



MAY 2023

Venezuela as a Petrostate

Satyansh Tomar

Edited by Aryan Gupta

About the author

Satyansh Tomar is a postgraduate at the Jindal School of International Affairs and is Research Intern at the Centre for Security Studies, JSIA.

About the Centre for Security Studies

The Centre for Security Studies (CSS) was established in 2020 as the Jindal School of International Affairs' first student-run research centre under the aegis of Prof Dr Pankaj K Jha. Researchers at CSS – through in-depth analysis briefs and events, reports, policy briefs and print publications – explore both regional and thematic topics in the broader field of international security studies. The concept of international security has been expanded to reflect not merely the study of state security, but also include topics like ethnic, sectarian and religious conflict; civil wars and state failure; cyber and space warfare; resource-related security issues; the proliferation of weapons of mass destruction; defence economics and also the role of ethics or morality in the formulation of security policies. The complexity of these matters is what the Centre for Security Studies attempts to unfold. Please refer to www.cssjsia.com for further details, and follow the Centre's social media platforms for critical news and research updates:



www.linkedin.com/company/jindal-centre-for-security-studies/



www.instagram.com/css_jsia/



https://twitter.com/Css_Jsia

Get in touch with us through email: css@jgu.edu.in

Important disclaimer

All views expressed in this publication belong to the author and do not reflect the opinions or positions of the Centre for Security Studies. While researchers and editors at CSS strive towards any instances, CSS as an organisation does not take any responsibility for any instance of plagiarism committed by any authors. The onus to ensure plagiarism-free work lies with the authors themselves.

IB2305003

Introduction

Venezuela is a South American country renowned for having the largest reserves of oil in the world and has long been recognized as a petrostate. A Petrostate is defined as a country that is heavily dependent on oil exports for its economic sustenance. With one of the world's largest oil reserves, Venezuela's oil industry has historically played an important role in shaping its economic policies, political landscape, and social dynamics. This dependence on oil while initially beneficial, has led to a unique set of challenges and complexities for the country as the resource is exploited irresponsibly. In order to make sure that a country does not go through an economic crisis, the concept of petrostate needs to be studied, with Using Venezuela as an example, we can explore the concept of a petrostate and the ramifications of heavy reliance on a single industry and understanding how the intricate relationship works between oil, wealth, governance and the Venezuelan society as a whole.

Venezuela is a standard example of a petrostate, as most of its economy is dependent on one sector which is the oil sector. Most of its income comes from the exports of fossil fuels, and in order to keep that under control, the power of the country is concentrated. This can be a problem in itself as there's a chance that the resource will be exploited, instead of using it responsibly. The political institutions governing the country are weak and they have little to no control over the daily affairs of the country. In addition to this, a petrostate generally has high levels of corruption. Venezuela is ranked 177 out of 180¹ on the 2022 Corruption Perceptions Index. Venezuela has the world's

¹ "2022 Corruption Perceptions Index: Explore the Results," Transparency.org, accessed August 13, 2023, <https://www.transparency.org/en/cpi/2022>.

largest oil reserves, with 18.2%² of the world share. It is also a part of the Organization of Petroleum Exporting Countries (OPEC), which controls almost 80% of the world's oil³. A quarter of that is under the control of Venezuela, which cements its position in OPEC. But irresponsible use of this oil has led to a case of hyperinflation, in which even a basket of food costs equals 22 minimum wage salary. This has led to one of the worst humanitarian crises of all time in which the Venezuelan economy has collapsed and there are no signs of any revival.

Dutch Disease

All the above arguments direct us towards the Dutch Disease, which is an informal term referring to a situation in which a government develops an unhealthy dependency on natural resource exports which could be detrimental to the growth of other sectors. Petrostates are generally vulnerable to Dutch Disease⁴. The term was first coined in 1977 to explain the situation of the Dutch economy, which was dependent on the oil resources that were found in the North Sea. In a typical case of Dutch Disease, the country in question sees a resource boom economically and attracts large sums of foreign capital in the form of Foreign Direct Investment (FDI). This in turn leads to an appreciation of the currency as compared to other currencies. A drastic increase in the number of imports is observed. This boost in the number of imports is due to the fact that the

² “Venezuela Oil,” Worldometer, accessed August 13, 2023, <https://www.worldometers.info/oil/venezuela-oil/>.

³ “OPEC Share of World Crude Oil Reserves,” OPEC, accessed August 13, 2023, https://www.opec.org/opec_web/en/data_graphs/330.htm.

⁴ Satu Santala and Nicole Kearse, “Dutch Disease: An Economic Illness Easy to Catch, Difficult to Cure,” Brookings, March 9, 2022, <https://www.brookings.edu/articles/dutch-disease-an-economic-illness-easy-to-catch-difficult-to-cure/>.

imports are cheaper than ever as the currency of the home country has appreciated, and people start preferring quality goods or services of other countries over the domestic ones. This takes away the labour and capital from other sectors of the economy, including agriculture and manufacturing, which are more important for the growth and competitiveness of a country. Due to this, the labour-intensive industries start lagging behind others. This directly contributes to the rise of unemployment in the country. Therefore, the country does not give enough importance to its essential industries and develops an unhealthy dependence on the exports of natural resources.. They derive their oil wealth by putting high taxes on foreign drillers. Petrostates are more prone to the Dutch Disease and have certain specific symptoms, which are:

1. The Government is heavily reliant on the export of oil and natural gas.
2. Economic and political powers are highly concentrated in an elite minority.
3. Political institutions are diluted and unaccountable.
4. Widespread Corruption.

Evolution of the Petrostate

In 1922 Royal Dutch Shell geologists found oil at La Rosa, a field in the Maracaibo Basin⁵. In a few years, more than 100 foreign companies were producing oil and had the backing of Juan Vicente Gomez, who was the dictator of Venezuela from 1908 to 1935. Annual production of oil in Venezuela expanded and resulted in massive economic gains. By 1929, Venezuela became the 2nd largest producer of oil, just behind the US, and by 1935, Dutch Disease had settled in due to

⁵ “Venezuela: The Rise and Fall of a Petrostate,” Council on Foreign Relations, accessed August 13, 2023, <https://www.cfr.org/backgrounder/venezuela-crisis#chapter-title-0-5>.

this dependency. Due to this, the Venezuelan Bolivar ballooned. The oil in Venezuela shoved aside all the sectors and their growth stunted. Oil accounts for 90% of Venezuela's total exports⁵. By the 1930s, three companies, namely Royal Dutch Shell, Gulf, and Standard Oil, controlled 98% of Venezuela's oil market⁵.

Such large-scale involvement of foreign companies in the country's resource management affects its politics in adverse ways. Due to this, Oil reforms were carried out in Venezuela to make sure that these companies don't enjoy a lot of power in the country and most of the profit stays back in the country. The **Hydrocarbons law** was introduced in 1943 which required these foreign companies to give half of their oil profits to the state leading to the government's income skyrocketing and this went on for a while. 1958 saw the rise of democracy after a succession of dictatorships, in which the first stable elected democratic government was set up. However, this was followed by the infamous **Punto Fijo Pact**, in which the three major political parties were guaranteed state jobs, and the oil rents would be divided among themselves in proportion to the votes received by them.

In 1959, **Romulo Betancourt** became the president of Venezuela and is also known as the **father of Venezuelan democracy**. The purpose of the Punto Fijo pact was to act as a guard against dictatorship and strengthen Venezuelan democracy. The profit earned by Venezuela was concentrated with the state, and it was still not going to the public. It helped in stabilizing Venezuela as a democracy and led to one of the most stable periods in the history of Venezuela.

Just two years after this in 1960, a landmark decision was taken by the oil-producing countries to establish the Organisation of the Petroleum Exporting Countries (OPEC). The founding members of OPEC were Venezuela, Iran, Iraq, Kuwait, and Saudi Arabia. This was done to influence the oil market and maximize oil profit by controlling the price of oil all over the world. 1960 was also the year when Venezuelan Petroleum Corporation was established to regulate petroleum-related activities in Venezuela. The tax on oil companies that were producing oil in Venezuela was also

increased to 65% of the profits earned⁶. This helped the Venezuelan economy even more. In the 1970s, the world saw the oil boom in which oil prices skyrocketed. This was a direct consequence of 1973's Yom Kippur War, which led to a five-month embargo on Israel-supporting countries. During this time, the prices of oil increased 4 times that of pre-war prices. Venezuela became the country with the highest per-capita income in Latin America.

In 1976, amid the oil boom, the President of Venezuela, Carlos Andres Perez nationalized the oil industry by creating a state-owned company, by the name of **Petroleos De Venezuela, S.A (PDVSA)**. Venezuela allowed PDVSA to partner with foreign oil companies with the condition that PDVSA should have 60% equity in joint ventures⁶. PDVSA was also structured in a very different way. They made sure that the company is being run as a business with minimal government regulations. But all this was about to take a very dramatic turn.

With the 1980s came the oil glut. Oil prices all over the world plummeted in the 80s, and due to high dependence on oil, the Venezuelan economy contracted, and inflation soared. To tackle this issue, newly elected president Carlos Andres Pérez implemented free-market reforms, the so-called Washington Consensus, and launched a fiscal austerity package as part of a financial bailout by the International Monetary Fund (IMF). This provoked deadly riots in the capital city of Caracas, which were a direct consequence of an increase in gas prices, and they were brutally suppressed by the government. The government reported that only 275 people had died, but Venezuelan media reported that the number was around 3000. This came to be known as Caracazo or "Caracas Smash". This led to a huge distrust among the citizens of Venezuela on their democracy and its image of a harmonious functional democratic state was shattered. In February

⁶ "Venezuela: The Rise and Fall of a Petrostate," Council on Foreign Relations, accessed August 13, 2023, <https://www.cfr.org/backgrounder/venezuela-crisis#chapter-title-0-5>.

1992, Hugo Chavez, a military officer of the Venezuelan army, launched a coup against the president which was in response to the corrupt practices of the Punto Fijismo system. But the coup failed as there was no coordination among them. But due to his charismatic personality, he rose to national fame after this. Hugo Chavez was inspired by the 19th-century Venezuelan revolutionary Simon Bolivar. Chavez established the leftist Revolutionary Bolivarian Movement-200. As he was a teacher in the military academy, he knew how to influence the public and was famous for giving rousing speeches. He was released from prison in 1994 and decided to run for president. He promised to scrap Venezuela's age-old political system of Punto Fijismo. He won the 1998 election with the largest percentage of popular votes in the last 4 decades (56%). He takes office in February 1999 and launches Plan Bolivar 2000, which is essentially an anti-poverty program. It includes road building, house construction, and mass vaccination. He also increased the Presidential term to 6 years through a public referendum. It was the first time in Venezuelan history that a constitutional amendment was approved by a popular referendum.

There was a coup against Chavez in April 2002 as well, in which he was taken as a prisoner, but he was later reinstated in power after condemnation from the Latin American states and the US. This was mainly because Chavez was a popular figure among the general population. In December 2002, PDVSA went on a strike for 2 months, affecting the production levels adversely. Chavez fired the top management and nearly 18,000 employees of PDVSA and asked the rest to go back to their work as soon as possible. This situation had a dire effect on the economy of Venezuela. Chavez's government launched a series of wide-ranging social programs that comes under the Bolivar missions. In addition to social development, he also focused on the military aspect of the country. Chavez created a 2 million-civilian military reserve force to defend against any kind of foreign invasion.

Hugo Chavez ended Venezuela's 35-year-old military relationship with the US. Previously, the two nations had cooperated on trade and anti-narcotic initiatives. The subsequent souring of relations was due to the close relationship between Chavez and Castro. Venezuela also struck a

deal with Russia in 2006 to procure \$2.9 billion worth of arms⁷. He also developed ties with Iran, Russia, and China to move away from the US. He nationalized the telecommunication sector, the electricity industry, the central bank of Venezuela, and the Orinoco Belt which was the largest petroleum reserve in the world. In 2007, Venezuela withdrew from the International Monetary Fund (IMF) and the World Bank. Chavez wanted to develop Latin America and for this, he established the **Bank of the South**. Chavez having the support of the majority of Venezuelans went ahead and introduced a bill to make 69 changes to the 1999 constitution. A constitutional referendum was held, and this failed leading to a loss of his control over Venezuela as the referendum failed as it got 49% of the total votes.. In 2008, relations between US and Venezuela reached an all-time low, when Venezuela expelled Patrick Duddy, US ambassador to Venezuela, and called their ambassador back from the US. This was done to show solidarity with Bolivian President Evo Morales, who also expelled the US ambassador from his country, and claimed that the US is organizing a coup against him. The rivalry was not one-sided as New York-based non-Governmental watchdog Human Rights Watch released a 230-page report which was highly critical of the Chavez regime's human rights record. It said that Chavez is manipulating the country's courts and intimidating the media, labour unions, and civil society. It also said that they were doing discrimination on political grounds. The US government's Government Accountability Office (GAO) also released a report saying that drug trafficking has also increased and cited widespread corruption and the Venezuelan administration's unwillingness to cooperate with the US authorities. The US also alleged that the Fuerzas Armadas Revolucionarias de Colombia (FARC), which was Columbia's leftist paramilitary group, is being funded by Venezuelan drug

⁷ Council on Foreign Relations, accessed August 14, 2023, <https://www.cfr.org/media/25741/modal?anchor=timeline-25741>.

traffickers. In September 2009, the Chavez administration announced that they have agreed to a deal with Russia, in which Venezuela will buy \$2.2 Billion⁸ worth of arms. The deal was to buy 92 T-72 tanks and one S-300 anti-aircraft defense system. This announcement came after the tensions between Venezuela and Columbia flared up due to the FARC issue. In addition to this, the accord that was signed between Columbia and the US to use the Columbian bases in its counter-narcotic efforts. The S-300 air defense system was to guard the Venezuelan territory from any kind of US air attack. In September 2010, the opposition won 65 seats out of 165 in National Assembly. This was the first time that the Chavez government has lost two-thirds of the majority in the National Assembly. They got the majority of those seats back by redrawing the district's boundaries. After months of struggling with his health, Chavez was diagnosed with Cancer in 2011. He left for treatment in Cuba and had a quick recovery initially. His health relapsed in 2012 and a strong opponent emerges with the name of Henrique Capriles Radowski. Chavez comes back after making another recovery and wins the 2012 elections with 54% votes in his favour, by putting emphasis on economic future and domestic security. But Chavez's health deteriorated again and he had to leave the country. He selects Nicolas Maduro as his Vice President, who was formerly the Foreign Minister of Venezuela. Chavez died in March 2013 after a long battle with Cancer and lets his wish known that he wants Maduro to be the President of Venezuela. In the 2013 elections, Maduro narrowly defeats Capriles by getting 50.6% votes⁸. This leads to a new Venezuela after years of political stability in terms of the government staying in power.

Over the course of Chavez's presidency which lasted until 2013, strategic petroleum reserves dwindled, and the debt on the government also doubled during this period. Chavez also edged the country towards authoritarianism as he ended the terms limit of the presidential term, meddled

⁸ Council on Foreign Relations, accessed August 14, 2023, <https://www.cfr.org/media/25741/modal?anchor=timeline-25741>.

with the press, effectively controlled the supreme court, and nationalized hundreds of private businesses and foreign-owned assets. These decisions paved the way for Maduro to establish a dictatorship. As they were totally dependent on oil, it led to another situation that could've fallen apart anytime. That came true in mid-2014 when the global oil prices tumbled, and Venezuela's economy went into a free fall. While all this unrest was happening, Maduro took control of the country through political repression, censorship, and electoral manipulation. It is widely believed that Maduro came back into office in 2018 through unfair and undemocratic means. Washington in response to this has imposed sanctions against Venezuela over the last decade, with the most significant being the blocking of oil imports from PDVSA and preventing the Venezuelan government from accessing the US financial system. In January 2021, Maduro and his allies took control of the National Assembly after claiming victory in the legislative elections. The opposition, including Juan Guaido, who was a strong opposition leader boycotted the vote alleging that the elections are fraudulent. Regional elections that were conducted in November 2021, were also won by Maduro's party and further cemented his position. Russia's invasion of Ukraine in February 2022, and this affected the oil trade all around the world. In November 2022, to help balance the rising prices of oil all around the world, due to the war in Ukraine, the US permitted American oil giant Chevron to resume limited operations in Venezuela. In exchange, the Maduro administration agreed to hold a dialogue with the opposition following a year-long stalemate.

Way Forward

A country can take steps that might lower the chances of dependency on its money-making resource. The first thing it can do is put a lot of effort into making democratic institutions robust so that they're better able to avoid the resource curse. The best example of this practice would be Norway. The Norwegians put a lot of effort into making democratic institutions first and then moved to the resource. Strong democracies with an independent judiciary and press also help in limiting the classic petrostate problems by holding government and energy companies accountable. Low-income countries and developing countries can use the oil earnings to build a platform, which can promote private investment and long-term growth. This can be done by broad-based investing in international assets. In addition to that, building infrastructure and quality education for its citizens can contribute. Sovereign Wealth Funds (SWFs) can also be set up, which can act as a reserve in case of a contingency. Norway and Saudi have their own SWFs and

around \$10 Trillion globally are held in SWFs. Another factor that could lead to a revolution in this field would be the use of green energy. The global shift from fossil fuels to renewable sources of energy such as solar and wind power would force petrostates to diversify their economies. Venezuela needs to revive its oil sector in order to develop its other industries. It remains to be seen what the future of Venezuela will be, as it is facing one of the worst economic crises ever.

BIBLIOGRAPHY

1. “2022 Corruption Perceptions Index: Explore the Results.” Transparency.org. Accessed August 13, 2023. <https://www.transparency.org/en/cpi/2022>.
2. Cohen, Luc. “PDVSA Begins U.S. Trial over Claim Sanctions Prevented Debt Payments.” Reuters, September 21, 2021. <https://www.reuters.com/legal/transactional/pdvsa-begins-us-trial-over-claim-sanctions-prevented-debt-payments-2021-09-21/>.
3. Council on Foreign Relations. Accessed August 14, 2023. <https://www.cfr.org/media/25741/modal?anchor=timeline-25741>.
4. Dino, Danielle. “Venezuela and the Pitfalls of a Petrostate.” Concentric, October 19, 2021. <https://www.concentric.io/blog/venezuela-and-the-pitfalls-of-a-petrostate>.
5. “OPEC Share of World Crude Oil Reserves.” OPEC. Accessed August 13, 2023. https://www.opec.org/opec_web/en/data_graphs/330.htm.
6. Santala, Satu, and Nicole Kears. “Dutch Disease: An Economic Illness Easy to Catch, Difficult to Cure.” Brookings, March 9, 2022. <https://www.brookings.edu/articles/dutch-disease-an-economic-illness-easy-to-catch-difficult-to-cure/>.
7. Urdaneta, Sheyla, Anatoly Kurmanaev, Isayen Herrera, and Adriana Loureiro Fernandez. “Venezuela, Once an Oil Giant, Reaches the End of an Era.” The New York Times, October 7, 2020. <https://www.nytimes.com/2020/10/07/world/americas/venezuela-oil-economy-maduro.html>.
8. “Venezuela Oil.” Worldometer. Accessed August 13, 2023. <https://www.worldometers.info/oil/venezuela-oil/>.
9. “Venezuela: The Rise and Fall of a Petrostate.” Council on Foreign Relations. Accessed August 13, 2023. <https://www.cfr.org/background/venezuela-crisis#chapter-title-0-5>.
10. “Who Are the FARC?” BBC News, November 24, 2016. <https://www.bbc.com/news/world-latin-america-36605769>.