would never end.

Economic wealth and development, invested into imports and commerce projects, rapidly ran into bureaucratic obstacles and corruption. Only 25 percent of government projects between 1974-1975 were completed as government deals were full of bribes and kickbacks. Long-term industrial projects that did not rely on foreign imports or foreign technical knowledge were neglected in favor of government subsidies that allowed the private sector to maintain high profits while borrowing technology from other countries. Venezuela continued to rely on foreign imports without modernizing its industrial base.

Foreign observers clearly saw Perez's contradictory economic policies. Why would government planners, fearful of inflation and a limited supply of oil, have condoned a seemingly endless spending spree? To Venezuelan government planners, however, the policy of diversifying the economy while appeasing interests that could threaten to effectively undermine the government was perfectly rational. It is true that Venezuelan economic planners did not expect such a demand for government spending from the private sector. The fact was that Venezuelan officials only saw the endless revenue from oil and the political difficulty in not spending money so freely. There was no strong incentive to restrain the spending spree. The spending should have been restrained, because, to quote the December 27, 1975 issue of the Economist: "It would be wise to be a little more cautious in the spending of the oil money. There is nothing wrong at all, even in these days of financial sophistication, with having some cash in the bank."

VIII. Social Conditions and National Debt

The dramatic increase in government spending triggered a domino effect that infected the government, the economy, and the nation. Perez's initial popularity among the public along with his "extraordinary executive authority" meant that his programs received no viable public criticism and no effective government oversight. During Perez's first year in office, the administration formed no organized economic proposals or
priorities, just a vague outline of industrial development projects. The complete lack of political opposition allowed Perez and his subordinates to enact legislation without research and concrete guidelines. The result was an economic plan in which the government deemed every act a priority, as historian Terry Lynn Karl observes, “yet, if everything is a priority, there are in fact no priorities at all.” The lack of proposals for major industrial changes in the economy revealed that there was no real change from previous policy. The plan to extract state revenue from the domestic economy was not followed by a “redistributive income tax.” Not only did the FIV never receive its mandated half of all oil revenue, after 1975 it received no new oil revenue.

The patterns of urban development reflected sharp social divisions in society in which the poor stayed poor while the middle and upper classes got wealthier. Corporate skyscrapers and and high-income areas, such as luxury apartments, received government supplies, support, paid labor, and money from banks for investment and construction. By contrast, low-income areas were settled through illegal occupations of state and private land, although families did purchase occupancy rights within these areas. Construction and financing was undertaken by the poor themselves. While some government officials viewed this development as separate from the wealthier classes, the reality is that both were a part of Venezuela’s oil economy. Upper level areas enjoyed connections with politicians and banks, while low level areas relied mostly on self-help and minimal government aid. The government’s goal to improve housing by subsidizing construction resulted in higher land and housing prices. Speculators, believing that soaring real estate prices would last for years, developed and sold more land for housing projects. Yet as real incomes declined developers abandoned their plans and finished dwellings remained unsold. The price drop was portrayed to the public by the government as temporary. Instead, the sudden increase in the housing supply, for the middle class, had exceeded the demand. Residential development suffered as investors moved capital into other areas.
City level political leaders, in return for votes, lobbied to get their areas the most development funding and investments. However, the limits of government spending meant that not all sectors could receive aid, prompting city level politicians to ignore certain land development violations in return for the maintaining the patronage system. The wealth from oil could have been invested in low-income housing to improve the conditions of the poor while businesses would have profited from housing construction and building supply sales. Instead, a political system that relied on middle and upper class votes, supporting an ingrained patronage system, remained intact and the poor were neglected. The upper classes received a majority of the wealth and invested it in economic ventures that only benefited the wealthy. While this approach prevented a military coup, unlike other South American countries in the 1970’s, the government sector increased without stable planning or visible productivity. Most of the oil revenue was not distributed evenly across the social classes and urban development.33

In Maracaibo, hundred of old buildings were demolished during the early 1970’s to make room for an expanded highway system while new apartment and office buildings were built on the Lake Maracaibo shoreline.34 Opportunities for urban development, reinforced by the increase in oil revenue, made real estate seem a profitable investment. The downside was that the profitability of real estate attracted too much investment. As the late 1970’s brought rising interest rates, economic recession, and decreases in government spending, land and building sales decreased. Venezuelan companies had failed to learn the management procedures and skills needed to sustain a viable manufacturing base.35

The Fifth National Plan, designed during the Perez administration, had assumed that oil prices would sustain high amounts of government spending for the entire decade. The reality was that oil income leveled off in 1976, as OPEC ended the embargo, and prices began to decline in 1978. The government therefore turned to foreign banks for money to continue the plan without making significant alterations. Foreign investments
and loans faced two outcomes: while Venezuela was an acceptable credit risk for banks, the autonomy of government entities allowed for massive borrowing with no central government accounting. The autonomous government entities chose high interest, short-term loans that led the public-sector to a twelve billion dollar debt by 1978, a five-fold increase in four years. Investment levels remained the same in the year of nationalization as industry planned for new expenditures. Investment levels doubled in 1977 and in 1978, with 75 percent of the money invested in oil exploration. Exploration investments totaled 179.4 million dollars, 20 percent of capital expenditures. Refining investments, which rose by a factor of four, went towards the building of one flexicoker and two catalytic crackers. Exploration drilling was undertaken offshore and in the Orinoco Basin. The rapid expansion followed two decades of contraction before 1975. By 1975 expenditures had all but been eliminated and managers were reluctant to change a philosophy of caution and austerity. Industrial directors and managers had to switch from the traditional philosophy of “save” to the new philosophy of “spend wisely.”

The Venezuelan government’s decision to borrow from overseas creditors was supported by foreign banks that saw a way to gain some of Venezuela’s oil revenue and Venezuela could get favorable terms on credit with its oil collateral. Other industrialized countries were bad risks since they were suffering a recession. The credits were spent by the government, although a wiser course would have been to leave the oil in the ground for a greater value in the future. Perez focused on speed rather than a plan for cheap capital that could be invested in new ventures. AD party leaders saw that the amount that Perez wanted to borrow, 14.734 billion dollars, was extreme. Acting Finance Minister Ivan Pulido Mora emphasized that the Central Bank had previously objected to borrowing a sum totaling only 60 percent of Perez’s request. Mora argued that a successful debt strategy required projections on annual investments and a development plan, none of which existed. Mora also argued that excessive borrowing could not be merged with the previous policy of restricting the money supply to avoid inflation. This criticism led Perez
to reduce the requested amount from 52.9 billion dollars to 27.6 billion dollars. This caused a problem as Perez’s government still planned on investing in industry along with more social programs, leading to spending.

Venezuelan bankers did not understand the dangers of borrowing so heavily. A group of bankers suggested that all investments should be kept liquid form outside Venezuela. The advantage of this strategy was that the money would serve as foundation to support larger amounts of overseas borrowing. The disadvantage was that Brazil had tried this strategy to finance industrial growth and had instead accumulated a 22 billion dollar foreign debt. Brazilian industries had not been able to produce the amount of exports required to repay the overseas loans. 

Venezuela would eventually suffer the same economic fate.

The greatest flaw of the borrowing plan was that the foreign borrowing was intended to replace a wide-ranging tax-reform policy. Once the borrowing began, it destroyed any chance of convincing Venezuelans that additional revenue was needed. Foreign borrowing became a substitute for increased taxes. The Central Bank’s report on Perez’s borrowing plan stated that “the Fifth Plan could be through the combination of income generated by oil, the state enterprises, and debt alone ‘if the alternative of financing the activities of the public sector through greater internal taxation is postponed for now.’” This statement masked the struggle between Perez, the Central Bank, and the Finance Ministry over the debt policy and tax reform. Perez finally succeeded in promoting the debt policy.

IX. Political Divisions

The failure of the Perez administration to modernize Venezuela become more evident as the initial plan to transform Venezuela into a first world nation through massive industrialization only led to higher national debt, payment deficits, and higher inflation rates. This was a classic example of an economy falling under the control of oil revenues.
Imports rose by 30 percent per year while investments failed to produce useful results, which led to government borrowing and spending lacking any controls.

In 1977 Perez and the government realized that the economy had to be stabilized before it collapsed. The money supply was curtailed and imports were placed under increased government control. Perez hoped this would control inflation and limit imports, but neither hope was realized. Perez’s successor, Luis Herrera Campins of the Comite de Organizacion Politica Electoral Independiente (COPEI) party, said “that he had received a mortgaged country.” Campins’ monetary policies included subsidy termination and price deregulation. This resulted in price increases for consumer products. A subsequent wage increase, in response to increased prices, simply stimulated economic inflationary. It also contributed to cost increases for oil industry operations. Oil industry officials responded by stating that increased oil revenue would not be sufficient to counter a deficit imbalance. The solution proposed by the government to save the national economy was to exploit the Orinoco oil deposits to maintain a steady flow of revenue. However, development of the Orinoco meant that other sectors of the economy had to relinquish huge amounts of money from their individual budgets.

Between government spending and foreign debt accumulated from 1973-1978, the Perez government had spent more money in 5 years than all previous governments combined. Much of this revenue had been wasted through ineffective government supervision, project cost overruns, and a myriad of corrupt deals. The failure of the government to show any viable accomplishments raised doubt among the Venezuelan public. This widespread public doubt became evident during the presidential election of 1978 when the AD party lost to COPEI. COPEI’s victory was the result of the AD party’s economic failures, the campaigning candidate’s political platforms were not a major factor. The success of COPEI also indicated a decline in the AD’s rural support base as more people had moved to urban areas.
Between 1976 and 1978, the AD party had neglected economic problems in favor of political party infighting. Forty-one percent of the AD party’s 1.3 million party militants refused to vote during the election, evidence of how much support the Perez government had lost. COPEI candidate Luis Herrera Campins said that his AD opponent, Luis Pinerua Ordaz, was his “best ally.” Every time Ordaz denounced corruption, he further discredited the Perez administration. The leading figure of the 1978 campaign was Carlos Andres Perez, whose attempts to gain support for the AD party proved ineffective against increasing suspicions of his involvement in the corruption and the COPEI slogan of “Where has the money gone?” Before the elections, a Caracas lawyer, investigating fraudulent deals involving some of Perez’s closest associates, had been ordered killed by the head of the federal police, a presidential appointee. Perez, after leaving office, was tried by Congress and escaped by one vote the Congressional censure that would have denied him the ability to run for reelection. More Venezuelans viewed the AD party as having wasted oil revenue and neglected the national good. In the presidential elections, Campins received 46.3 percent of the vote compared to Ordaz’s 43.3 percent. The Congressional vote was split at nearly 40 percent for each party. The elections of 1978 had been turned into a public trial on the Perez administration. Datos, a polling agency, found that the Venezuelan public held the AD party responsible for high living prices and scarce supplies.42

X. Conclusion

In conclusion, the promise of the AD party and Carlos Perez to modernize Venezuela into a first world nation failed, due to a lack of planning or realistic goals. Perez’s economic measures centered on increasing government spending during a time when controlling the money supply was vital to avoid inflation. The emphasis on subsidizing heavy industries while neglecting agriculture led to higher imports rates, undermining efforts to reduce the need for foreign goods. The economic measure that most hurt Venezuela was the plan to borrow heavily from other nations when Venezuela
should have reformed the tax system, instituted realistic economic goals, and saved much of the revenue for the future.

Venezuela could have avoided a majority of its problems if the political structure and the leaders had shown more cooperation and pragmatism. The most helpful factor would have been if Perez and the AD party had included Congress and the other political parties in determining economic policies. This would have subjected economic planning to more oversight and nearly eliminated Perez's uncontrolled spending spree. Another problem that was ignored was the government's failure to regulate the money supply when the economy faced the visible danger of inflation. In addition, private business was included in planning the economy. Business leaders succeeded in lowering government regulations and maintaining government subsidies, perpetuating a non-sustainable spending plan. Finally, the nation as a whole believed that the prosperity would continue and no plans were formed to deal with the possibility, and reality, of oil prices falling.

As dependency on oil revenue increased, the government could not repay foreign debts or manage an economy suffering from inflation. Living conditions remained the same, the wealthy got wealthier, the poor stayed poor, and the middle class saw real incomes first rise and then fall. What Venezuela needed to effectively build Perez's vision of a prosperous and modern "La Gran Venezuela" was a completely new method of economic planning that diversified the economy away from oil and encouraged cooperation among the Venezuelan political parties.
Endnotes


5. Karl, Paradox of Plenty, 12-16.


18. Karl, Paradox of Plenty, 119-123.


22. Karl, Paradox of Plenty, 125-126.

23. Karl, Paradox of Plenty, 126.

24. Karl, Paradox of Plenty, 127-130.


27. “How Oil is Creating a New Power in Center in Latin America,” 49.


29. Karl, Paradox of Plenty, 133-134.

30. Morley, Nationalization of Venezuelan Oil, 76-78.


34. “How Oil is Creating a New Power in Center in Latin America,” 48-49.

35. Gilbert, Political Economy of Land, 140.

36. Haggerty, Venezuela, a country study, 34-35.

37. Coronel, Nationalization of Venezuelan Oil Industry, 159-162.

38. “Oil, democracy, development,” 22.


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