
The Idle Speculator™

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Deciphering Chavez

As a follow up to [yesterday's blog post](#) on Hugo Chavez, our friend Reuven Brenner suggested we revisit what he wrote about Chavez in his 2002 book, [The Force of Finance](#). We've always found the power of Reuven's work to lie in its ability to explain far reaching political and economic behaviors in sensible ways, even those that when analyzed under competing frameworks only leave you scratching your head. With that in mind, we've decided to take this opportunity to further expose our readers to Brenner's work, and to apply it to current events in Venezuela.

Understanding Entrepreneurship and Capital

The unique thesis running through [The Force of Finance](#) (TFOF) can be summed up as follows:

- Economic growth and accompanying improvements in standards of living are driven primarily by entrepreneurial innovation;
- Entrepreneurial innovation can only occur via matching of human capital (new ideas, unique talents, etc) to financial capital (bank loans, debt and equity investment, grants, etc) in a social environment where both sides are held accountable (eg, by cultural norms and political institutions that enforce contracts and property rights in a fair and transparent manner);
- Entrepreneurs have five primary sources of financial capital: savings, inheritance, financial markets, government, and crime. When the first three are not widely available, people will turn to the latter two.

Understanding Latin American Populism

One of the questions that stumps most observers of Venezuelan politics, and Latin American politics generally, is this: Why have Chavez and other leftist leaders proven to be so popular in national elections? It's an especially vexing question to those of us who believe in both the importance of capital markets and the accuracy of political markets. Reuven's discussion of the Chavez/Venezuela situation as it was unfolding in 2001 gives sound historic context to the question as it concerns Chavez, and reinforces our belief that his policies are clearly on the wrong track.

Reuven tees up the discussion by using Mexico as an example, examining the privilege and entitlement plagued system that inhibits effective capital matching. Why has Mexico's material well-being lagged so far behind its neighbors to the north? Why does the 'immigration problem' run in only one direction? The answer is common to many countries, and can be distilled into two primary developments. First, political power has been carefully protected and preserved in Mexico, allowing the politically connected to maintain control over the formulation, administration, and enforcement of laws. Second, instead of competitive financial markets, the government has exercised most control over access to credit, and the result is that capital is allocated on the basis of political connections, rather than who can do the most with it. These two factors have caused persistent economic and social stagnation, and have contributed to stubbornly high levels of poverty and a continuous emigration of human capital in search of opportunity.¹

An Evolutionary Diversion

We would note that this kind of cronyism and self-insulation is found in every political and economic system throughout history, and it's reasonable to hypothesize that these kinds of behaviors are essentially hard wired into our DNA. If we consider the antecedent human environment as one where

resource and technological constraints limited the potential availability of calories at any time, we can assume that there would be strong natural selection for behaviors that provided 'competitive insulation'. What a handful of human societies have demonstrated in recent centuries, however, is that openly competitive matching of human and financial capital transforms human existence from a zero sum game into something quite different². The critical requirement for making these newer systems viable is to have sufficient checks and balances on privilege and entitlement³ however, and that runs counter to some of our most deeply ingrained tendencies.

Coups d'Etat

When anti-competitive behaviors reach a tipping point, reactions to them can take multiple forms. In many countries, including Venezuela, the structure of the military lends itself to coup d'etat. Reuven describes the process by which these popular uprisings take hold:

...when the judiciary is corrupt, when contracts are not enforced, when members of the elite collude to keep financial markets closed, people will turn to another source of power to try to extract rights. In most of these places, the only alternative organized institution happens to be the army.

The net effect of military coups depends largely upon how they are carried out. Reuven points to the case of Turkey where, in relatively short order, power was returned to the civilian government after each coup in recent decades, noting that "Today, Turks rate the military as their most trusted institution."

The Fruits of 'Partyarchy'

Thus, when we examine Chavez within Brenner's framework, it's not surprising to see that he is a political outsider with a military background, and it enables us to make sense of his popular support. Consider the following evidence:

- In 1992, Chavez led an unsuccessful coup d'etat that followed on the heels of the 1989 anti-government riots in Caracas⁴. According to [Wikipedia](#), "The 1992 Coup Attempt in Venezuela has its origins based in the system of 'partyarchy'...From 1959, Venezuelan politics had been dominated by two major political parties...these two parties had formed themselves into a loose coalition which...soon led to problems with corruption...*Money was diverted from the government into the hands of officials. The courts who had aligned themselves along party lines were reluctant to convict those accused of corruption.*"⁵ (emphasis added)
- In 1998, Chavez was elected president. According to [Wikipedia](#), he received 56% of the popular vote, the largest percentage in four decades, running "on an *anti-corruption and anti-poverty platform, condemning the two major parties that had dominated Venezuelan politics since 1958.*" (emphasis added)
- In 1999, Chavez followed up his electoral success by convening a constitutional assembly, which culminated in the ratification of the country's [26th constitution](#) by popular referendum.⁶ It created two additional branches of government, one to provide independent oversight of all elections, the other to represent the public in its dealings with the state.
- In 2000, Chavez stood for reelection to head the reconstituted government, and received 60% of the popular vote.
- In 2002, Chavez was overthrown and arrested during a [brief coup](#) from the right, but was reinstated two days later following riots, a popular uprising of supporters, and retaking of the presidential palace by The Presidential Guard. It's interesting to note that members of the military were involved in the coup attempt, holding Chavez at a military base and attempting to force his resignation. Perhaps not surprisingly, those who had been shut out by Chavez' machinations had turned to the military to "try to extract [their lost] rights."
- In 2004, opponents secured a recall vote on Chavez' presidency, but 59% voted to retain him.
- In 2006, 63% voted for his reelection.

¿Qué significa?

We wouldn't deny that Chavez manipulates electoral and political processes to his advantage—he is a politician, after all. But he clearly enjoys a large measure of popular support. And though he continues to consolidate power in ways that will severely undermine the efficient matching of financial and human capital in Venezuela, he remains, at least to this point, an undeniable political force. Returning to TFOF, Brenner assessed Chavez in this way in 2001:

...Venezuela has been like Mexico. Behind the façade of democracy, the country has been riddled with special entitlements...the middle class (and those aspiring to it) has fallen farther and farther behind...[the election of Chavez] does not mean that Venezuelans want big government, want to move to the left, prefer dictators to democracy...people hope for enlightened despots...Chavez may turn out to be the wrong choice...there is a danger that Chavez will turn out to be a new dictator. But when the army is the only institution with the power to extract rights from corrupt governments, people do not have much choice but to support it.

The biggest risk to Chavez at this point would appear to be...Chavez. He has certainly been busy erecting political and economic facades, and has done little to enhance economic opportunity. His political future will come under pressure if he creates new classes of privilege and entitlement, and continues down the path to dictatorship. The same laws of behavior apply to everyone in power, regardless of their political stripes.

More striking to us than his future are the implications of his continued popularity, when you take into consideration his anti-growth and anti-competitive actions. Either the electorate of Venezuela are stupid⁷, a conclusion that doesn't fit with our view of the world, or the alternatives to Chavez are seen to be that much worse by a majority of the country's electorate. The latter implication does fit with our world view, and it's a distressing one, as the message from the Venezuelan electorate is this: even if our country were to become a friendlier environment to financial capital and investment, we do not expect to reap any meaningful benefits. In other words, despite the economy being worse off under Chavez in the long run, they expect to be better off comparatively. That makes Chavez the least crummy of the crummy choices available. Again, from TFOF:

If the goal is to extract rights from an entrenched establishment, Adam Smith and "free market" theories will never do. Most rulers know these theories well—that is why they want to prevent competition and keep capital markets closed. Private citizens may not be able to articulate these theories as easily, but they understand nevertheless that without a countervailing power, they will not prosper. So they are pragmatic, and try to use the institutions they have. People want to live first and philosophize later.

Aggregate measures like GDP and per capita income don't tell us everything—market outcomes like elections can often tell us a lot more. The Nicaraguan, Bolivian, Mexican, and Venezuelan electorates have all sent a similar message recently, implying widespread dissatisfaction with prevailing institutional environments. Some prominent Wall Street economists continue to prattle on about global economic imbalances and the like, but to us, the heavy lifting of globalization is to be found in the ongoing political tensions and frustratingly slow pace of development in countries like Venezuela.

Sources

Brenner, Reuven (2002). The Force of Finance. New York: Texere.

http://en.wikipedia.org/wiki/1999_Venezuela_Constitution

http://en.wikipedia.org/wiki/Venezuelan_coup_attempt_of_2002

http://en.wikipedia.org/wiki/Venezuelan_coup_attempts_of_1992

http://en.wikipedia.org/wiki/Venezuelan_presidential_election%2C_1998

Endnotes

¹ The recent Mexican elections and their aftermath provide more evidence that leftist populism is still potent.

² Importantly, these modern forms of society introduce novel selective forces on human beings. See, for example, the work of philosopher Daniel Dennett.

³ This is one reason why democracies are, in theory, the “least bad” form of government, to borrow Winston Churchill’s description. But it also shows how and why other forms of government can work, and have worked, reasonably well at times.

⁴ A second military coup that did not involve Chavez was attempted later that year, lending further support to Brenner’s thesis.

⁵ It can be asked why the U.S. political system has not stagnated under the influence of two major parties. Our back-of-the-envelope thesis is that at different times, the two parties have exhibited an openness to new ideas and/or constituencies that has kept them sufficiently responsive and flexible for the U.S. electorate’s tastes.

⁶ Chavez insisted that the constitution rename the country ‘The Bolivarian Republic of Venezuela’ after the 19th century Latin American military and political figure Simon Bolivar. At a certain level, the admiration makes some sense, as Bolivar hoped to appoint himself and his chosen successor president for life. But at another level, it’s a bit ironic, as Bolivar was an aristocrat and a great admirer of the American Revolution.

⁷ That said, we still attach a great deal of importance to education and information flows. Autocratic governments engage in propaganda and censorship for good reason.