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COLLEGE 4

Societal Collapse and Resilience Qualitative Modelling Project 1

**The Downfall of Venezuela: Understanding the Causes
and Consequences of a Petrostate's Collapse**

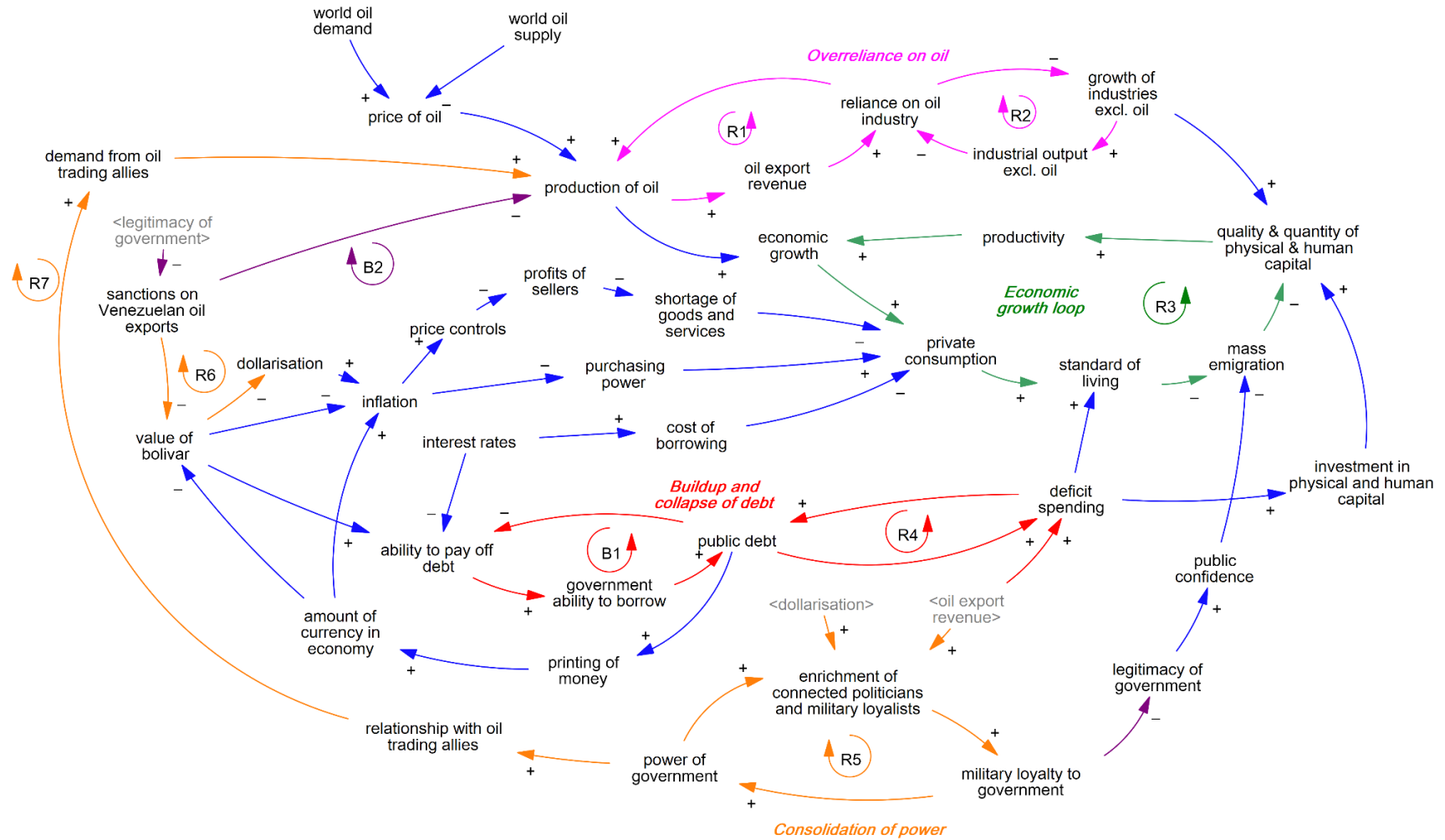
Introduction & Background

Venezuela, a country endowed with the most abundant oil reserves worldwide, is a prime example depicting the fall of a petrostate. Despite the potential these resources presented, many factors revolving around misgovernance ultimately led this nation to its downfall. Subsequently, Venezuela has been plagued by a myriad of issues including hyperinflation, mass emigration, poverty and shortage of basic necessities in recent years.

The over-reliance on oil exports is a mindset that is deeply entrenched in the Venezuelan government. In the past, this strategy worked well for Venezuela and led the nation on a trajectory of economic growth. From 2004 to 2013, oil revenue reached 700 billion US dollars, equivalent to 96 percent of export income for the country. (Ramírez, 2021) However, in 2014, the newly established Maduro government attempted to gather more power by obtaining total control of two major oil-exporting companies for the revenues earned. (Ramírez, 2021) This led to the mismanagement of Venezuela's largest sources of income thus, beginning the downward spiral of the country. Alongside the mismanagement, the declining oil prices that started from mid-June in 2014 highlighted the vulnerability to volatile oil prices that Venezuela's economy was subjected to. (Mead & Stiger, 2015)

Following the shocks to Venezuela's economy, the Maduro government attempted to salvage the situation by implementing policies such as price controls on basic necessities and the printing of money. This unfortunately led the nation even further into its demise. Hence, in this essay, we seek to understand the main factors that caused the downfall of the country once known as Latin America's richest country (Escobari, 2019). We will further analyse the consequences of Venezuela's collapse using a Causal Loop Diagram (CLD) and propose what could have been done differently to prevent the unfortunate collapse of this once promising petrostate.

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Over Reliance on oil: Venezuela's economy is dangerously reliant on oil exports due to the "Success to the Successful" structure created by two reinforcing loops: **R1**, where oil production and revenue prop up the economy (*Venezuela*, 2023), and **R2**, where this dependence draws resources away from other industries, leading to declining output and further reliance on oil (Cheatham et al., 2021). With oil export revenue constituting the bulk of exports, Venezuela is without other industries to soften the blow should the oil industry falter.

Consolidation of power: The government, under Maduro, is enriched by oil exports through nationalised PDVSA and taxes on international oil firms (Johnson, 2018), while providing financial incentives to the military to stay loyal ("Venezuela Crisis," 2021), creating a reinforcing loop **R5**. Furthermore, while the government remains in power, it seeks to maintain relationships with allies like China and Russia which drive demand for Venezuelan oil, again contributing to the enrichment of politicians and military loyalists by oil export revenue — creating a reinforcing loop **R7**. This is countered by US sanctions on Venezuelan oil, imposed in response to the decline in legitimacy of the military-supported Maduro administration and in support of the opposition led by Guaidó (Roy, 2022). These sanctions curtail oil export revenues and ultimately the power of the government, thus creating a balancing loop **B2**. However, the blow of such penalties may be cushioned. The sanctions lead to a loss in foreign exchange earnings (Weisbrot & Sachs, 2019), reducing the government's ability to defend the value of the bolivar. The bolivar devaluation increases dollarisation — the use of the US dollar instead of the bolivar — which government officials benefit from by accessing a more favourable preferential exchange rate (Curzon, 2018). This forms a reinforcing loop **R6**.

Buildup and collapse of debt: The sole reliance on oil exports means when oil revenue declines, Venezuela would turn to borrowing to support public spending — with the government running a budget deficit since the 2010s (*Venezuela Government Budget*, n.d.). To avoid the consequences of austerity, Venezuela has to continue with deficit spending, which leads to the government taking on more debt. This forms a reinforcing loop **R4**. This situation is dangerous when the government becomes less able to pay down debt as the amount of debt balloons, which in turn reduces the government's credibility and their ability to borrow (Yapur, 2020) — eventually limiting the amount of debt the government can take on through a balancing loop **B1**, and placing hard constraints on continued deficit spending.

Effect on economic growth loop: Adequate private consumption is needed to support the standard of living, which would retain the people of Venezuela and reduce emigration, protect the quality and quantity of physical and human capital, drive productivity growth, and ultimately economic growth. This forms a reinforcing loop **R3**. However, this loop is affected by other

variables and loops. First, money printing to combat increasing debt burdens and deficits further devalues the bolivar and causes rapid inflation (Young, 2018), price controls on necessities erode profits of sellers and causes severe shortages (Gupta, 2015), and increasing global interest rates increases cost of borrowing — all causing private consumption to fall. Second, poor growth in non-oil industries and inability to continue with deficit spending mean severe declines in the quality and quantity of physical and human capital. Third, falling public confidence due to the decline in the legitimacy of the government causes mass emigrations (Buschschlüter, 2022), which again reduces the quality and quantity of physical and human capital. The economic growth loop therefore collapses when it is being dominated by these other components.

Insights from CLD about cause and consequences of collapse

We observed that the root cause of Venezuela's collapse was likely its misgovernance and misuse of resources. Under the Chavez administration, the country had heavily relied on its oil industry for economic development. This led to a lack of diversification in the Venezuelan economy, which caused serious implications on the Venezuelan economy and is one the main drivers of its current economic and political crisis. The country hence became vulnerable to global oil price fluctuations. These problems were inherited by the current Maduro administration, who are also unable to effectively address the lack of diversification in the Venezuelan economy. This was exacerbated by a fall in Venezuela's oil revenue over recent years.

Western sanctions have also worsened the state of the country's economy. These sanctions led to a decrease in foreign investment and by cutting the Venezuelan government off international credit, the availability of foreign goods and services worsened rapidly. These sanctions also caused the Venezuelan Bolivar to depreciate significantly, which in turn led to hyperinflation (Roy, 2022). The sanctions also included a restriction in the amount of oil that the Venezuelan government could export, which severely weakened the economy as the country heavily relied on oil export revenue.

Support for Juan Guaidó, the opposition leader and self-proclaimed president of Venezuela has also had a significant impact in the collapse of Venezuela. Guaidó had been widely recognised in the international community as Venezuela's legitimate leader. This caused the Maduro administration to lose legitimacy in the perspective of the international community. The Guaidó-led opposition also attempted to force the government to hold new elections, but

unsurprisingly the Maduro administration refused to comply. This led to increased tensions between the government and the opposition, worsening the instability in the country. However, with the Maduro administration still in control of the military, and with the recent election of left-wing leaders in nearby countries, support for Guaido worsened as these left-wing leaders are in support of the Maduro administration, and have even offered support in the form of financial aid or by continuing to purchase oil from them (Aquino & Rochabrun, 2022). This enabled the incompetent Maduro administration to continue to remain in power and weakened Guaido's efforts to force the government to step down.

With the Maduro administration remaining in power, ineffective policies and misgovernance will continue to worsen Venezuela's economic struggle. Policies such as price controls, devaluation of the currency, and a lack of development of other industries all have had a detrimental effect on the Venezuelan economy. Knowing that, many Venezuelans have decided to seek a better life elsewhere, with 6 million settling in other Latin American countries (Arena & Corugedo, 2022). This further worsened the current crisis in Venezuela, and coupled with all the other factors led to the collapse of Venezuela.

What could have been done to prevent collapse

As identified previously, the root cause of Venezuela's collapse was the misgovernance and misuse of resources, ultimately leading to a failure to diversify beyond the oil industry. From the CLD, we have identified a few points of leverage.

The first point of leverage would be the reliance on the oil industry which is a variable in loops R1 and R2. In order to overcome this, more financial resources should have been channelled towards the development of other industries from the start. Subsequently, the quality and quantity of physical and human capital in Venezuela could have been enhanced. With higher quality capital, productivity in the economy for other industries would rise. Thus, these other industries will be able to contribute more to the Gross Domestic Product (GDP) and hence, economic growth of Venezuela. Therefore, the impact of external factors which influenced the demand for oil to dwindle could have been cushioned by the contributions of these other industries.

A major issue that accelerated the inflation in Venezuela was the printing of money and poor choice of policies. Due to the large amount of public debt accumulated, the government had resorted to printing money in hopes of reducing their debt. However, an increase in the amount

of Bolívar in the economy further diminished its value. This inevitably drove inflation rates even higher. This rise in inflation, coupled with the price control measures set on basic necessities led to numerous other issues. These issues include the shortage of goods and services in the economy, which acted as a catalyst to the mass emigration that Venezuela faced. In order to avoid these dire consequences, better policy planning was required and the short-term solution of printing money should not have been utilised.

Analysis of relevance of theory or if another theory better explains some aspects

Out of the various theories taught, we found that Dmitry Orlov's 5 stages of collapse seemed to be, while not completely identical, the most relevant with regards to Venezuela's collapse. Upon research on the collapse of societies in the past, he identified a typical sequence of collapse stages that they tended toward, starting with financial, commercial, political, social and finally, cultural collapse.

In Venezuela's case, the collapse started **financially** when oil prices declined in 2013 and the country entered recession. The overreliance in the oil industry and unrestrained spending despite the plummeting oil prices caused the country's descent into a huge budget deficit. This eventually led to a decrease in Venezuela's savings, build up of public debt and inflation followed. Orlov mentioned that the "extend and pretend" method has been used before, just like how the Venezuelan government denied the existence of the economic crisis, and this fails to tackle the root of the problem.

While inflation and debt occurred, the country transitioned into the **commercial** collapse stage as the government used price controls to address the inflation rates and printed more money to pay off debts. The increase in the amount of currency in the economy, accompanied by sanctions on oil exports, led to the devaluation of the Bolivar. The price controls also led to a shortage of goods and services as suppliers had less incentive or could not afford to provide them.

They continued into **political** collapse as the government had to decrease social spending due to the growing deficit. Alongside the shortage of basic necessities, the decline of the national government's legitimacy occurred as their incapability of providing for the people started to show.

As of now, Venezuela has yet to enter social and cultural collapse but seeing as how their collapse has been gradually aligning with Orlov's deductions, it is possible for them to enter those stages if they do not take the necessary action.

While Orlov's framework accurately reflects much of Venezuela's collapse, there are still certain factors not mentioned that Jared Diamond's 5 point framework covers. One of which is Venezuela's relations with friendly societies such as Russia, Iran and China. These countries have been supporting Maduro who has only continued Venezuela's downfall by committing actions like refusing foreign aid and denying the claims that Venezuela has been in a humanitarian crisis. Conversely, for countries hostile towards them, the U.S., along with more than 50 countries, recognized opposition leader Juan Guaidó as Venezuela's rightful president and they also put forth sanctions on Venezuela's oil exports. Ultimately, all of these international relations in Jared's framework and the factors in Orlov's framework collectively contributed to Venezuela's collapse.

[2000 words]

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