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## Venezuela: More Corruption and Inefficiency

Venezuela returns to corrupt and inefficient state companies, but oil will help soften the blow.

### BY CHRONICLE STAFF

Venezuela is building 21st Century Socialism, says President Hugo Chavez, who recently was re-elected for a new five-year term. However, it is using a formula from the 20th Century - the failed state enterprises that dominated Venezuela and Latin America in the 1970s.

In the end, Chavez's plans to consolidate economic and political power in his hands will only result in increased corruption, economic inefficiency and even more tensions with the United States, experts say.

Local and foreign investors are concerned about the combined results of nationalizing the telecom company CANTV and electricity company EDC, the removal of the Central Bank formal autonomy and new rules for the key oil sector.

"This triple-play sends a crystal clear, anti-capitalist message to both foreign and domestic investors in sectors deemed "strategic" by the Chavez government," says Jerry Haar, a professor of management and international business and associate director of the Knight Ridder Center for Excellence in Management in the College of Business Administration at Florida International University. "A quantum leap backwards to state-owned enterprises, filled with corruption and inefficiency; a politicized monetary policy; and arbitrary and capricious regulation of the oil sector converge to the detriment of Venezuela and its people. This xenophobic *caudillismo* is an anachronism in a region where all nations, except Cuba and Bolivia, are supportive of private enterprise."

### BLACKOUTS AND SLOW PHONES

The nationalization of EDC will result in increased blackouts in Caracas, just like the areas in Venezuela serviced by state electricity companies, former planning minister Teodoro Petkoff warns. And "phones will again let you wait ten minutes for a dialtone," he said last week, according to AP.

"Nationalizations are prone to disaster," Walter Molano, head of research at BCP Securities, said in a commentary on Venezuela last week. "The governments do not have the capital, experience or talent to maintain the physical plant or keep up with new technology. Productivity and efficiency typically declines under government ownership, leading to lower output, poorer service and (eventually) higher prices."

The nationalizations were partly sparked by the declining oil prices, he argues. "The country's over-dependence on oil, the recent plunge in energy prices and the operational problems at [state oil company] PDVSA are forcing the Chavez Administration to look for alternative economic resources—and the large utilities make a very tempting prize."



GROWING POWER: Hugo Chavez addressing Venezuelan lawmakers last week. (Photo: Marcelo Garcia/MinCi)

Venezuela's overall trade boom is slowing down, thanks to the reduced oil prices. This year exports should reach \$70. billion, a 6.8 percent increase from last year. Imports should fall by 6.3 percent to \$30 billion, BCP securities forecasts. By comparison, exports grew by 28.4 percent last year and imports expanded by 77.8 percent. As a result, the economy is expected to expand by only 3.7 percent this year, following three years of high growth, according to the International Monetary Fund.

Venezuela also faces stagnant oil production. According to the BP Statistical Review of World Energy, Venezuelan oil production grew slightly in 2005, but is still beneath the average in the 1996-2001 period. Experts blame the politicalization of state oil company PDVSA.

### **OIL: NO NATIONALIZATION?**

So far, Chavez has not announced a nationalization of the key oil sector, although he has pledged to increase government control.

"Clearly, complete nationalization of the oil sector in Venezuela would be disastrous," says Jeremy Martin, director of the energy program at the Institute of the Americas. "However, that is not the case, nor do I believe it will be the case in the future in Venezuela."

However, foreign oil companies are expected to suffer from growing restrictions and taxes. Chavez has already forced foreign oil companies to sign new contracts that reduce their share of revenues. "The reactions of the various companies have ranged from cooperative to 'I'm getting the heck out of Dodge' to 'I wish I got the heck out of Dodge'," Martin says. "Chavez's statements about gas projects don't bode well for smooth sailing by those investors either. The bottom line is that clear and consistent rules of the game for investors is not at the top of Mr. Chavez's list of priorities, though when it comes to oil he is fortunate – and he knows it - that Venezuela's tremendous potential makes it such a unique case for investors."

U.S. energy companies will accept a lot of punishment from Chavez just to maintain access to Venezuela's reserves, argues William Ratliff, a research fellow at Stanford University's Hoover Institution. "Other foreign investors will be less tolerant, and the constant shifting of terms over the past couple of years will discourage many investors and drive increasing amounts of Venezuelan money abroad," he says.

### **CORRUPTION AND CRIME GROWS**

Despite his pledges to reduce corruption before he assumed office, Chávez has presided over growing corruption. Venezuela is now the second-most corrupt country in Latin America, according to the 2006 Corruption Perceptions Index from Transparency International. Only Haiti is more corrupt, the organization says.

By taking control of CANTV and EDC, as well as creating other state companies, Chavez will only spur more corruption, experts say.

"Corruption now permeates all levels of Venezuelan society," Gustavo Coronel, a former Venezuela representative to Transparency, wrote in a recent Cato Institute report. "Bureaucrats now rarely follow existing bidding regulations, and ordinary citizens must pay bribes to accomplish bureaucratic transactions and have to suffer rampant neglect of basic

government services. All this has been encouraged by a general environment of impunity: officers implicated in major corruption scandals have sometimes been removed from their posts, but they have not otherwise been held legally accountable."

Meanwhile, crime (including kidnappings) is growing dramatically, partly helped by corrupt police officers.

"The situation in Venezuela is spiraling out of control," Molano says. "Crime has reached epidemic proportions, with the police often being the worst perpetrators. The country's infrastructure is buckling and corruption is rampant."

## US RELATIONS

The increased radicalization is also expected to worsen relations with the United States. While the Bush Administration may be hesitant to appear too aggressive, the new policies in Caracas may lead Democrats to become more critical of Chavez.

"Relations will worsen," Haar says.

But Chavez knows that there is very little the US can do due to the continued dependency on oil imports from Venezuela. "Additionally, the Bush Administration is increasingly committed now to improving relations with the region, and any retaliatory measures, no matter how justified, will be perceived by many in the Americas as beating up on Venezuela," he says. "The hypocrisy of these countries is that they loathe Chavez — see him as a dangerous clown — yet lack the *cojones* to publicly say so for fear of antagonizing the masses and leftist parties, pundits and intellectuals in their nations."

It is unclear how Citgo, the US gasoline chain owned by PDVSA, will be affected. Even if Verizon and AES are not compensated properly for their shares in CANTV and EDC, it is unlikely that the U.S. government will retaliate against Citgo, Haar believes. "It is highly unlikely that the U.S. government will punish service station owners, middlemen, and the entire supply chain of U.S. companies (employing Americans here) that do business with Citgo," he says.

Meanwhile, trade between the two countries will likely continue. "While Chavez clearly delights in his coronation as the new leader of the "Finger in the US's Eye" movement in Latin America, an interesting counterpoint is the tremendous commerce that is occurring between the US and Venezuela, especially for consumer goods," says Martin. "The oil wealth is clearly not just going to the *misiones*."

## CHAVEZ INTERNATIONAL

"Washington's chief concern with Chavez will be his active campaign to create an international axis of anti-Americanism and his involvement in radicalizing politics in Latin America, both of which are made much easier by the assertive policies and plummeting international status of the Bush Administration," Ratliff says.

Parallel with the increased radicalization at home, Chavez has been actively involved in economic deals in Argentina, Bolivia, Ecuador, Nicaragua and Uruguay. Venezuela and Nicaragua last week signed a series of agreements that covered oil, agriculture and finance. One deal calls for Venezuela to send 10,000 barrels of oil per day to Nicaragua. The new deals come on top of previous agreements in place between Venezuela and the

Sandinista Party, including Venezuelan deliveries of inexpensive fuel to Alba Petroleos de Nicaragua, a Sandinista company named in honor of ALBA and fertilizer to Sandinista-controlled rural associations.

Chavez is also taking a more aggressive stance in the international financial markets. "There are rumors that the Venezuelans are providing the funding for the so-called Velvet Hand," Molano points out. "This is an aggressive investor allegedly operating out of Switzerland, who squeezed the Argentine Pars and Discounts at the end of 2006."

### **CHAVEZ FOREVER?**

Chavez is also asking the national assembly to pass a law that will allow him to run for re-election indefinitely after his current term ends in 2011.

"Public disgust with corrupt democratic regimes combined with high oil prices, paved the way for the election and reelection of Chavez and his slow motion larceny of democracy — now complete with the legislative, executive, judicial, and electoral powers, as well as the central bank, in the control of chavistas; the Church and the media harrassed, and a campaign underway to indoctrinate school children in socialism," Haar says. If oil prices continue to remain high, Chavez will be able to continue to rule. "Government control plus high oil prices mean Chavez can rule indefinitely," he says.

Ratliff agrees. "A substantial majority of Venezuelans think his handouts and a few programs justify his increasingly arbitrary, autocratic rule," he says. "Though many international factors can suddenly change any equation, there is a good chance that Chavez will survive for a long time."

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