



# Shortage In Prosperity: An Assessment Of The Political Economy Of Venezuelan Oil

Refah Kıtılıđı: Venezuela Petrolünün Ekonomi Politiiđinin Bir Deđerlendirmesi

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## ABSTRACT

Venezuela, which has not been able to use its underground resources properly since the beginning of the 1900s when Venezuelan oil was discovered, is one of the countries where hunger and inflation rates are very high today. The main reason of this can be explained by the fact that Venezuelan oil could not find the value it deserves until Chavez's time due to wrong policies applied in different periods such as an unsustainable taxation system, inapplicable neoliberal approaches, and number of patronages. Sometimes, rising or falling oil supply-demand rates and oil prices, due to uncontrollable events like the 1930 world depression or Yom Kippur War also affected the Venezuelan economy directly, which rigorously depends on oil. Moreover, since Maduro is still not able to manage the idea of 21st century socialism well, these rates go up day by day. In this study, the impact of Venezuela's petroleum policies and other cases, which have been the milestones to date, on the economy will be examined and an answer will be tried to be found out why this country, which has the world's largest oil reserves, is in poverty. The study also carries an aim of being scientific literature about Latin America and Venezuela which are known less in Turkey.

**Keywords:** Political Economy, Oil, Venezuela, Latin America, USA, China, Russia, Neoliberal Approach.

## ÖZET

Venezüella petrolünün keşfedildiđi 1900'lü yılların başından itibaren yeraltı kaynaklarını gerektiđi gibi kullanamayan Venezuela, günümüzde açlık ve enflasyon oranlarının çok yüksek olduđu ülkelerden biridir. Bunun temel nedeni, Venezuela petrolünün, sürdürülemez vergilendirme sistemi, uygulanamayan neoliberal yaklaşımlar ve patronaj sayısı gibi farklı dönemlerde uygulanan yanlış politikalar nedeniyle Chavez dönemine kadar hak ettiđi değeri bulamamış olması ile açıklanabilir. 1930 Dünya Buhranı ya da Yom Kippur Savaşı gibi kontrol edilemeyen olaylar nedeniyle yükselen ya da düşen petrol arz-talep oranları ve petrol fiyatları, sıkı bir şekilde petrole bađlı olan Venezüella ekonomisini de doğrudan etkilemiştir. Üstelik Maduro hala 21. yüzyıl sosyalizmi fikrini iyi yönetemediđi için bu oranlar her geçen gün artmaktadır. Bu çalışmada, Venezuela'nın bugüne kadar kilometre taşları oluşturan petrol politikaları ve diđer vakaların ekonomiye etkisi incelenecek ve dünyanın en büyük petrol rezervlerine sahip bu ülkenin neden hala yoksulluk içinde yaşıadıđı sorusuna cevap aranacaktır. Çalışma aynı zamanda Türkiye'de oldukça az bilinen Latin Amerika ve Venezuela hakkında bilimsel bir literatür olma amacını da taşımaktadır.

**Anahtar Kelimeler:** Ekonomi Politiiđi, Petrol, Venezuela, Latin Amerika, ABD, in, Rusya, Neoliberal Yaklaşım

## 1. INTRODUCTION

Venezuela is the country with the largest oil reserves in the world with approximately 303 billion barrels. (OPEC, 2019). It makes this country one of the most interested ones in the oil sector. Moreover, due to the majority of Venezuelan oil is extra-heavy and it is one of the few heavy oil producer countries, which provides a great advantage to this country. However, although it has great oil potential because of technological deficiencies and wrong policies implemented, shortage and high inflation rates dominate the whole country. Some authors attribute this poverty to the wrong socialist practices of Chavez and Maduro, while others argue that Venezuela's oil policy has been wrong from the very beginning. The aim of this article is to show how Venezuelan oil is managed from the beginning to the end and the impact of the important milestones on the country's oil economy in an analytical approach, in the light of numerical data and graphs.

In Venezuela, where general livelihood was based on agriculture, oil activities started in 1878 for the first time with the establishment of the first national mining company which is called Company Petrolia del Tachira. (PDVSA, 2016).

In the early 1900s when General Caudillo<sup>1</sup> Vicente Gomez come to the power, due to great concession agreements on behalf of international oil companies (IOCs), the oil industry started to improve. Later, concession agreements gained importance with the production of 200b/d from the Zumaque<sup>1</sup> oil well in 1914 and the first hydrocarbon law was created in 1920 (Vassiliou, 2018, p.493). Especially after the oil potential was noticed in the Maracaibo Lake in 1922, with the great attention of international companies, Venezuela started to make huge amount of concession agreements with these companies and oil became the main product which is exported with 76% in 1929 (Liuwen,1955, p.54). After that time, Venezuela's oil revenues have reached very high levels, and it has stopped

<sup>1</sup> Caudillo which means a military leader comes from Spanish. However, Caudillo in 1900s Latin Americas differed from the caudillo in Spain with little differences. (Bos, 2015, p.2)

production other than oil and came down with a Dutch Disease<sup>2</sup> which was going to be the curse of Venezuela. During the presidency of Gomez, even though oil income went up, due to the unsustainable taxation system and Gomez’s protection on imperialists’ interests country could not be profited from oil efficiently. Also, due to the autocracy of Gomez, lack of supervision caused number of patronages to increase. After Gomez, Eleazar’s and Medina’s times began. In these periods first democratic steps were taken and seeds of nationalization were sown for the first time. Although these actions were not liked by the IOCs, number of treaties continued to increase due to low sunk costs and high profit rates. Moreover, net profit of the government reached to 50% by the fifty-fifty agreement (Yergin, 2012). In 1958, a pact which is called Punto Fijo started and it was going to continue for forty years. During this period, democratic elections were done and only one coup was staged. While nationalist policies were adopted until 1979, increase in foreign debt due to extreme public spending during Perez’s presidency caused executives to apply neoliberal policies. At the end, unsuccessful management and lack of progressivity in technology lead to percent of the people who are under the breadline to increase from 10% to 34%. (Dincer, 2017, p.47 as cited from Word Bank, 2016). Depending on that poverty, the Caracazo uprising occurred. These all caused people to search for a new president who was going to be Chavez in 1999. When Chavez won the election, he created a new system which is called 21<sup>st</sup> Century Socialism. He wanted to get rid of American hegemony and reunite Venezuela and all Latin American countries (Kaya, 2014, p.194). To achieve this, he also adopted nationalist policies. In the Chavez period, due to increase in oil prices by decreasing oil production, successful economic management rather than other politicians, and due to mission duties, which were helping people economically, poverty almost disappeared. When he died in 2013, Maduro who was the successor of Chaves took the power. After Chavez’s death, oil average production rate reached the lowest level in Venezuelan history because the chemicals which are needed to produce heavy oil were cut by European countries and oil prices sharply decreased.

The government started to monetize without control, so the inflation rate reached the maximum level and people experienced the worst conditions. Today, the situation goes bad each day.

## 2. POLITICAL ECONOMY OF VENEZUELA BEFORE 21<sup>ST</sup> CENTURY SOCIALISM

### 2.1.Gomez’s Farm

After Cipriano Castro who had confronted imperialists such as U.S. and England, general Vicente Gomez under the support of America came into the power in 1909. That’s why Gomez tried to rule the country in a way that would not harm the interests of the imperialists (Manzano&Monaldi, 2010, p.9). He also did not forget to fill the pockets of his acquaintances while doing this. In this period, number of patronages was high. General Gomez was giving the acquisition of lands which have good potential to be produced to his acquaintances and then they were selling right of exploitation of there to International oil companies.<sup>3</sup> For this reason, this period is mentioned as Gomez’s Farm in some sources<sup>4</sup>.

	Royalty	Superficial Tax	Export Tax	Other Taxes
1909 Mining Law	2%	Bs. 0.5 / ha yearly.		Landowners’ payment: one third of profits.
1910 Mining Law	3%	Bs 1 / ha yearly		Landowners’ payment: one third of profits. Exploitation tax: Bs. 2 per ton or Bs. 1.000 per concession.
1915 Mining Law	8%	Between Bs. 0.01 and 0.02 / ha yearly.		
1918 Mining Law	8%	Between Bs. 0.05 and 0.1 / ha yearly and eventually between Bs. 2 and 5 / ha yearly.		
1920 Hydrocarbons Law	15%	Bs. 5 / ha yearly.		Initial superficial tax: Bs. 1.000 on receiving the concession. Minimum exploitation tax: Bs. 1.000 yearly
1921 Hydrocarbons Law	15%	Exploration: Bs. 0.05 / ha yearly. Exploitation: Bs. 5 / ha yearly.		Initial superficial tax: Bs. 1.000 on receiving the concession.
1922 Hydrocarbons Law	Between 7.5% and 10%	Exploration: Between Bs. 0.01 and 0.05 / ha yearly. Exploitation: Bs. 2 / ha the first three years. Bs. 4 / ha the next twenty seven years and Bs. 5 / ha the last ten years.		Initial superficial tax: Bs. 0.1 / ha for exploration contracts; Bs 2 / ha for exploitation contracts.
1925 Hydrocarbons Law*	Between 7.5% and 10%	Exploration: Between Bs. 0.01 and 0.05 / ha yearly. Exploitation: Bs. 2 / ha the first three years. Bs. 4 / ha the next twenty seven years and Bs. 5 / ha the last ten years	Bs. 2 per ton.**	Initial superficial tax: Bs. 0.1 / ha for exploration contracts; Bs 2 / ha for exploitation contracts.
1928 Hydrocarbons Law	Between 7.5% and 10%	Exploration: Between Bs. 0.01 and 0.05 / ha yearly. Exploitation: Bs. 4 / ha the first three years. Bs. 5 / ha the next twenty seven years and Bs. 8 / ha the last ten years.	Bs. 2 per ton.	Initial superficial tax: Bs. 0.1 / ha for exploration contracts; Bs 2 / ha for exploitation contracts.
1930 Hydrocarbons Law	15%	Exploration: Between Bs. 0.01 and 0.05 / ha yearly. Exploitation: Bs. 4 / ha the first three years. Bs. 5 / ha the next twenty seven years and Bs. 8 / ha the last ten years.	Bs. 2 per ton.	Initial superficial tax: Bs. 15 / ha for exploitation contracts.
1935 Hydrocarbons Law	15%	Exploration: Between Bs. 0.01 and 0.05 / ha yearly. Exploitation: Bs. 4 / ha the first three years. Bs. 5 / ha the next twenty seven years and Bs. 8 / ha the last ten years.	Bs. 2 per ton.	Initial superficial tax: Bs. 15 / ha for exploitation contracts.

Figure 1: Taxes on Oil Production in each Law 1909-1935

Source: (Manzano and Monaldi, 2010).

<sup>2</sup> Dutch disease is the phenomena which is mainly about structural change in production. A favorable discovery dominates the whole economy due to its highly profitable advantages, and in time country becomes strictly depend on it. (Brahmbhatt et al. 2010, pp.1-2)

<sup>3</sup> As an example, “Max Vallandares, a Venezuelan banker, obtained Tregelles-Burch grant which is conveyed to Caribbean Petroleum, a subsidiary of General Asphalt.” (PDVSA, n.d.)

<sup>4</sup> The Prize which is very important book for oil sector is one of the examples.

Gomez chaired nearly 20 years between 1909 and 1935. He tried to keep royalties appropriate for the imperialists until his last time that he was head of Venezuela, while other executives were constantly raising the royalty rates in this period. Royalty rates are shown in figure 1 to understand the situation better. As a result, all of Venezuela's oil taxation policies shaped its economy.

At the first time, since Gomez had a debt of gratitude and it was necessary to take interest of IOCs interests, in 1909, the first concessions included only %1 taxation. After he started to make his pockets full of money, he became greed and increased percentage of taxes from %1 to %3. He was able to increase it just to 3 because of sunk cost<sup>5</sup> problem of petroleum exploration and reasons which are counted above. After Gomez's first presidency period ended and the well Zumaque<sup>1</sup> was successfully drilled, royalty rates increased to %8 because IOCs understand that Lake Maracaibo has a potential for commercial oil production with 200 barrels per day, and the president (Jose Gil Fortoul) who came into the power after Gomez did not give any importance to imperialists as gives as general Gomez. In 1920, the government of Victorino Marquez Bustillos who came after Fortoul, legislated the First Hydrocarbon law and royalties were fixed at %15. It was a very important step for Venezuela to profit from its sources; however, only 2 years later when Gomez took the power back, even though there is no need to take IOCs interests anymore thanks to the confirmation of very high potential of Venezuelan oil with Barosso<sup>2</sup> well blew out where 100.000b/d expelled around for 9 days, he reduced not only royalties but also other taxes.<sup>6</sup> This accident was going to affect Venezuela in many ways. Right after this explosion, IOCs understand the importance of Venezuelan oil as a high potential of the commercial source and they started to compete between them to obtain the exploitation rights of Maracaibo. Therefore, IOCs signed many agreements with no complaints. Gomez knew that it was a good chance to make money for both him and his country. Thanks to increase in both amount of production and taxes (by regarding 1909), Venezuela started to earn a huge amount of money. Figure 2 shows the increase in capital stock because of the increase in oil production. According to the graph, in 1922, production began sharply to go up and as depend on many variables such as price, number of active wells etc. capital stock of government also increased. In 1929, the production line reached its first peak and people started to leave being engaged with agriculture. It was one of the most important milestones in Venezuelan history because in time, it was going to cause Venezuelan economy become strictly dependent on petroleum.

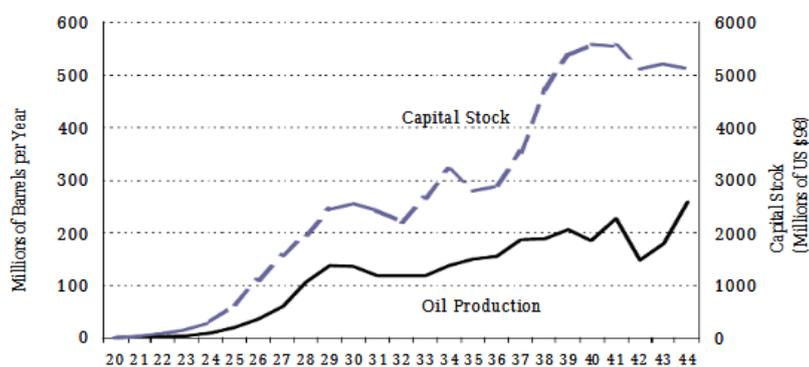


Figure 2: Effect of oil production and taxes on capital stock (Manzanao and Monaldi, 2010 (Baptista and their own calculations))

Baptista claims that in this year government revenue from oil had the biggest slice in the government's budget and it was not going to change anymore (as cited in Manzano&Monaldi, 2010, p.7). Moreover, Dincer (2017, p.29) mentioned that Venezuela whose main product was coffee in agriculture, is importing it now. Despite the short dip in 1930, word depression, production line, and capital stock line kept increasing until the end of Gomez's period. Venezuela had been rich enough in the long run. After Gomez, the dictatorship system was started to be left step by step and the new system was going to direct the head of Venezuela ship in the future.

## 2.2. First Democratic Step and Fifty-Fifty Agreements

Eleazar Contreras, who came to the power after Gomez, was a leader who defended the superiority of democracy and the interests of his country even though he was the successor of Gomez. Therefore, he limited the presidential term to 5 years and banned a president from being re-elected. Cox (2018, p.327) in his article said ' While López Contreras undoubtedly must be credited with setting the course that led Venezuela from the depths of personalist authoritarianism ultimately to democracy, his tenure was only a first step.' Cox was right because after this step, the Venezuelan workers' confederation and many parties were formed during this period. After Eleazar's period, Isaiah Medina who was the presidential candidate of the Democratic Party and shared the same democratic ideas which are

<sup>5</sup> Sunk costs are expenditure that has already been made with some objective, but which cannot be recovered if that objectives abandoned (Covey, 2010, p.98).

<sup>6</sup> Manzano and Monaldi (2010, pp. 9-10) defined these taxes as Superficial tax (in bolivars per hectare per year), exploitation tax (in bolivars per ton of oil extracted), initial superficial tax (according to the number of hectares assigned to the concession).

protecting the interests of the country with Eleazar became the new president. New parties were also established in this term.<sup>7</sup>

These newly formed parties have demanded a reconsideration of all oil treaties signed by Gomez so far because these treaties provided some illegal advantages to IOCs. These parties also claimed that companies did not pay their taxes regularly. Accordingly, the government started to judge these IOCs and ask them to pay money for compensation.<sup>8</sup> Moreover, in this period, presence of the items which were against the national interests was noticed in the taxation system and Medina's government renegotiated with IOC to decide the oil original concessions to solve this problem. Some of these problems;

- ✓ Production tax which was dependent per ton produced and superficial tax charged over hectares of land in use was not able to catch the advantages in oil price increase. Thus, in this economical approach, when the prices increase, since these taxes does not depend on price, the Venezuelan government's marginal take was not affected.
- ✓ These taxes were collected in bolivars. Therefore, they were also affected negatively from exchange when the bolivar depreciated against foreign currency and when inflation rates were too high. Moreover, devaluation was another problem because currency devaluation causes value of country's currency to go down against foreign currency (Krugman& Obstfeld, 1999). Therefore, it becomes cheaper for IOCs to pay some of their taxes which depend on bolivar.
- ✓ In addition, royalty rates were also low by considering the confirmed oil production potential of Venezuelan and low sunk cost.

Because of all these reasons, under the appropriate conditions where there was a great need for oil in World War 2 and Mexican nationalization, The Hydrocarbons Law of 1943 was approved. At first, it was opposed by IOCs fiercely because of the sharp decrease in company gross income. However, in a short time, they found themselves in a situation that they have to accept since many concessions were going to lapse soon. By this law, the royalty rate increased to minimum %16.67 and oil income tax was established for the first time. At the same time, oil exploitation rights were extended for 40 years on behalf of IOCs. In addition to that, in the presidency of Perez Jimenez surge tax was also established to keep average governmental take over %50 in case of any oil price down. Figure 3 is shown below to make the situation clearer.

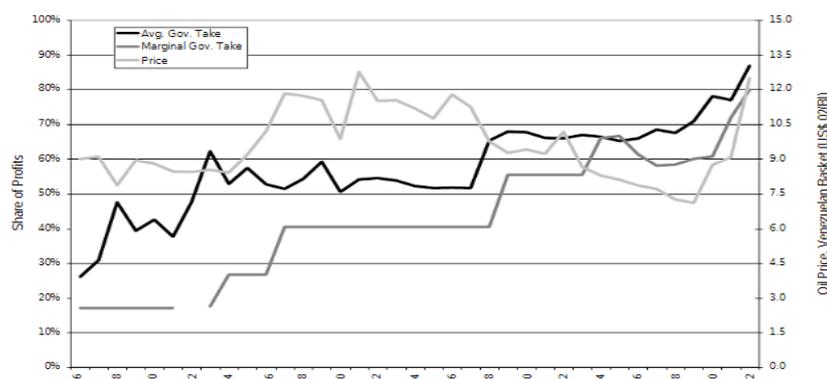


Figure 3: Effect Of Surge Tax On Average Government Take (PODE, Ministry of Energy and Mines)

With the new taxation system, after 1943 average governmental take never goes below %50. Despite there was no need to apply surge tax until 1966, when the oil prices sharply decreased, these new systems provided Venezuela keeps its profit over IOCs. Here, until 1966 oil price decrease was compensated by oil income tax.

### 2.3.The Reign of 40 years: The Punto Fijo Period

Despite all these democratic movements, in 1958, with the gathering of many parties, a group that called themselves the patriot junta staged a coup because of the fact that democracy was not fully implemented after Eleazar and Medina, and then took the administration. These parties signed the Punto Fijo pact. This period which was named contract democracy, lasted for about 40 years and participants of Punto Fijo pact decided not to coup anymore when one of them is selected. Coppedge (2002, p.9) in his paper mentioned that thanks to the democratic regime, guerrilla movements, terrorism, and several coup attempts were inaugurated and clean elections started to done every five years. Also, the parties would share the country's oil revenues equally, regardless of power (as cited in Dincer, 2017, p.46).

<sup>7</sup> Democratic Action (AD) was founded on this date, and later on, its name was heard frequently throughout the Venezuelan administration history.

<sup>8</sup> Tugwell (1975) claims that in 1938 Mene Grande (gulf) paid 10 million dollars.

Ramulo Betancourt won the first democratic elections held in 1959. Betancourt adopted the Import Substitution Industrialization (ISI) model.<sup>9</sup>

Accordingly, a Venezuela oil company (CVP) was established and protectionist policies were implemented. The aim was to shape the petroleum resources of the country according to the state's interest and to make agricultural incentives with the money coming from here. While being successful in the first of these objectives, agricultural policy was not maintained. In 1957 oil prices started to decline. IOCs started to lose their dominance on the oil sector because of not being able to satisfy oil demand. In order to compensate governmental take and create cash to achieve these two aims mentioned above, in 1958, tax rates increased unilaterally by the government with the 'Decreto Sanabria' agreement. They did this mainly by increasing the oil income tax and surcharge tax as additional. Amount of increase in these taxes is shown below in figure 4.

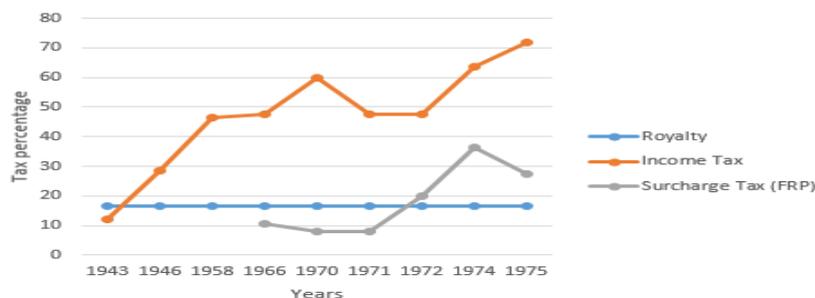


Figure 4: Tax Rates (Our own study)

Even though this increase was not enjoyed by IOCs, due to loss of their power in the sector and the technological improvements in the oil industry such as well logging and tests, it was accepted. Loss of money due to price decrease was compensated by production increase. Figure 5 shows the production increase due to technological discoveries.

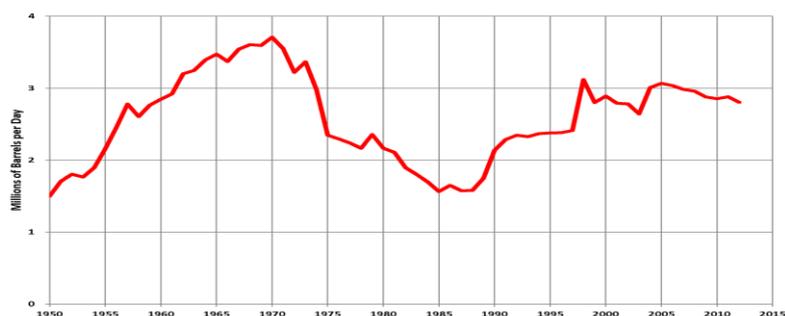


Figure 5: Venezuela's Production Of Crude Oil, 1950-2012  
Source: (Wikipedia, 2013 by Plazak)

In 1960, with the efforts of Betancourt, OPEC was established by Venezuela, Kuwait, Iran, Saudi Arabia, Iraq and laws that provided more control to the government were adopted, although it was not exactly considered as nationalization. OPEC's aim was to play a decisive role in pricing by controlling production volumes; however, although they had more than half of the world's proven oil reserves with 200 billion barrels in 1960<sup>10</sup>, it was not successful until the 1970s, because member states did not comply with the quota limits. By 1973, OPEC cut the production to punish America and some other countries since they supported Israel in the Yom Kippur war. Then oil prices soared up to \$ 10 based on the supply-demand economic principle where the prices increase when the supply decrease (See Figure 6).

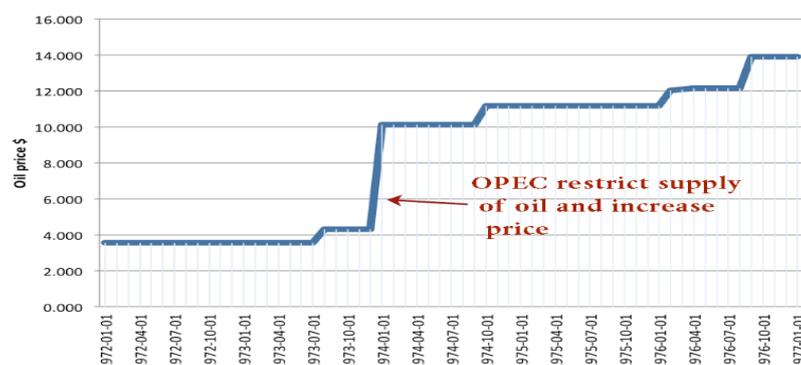


Figure 6: Effect Of OPEC Embargo On Crude Oil Price

<sup>9</sup> This economic policy was practiced almost throughout Latin America at that time (Dincer, 2017, p.31).

<sup>10</sup> BP statistical review of world energy, 1997

Source: (www.economicshelp.org, 2018).

Right after this increase, Carlos Andreas Perez from Táchira was selected in 1974. Perez also supported the protective policies, so he nationalized most of the important government institutions and established the national oil company PDVSA in 1976 to gain more profit. He also took some of the rights of IOCs with another unilateral decision. After these attempts, IOCs decided to stop their production and go because both the tax conditions were bad and threat of the government nationalization caused them not to see their future. When IOCs started to leave the country, government could not achieve the same amount of production because not only Perez but also previous presidents had not given importance to technological improvements. Adelman (1987) also claims that although the Venezuelan government wanted to follow its nationalization policies, it did not prepare for it. Therefore, it did not give importance to technological developments and consequently PDVSA, which was established in the name of nationalization, failed. Moreover, during his presidency, Perez tripled public spending. The public was happy, but government debt was increasing (See figure 7). Oil revenues could not cover these expenses.

Luis Herrera who came after Perez, took the opposite steps against Perez's policies. He restricted state intervention in the economy and lowered protectionist tax tariffs. However, instead of correcting the economy, because of the petroleum crisis occurred in 1980<sup>11</sup>, he raised foreign debt of the country to about 40 billion. The people, who did not forget about the prosperity of the 1970s, brought Perez to the administration again. Although Perez clearly criticized the IMF policies, he did not want to repeat his mistakes and this time adopted neoliberal policies. During this period, many institutions and organizations were privatized, and right after his term, many agreements (Orinoco, Exploration and Operational Service Agreements) were signed by IOCs; however, the country's economic problem was not solved. On the contrary, the unemployment rate increased from 10% to 34% (as cited in Dincer, 2017, p.47).

The Punto Fijo era, known as contract democracy, ended in 1999 when Chavez came to power. At the end of the 41-years period, a huge amount of dollars from oil income was distributed by elites gathered around this pact, and unfortunately the country could not benefit from these revenues effectively.



Figure 7: External Debt of Venezuela

Source: (World Bank, 2020).

### 3. POLITICAL ECONOMY OF VENEZUELA AFTER 21ST CENTURY SOCIALISM

#### 3.1. The Bright Face of Socialism: Hugo Chavez

The Chavez era was a period in which the country's economy was able to advance and develop slightly compared to other presidents, although there were cases of corruption. In this period, the increase in oil prices, the development of economic relations with foreign countries and the correct implementation of nationalization policies improved the country's economic situation and reduced the poverty rate of the people. The poverty rate decreased from 20% to 10% (World Bank, 2020). Simply looking at them, it can be clearly expelled that the public embraces socialism and supports Chavez.

Chavez first attempted a coup in 1992 with army officers who supported him because of the neoliberal policies implemented by the previous presidents and increasing the external borrowing rate. Despite this unsuccessful attempt, people suffering from poverty brought Chavez to management in 1999. The aim of Chavez was to make maximum use of the energy resources of Venezuela, to raise oil prices in order to make Venezuela a rich country, and to end the dependency on America in order to make the country freer. To do all these, he first changed the constitution. After the new constitution was approved, Chavez changed the economic policy of the country. The Hydrocarbon Law of 2001 was established.

Accordingly, while the royalty rate was increased to 30%, oil income tax was set to 50%. With this law, production income of government went up to %80 (Lifsher, 2001)

<sup>11</sup> Due to the price hikes of the 1970s, oil importer countries reduced their dependence on oil. The decrease in demand caused oil prices to decrease (Hamilton, 2011, p.18).

Oil service agreements, Orinoco Agreements and Exploration Agreements which started especially during the period of Rafael Caldera (1994-1999), caused the treaties to be in favor of international companies due to the inadequate investments of the country and caused the decrease of oil revenues of Venezuela. Manzano & Monaldi (2010, p.26) claims that IOCs paid only 34% non-oil income tax and very low royalty up to 10% for some of the areas instead of 16.67% royalty and 67% income tax. As a result of profitable treaties, the interest of the IOCs was withdrawn and foreign investments accelerated after 1994. When we look at Figure 8, it can be easily seen that the investments, which are around 2-3 billion, have reached around 7-8 billion by 2002. This is an indication that the Caldera administration is successful in attracting foreign investors. However, the country's profit rate was lower due to low tax rates. In addition, the state's national oil company rested its back on foreign investment and made no progress on this matter. Chavez followed a very smart way to turn this situation in his country's favor. The first 6 years did not break these treaties and did not touch the tax rates even though the new Hydrocarbons Law was accepted in 2001. The reasons for this are;

- ✓ The treaties had certain sanctions, and the low oil prices between 1999-2002 would not compensate for this.
- ✓ Orinoco projects were not completed, so investors could give up these investments in case of any expropriation, and therefore the investments would not be in the status of sunk costs.
- ✓ The economy of Venezuela, which weakened after the actions in 2003, needed the investments of the IOCs in order to gain strength.

After six years, in 2004 Chavez increased royalty rates from 1% to 16.67% for the extra-heavy Orinoco projects. In 2005, the government increased royalty and income taxes of both OSA and Orinoco AA projects to 30% and 50% respectively because IOCs produced more than the authorized level decided by Congress. Then, tax rates of the Exploration (Re) agreements were also increased and royalty rates become 33.33% for OSA agreements. McCoy and Myers (2004) explained that according to this political approach IOCs were wanted to pay more to be able to produce Venezuelan oil (as cited in Dincer, p.38). When it comes to 2007, PDVSA's share in these projects increased to about 80% by forcing IOCs to renegotiation or expropriation. Most of the companies accepted the renegotiations because they had already invested huge amounts of money for the projects and Venezuela was one of the few countries which allow companies to invest for its oil. On the other hand, some of the companies such as Exxon-Mobil, Conoco and ENI did not accept the conditions that imposed by the government and went for arbitration.

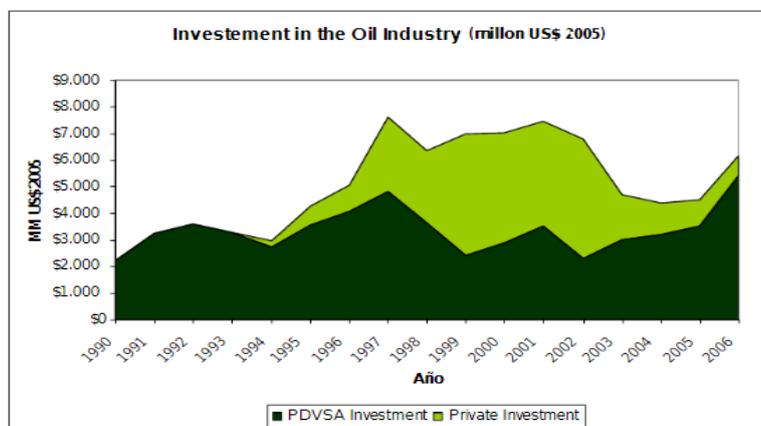


Figure 8: Investment In The Oil Industry

Source: (Manzano and Monaldi, 2010).

While Chávez was doing all these things, he was also dealing with the pressure of the US and Punto Fijo Pact elites, and he was also working for the welfare of the people. Because of Chávez's strict Bolivarian attitude and the regulations, he made in the constitution, up to this time, for 40 years, the wealthy who shared oil revenues among them fell into fear. Therefore, they started making anti-Chavez policies. In addition, since Chávez desired to get rid of the hegemony of America and adopted nationalization policies by taking steps in this direction, he disturbed the US. Especially in 2001 and 2003, the fact that the US had problems with Afghanistan and Iraq in the middle east and that Hugo Chavez supported these countries led to a deadlock between these two countries. Moreover, in the event of a possible problem with the Middle East, oil could easily be obtained from Venezuela right next to the US. Because of all these advantages, it had to be controlled definitely (Billig, 2004). For all these reasons, the US and Venezuelan generals who supported the US united and caused an uprising in the country by provoking PDVSA workers and managers towards the end of 2002. As it is claimed by Guerrero & Romero (2016, p.79) the government fired 18,000 employees and managers who were from the financial and human resources department. While this helped the Venezuelan government gain full control over PDVSA, it caused a dramatic reduction in oil production due to the lack of skilled workers. From figure 9 it can be easily seen that in late 2002 and early 2003, the oil production amount declined to 700,000 bbl per day only. This was a serious problem for Venezuela, whose whole economy is

based on oil. Moreover, this was not the only pressure that the US exerted against Venezuela. Venezuela was tried to be worn out by the embargoes, which were applied in the following periods after the escalation of the events.

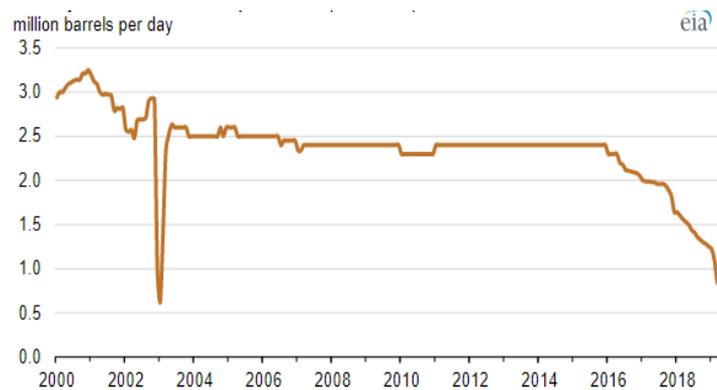


Figure 9: Venezuela's Crude Oil Production

Source: (U.S. Energy Information Administration (EIA))

After this attitude of the US, Chavez reduced the dependency on America by making export agreements with Russia and other countries, especially China. Li & Wang (2016, p.818) assert that Venezuela and China signed 11 new oil for loan agreements in 2007. In line with these oil for loan agreements, Venezuela was taking out large loans from China and paying them as oil within certain periods. China was also helping Venezuela with the equipment needed to extract oil. In this way, the economy of Venezuela was reviving and it was able to meet the increasing energy needs of China, whose economy was developing rapidly. Moreover, many agreements were done by Taiwan too. But while doing so he acted wisely. He did not cut the oil export to the US directly. According to the OEC Venezuelan oil export to the US was 65.4% in 2007 while it was only about 10 percent of US imports. Therefore, direct cut would be a serious problem for Venezuela. Between 2007-2013, Venezuelan oil export to China increased from 4.68% to 11.7% and oil export to the US decreased to 29.5% which was almost equal to the oil export rate to Taiwan (28.4%) in the same year. The U.S, which gradually lost its dominance over Venezuela, repeatedly attempted coups to lower Chavez from his seat. There were even reports that whether America would intervene in Venezuela for a while. It was a big challenge for Venezuela that the US implemented the Venezuelan arms embargo and did not sell the F-16 aircraft parts. Thereupon, Chavez increased his military power and found a new ally by signing treaties with Russia. Thus, a possible intervention problem was solved.

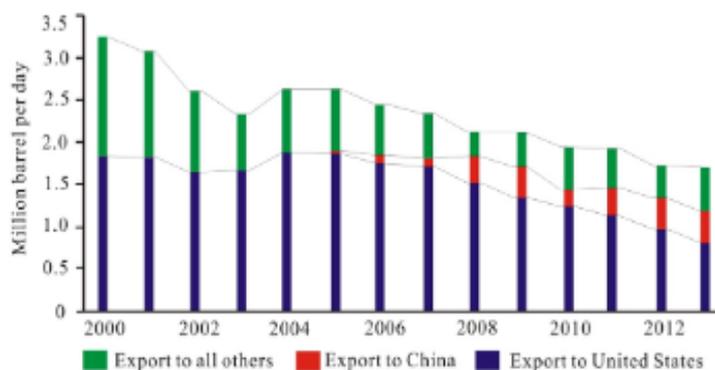


Figure 10: Venezuela's Crude Oil Export 2000-2013

Source: (Li and Wang, 2016).

During this time, there have been attempts to coup Hugo Chavez several times, but all trials have failed because Chavez was a leader loved and supported by the majority of the people. He adopted an opinion that he especially described as 21st century socialism where the country's wealth was used for the benefit of the people. Therefore, he was providing the welfare of the people with economic improvements and the people who became impoverished due to the mistakes of the previous rulers saw Chavez as their savior. In that line, a national development institute, FONDEN was founded in 2005 to provide food to the public at lower wages and to pursue various benefits as in socialist orders. However, in order to ensure the continuity of these aids, it was necessary to ensure the continuity of revenues. Venezuela, which was dependent on oil revenues, especially due to the Dutch disease, had 3 ways to achieve this. One of them was to increase oil prices, the second one was to increase oil production and the third was to increase the tax rates. Chavez was aware of all this. When he first came to management, OPEC did not comply with production quotas, and oil prices were low due to the supply-demand phenomenon of the economy. Therefore, he spoke with OPEC leaders and convinced them to cut oil production, so oil prices rose. Then, he changed the tax rates IOCs paid and increased the country's oil revenues. Lastly, as it is seen from the figure 8 investments of PDVSA to oil sector went up to 5 billion dollars and production amount was tried to be increased. Moreover, with the Oil Sowing Plans, which were planned for 6 years periods, investments to oil sector were continued. All these

actions help Venezuela to live a very bright period and sharply increased the GDP which was going to help the proportion of those living on the hunger threshold fall from 30% to 11% (World Bank, 2020). Although Chavez's name was occasionally mentioned with various corruption in some sources, he was able to keep the Venezuelan economy plus thanks to both increasing oil prices and his nationalistic policies until his death.



Figure 11: GDP of Venezuela 1960-2013

Source: (World Bank, 2020).

### 3.2. The Path from the Bus Driver to the Presidency: Nicolas Maduro

After Chávez's death, Nicholas Maduro who was a bus driver, came to the presidential chair first by proxy and then by election. Upon Maduro winning the elections with little vote difference, the U.S. said that it would not recognize the election results and showed that it was going to be a problem for the country from the very beginning (Dincer, 2017, p.44). Maduro, like Chavez, had to deal with these problems on the one hand, on the other hand, he had to continue the aid to the people to fulfill the requirements of socialism. But things did not go well during his period. Maduro, who has a socialist thought like Chavez, has made the country's economy terrible because of the falling oil prices, the inability to resist the American embargo, and the implementation of wrong economic policies.

Just before Maduro came to the power, the Chavez government devalued the bolivar of Venezuela. Due to this situation, Venezuelan money has lost value against foreign currency and budget started to have deficit. In fact, the aim was to reduce spending on imported products and enable the country to produce in areas other than oil. However, this plan did not work because the country was not able to provide products in other areas and was completely dependent on foreign for basic needs. Maduro began to print money uncontrolled which caused the inflation rate to go up to address its growing budget deficit and to create budgeted for public spending (Brown et al. 2021, p.9). Over time, the situation got worse. According to IMF data, the inflation rate of Venezuela increased to 476% in 2016 and 1,660% in 2017 (Koech, 2016, p.4).

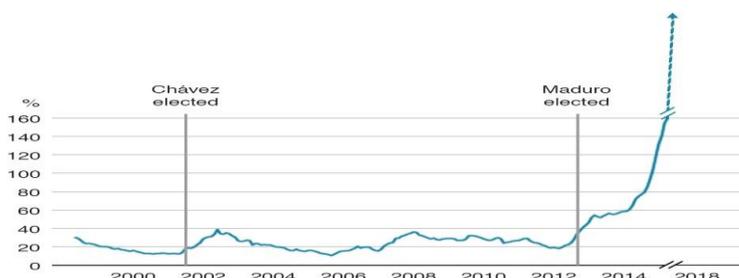


Figure 12: Inflation Rate Of The Venezuelan Economy

Source: (Bloomberg and Reuters).

After these developments, Maduro started to apply the price control system in order to control the increasing inflation. Accordingly, the foreign currency was going to be purchased at a certain price. This situation led to the emergence of black markets. People who changed the foreign currency in exchange for higher bolivar in black markets caused a decrease in the amount of dollars in the marketplace. Therefore, the inflation rate climbed faster. According to IMF again, the inflation rate of Venezuelans in 2019 reached 200,000%.

Oil prices, which fell sharply from 120 USD to below 50 USD after 2014, hit the Venezuelan economy and Maduro's management second time. The wells in Venezuela were old. Therefore, production was low. Due to the lack of necessary technological developments and insufficient investments, the production could not yield efficiency. Also, the fact that the oil here was extra heavy was another reason that made production difficult. To extract the oil, it had to be diluted first with naphtha or some other chemicals, and these chemicals were imported from Europe. These products were unavailable to obtain due to the fall in oil prices, the inflation problem in the country, and the American embargo. As a result, as can be seen from figure 9, production fell from 2.4 billion barrels per day to only 800 thousand barrels. These economic difficulties caused the public not to meet their basic needs. The financially troubled administration could not import these products. According to Encovi's 2017 research results, 6 out of each

10 people in the country were going to bed on an empty stomach because they did not have money to find food (BBC, 2019). As a result, the Maduro administration, which has the same idea as Chavez but cannot maintain the same economic stability, has dragged the country to an economic impasse and led the Venezuelan people to become super poor.

#### 4. CONCLUSION

Gomez, who was president of the country in the first years of Venezuelan oil, has made several arrangements for the country, but he was one of the leaders that mostly called with corruption. Many agreements were made with IOCs during this period due to the newly discovered oil potential in Venezuela. However, increasing the tax rates too late caused the government to profit less from oil income. According to McBeth (1983), although tax rates increased with the approval of the First Hydrocarbon Law in 1920, average oil taxes between 1922-1935 was equal to 8.4%. Later, a democratization period started with Eleazar and Medina and this process was completed with the Punto Fijo pact established in 1958. In this term, Medina increased the country's tax rates to over 50% with the fifty-fifty treaty. This agreement was a turning point for Venezuela. Venezuela started to earn a lot with the increased tax rate. After the Action Democratica party came to power with the Punto Fijo pact, a 40-years period was lived in which the majority of the oil revenues were shared among the elites. During this time, OPEC was established. Although oil prices increased due to OPEC's cut of oil production in 1973, the poverty rates in Venezuela increased even more, rather than falling, due to uncontrolled public spending and neoliberal policies that were followed. Then, in 1999, Chavez came to the administration and the country switched to socialism. During the Chavez era, completely nationalist policies were adopted and the country started to make 60-80% profit from oil revenues with increased tax rates as a result of these policies. Moreover, the increasing oil prices in the Chavez era almost made poverty forgotten. He also gradually brought 21st century socialism to the public by providing low-priced products and services during his period. By the time of Maduro, everything went wrong. The devaluation decision which was taken just before Chávez's death diminished the value of the country's money. Maduro printed uncontrolled money to correct this situation and as a result, inflation increased. In the same period, oil prices fell, and American embargos tightened. Lastly, Venezuela became unable to supply the chemicals it needed to extract oil, so the biggest famine in Venezuela's history was experienced by people.

In conclusion, Venezuela currently lives in poverty despite very rich underground resources., not because of the idea of socialism, but because of the sum of the right and wrong policies followed by each president coming to the administration and the negative effects of some events on oil prices.

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