

*Seção temática:*  
*Governança do Setor Público*  
**How resource nationalism hinders  
development: the institutional  
roots of the economic recession in  
Venezuela**

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How do institutions allow governments to manage dramatic variations of oil rents, and how do these variations impact public institutions is the twofold problem addressed here. We contend that high dependence on oil combined with low political accountability increases the economic vulnerability to external shocks. We sustain our argument with the analysis of the fiscal policies implemented in Venezuela under the administration of Hugo Chávez (1999-2012). A process tracing methodology focuses on the policy design of fiscal policies through the selection of instruments embedded in the Public Finance Management system (PFM), using a typology of the state's resources of information, authority, treasure and organization. During this period, the *constitutionalization* of the resource nationalism acted as a trigger to change fiscal policies through four major reforms including the creation of a highly centralized PFM, the takeover of the Central Bank, the reform of oil legal framework and the takeover of the national oil company, PDVSA. All of these reforms converged towards the elimination and/or manipulation of the instruments of political accountability, allowing discretionary management of oil rents and hampering the government's capacity to react to the oil price plunge, which ultimately led to the current economic recession.

**Keywords:** economic crisis, fiscal policy, public expenditure, fossil fuel, natural resources

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## **Como a nacionalização de recursos dificulta o desenvolvimento: as raízes institucionais da recessão econômica na Venezuela**

Este artigo analisa a forma como as instituições possibilitam aos governos enfrentarem grandes variações de receitas de petróleo e como esses fatores afetam as instituições públicas. Argumentamos que uma alta dependência do petróleo, combinada com baixa responsabilidade política resulta em maior vulnerabilidade a choques externos. Amparamos na análise da política fiscal implementada na administração de Hugo Chavez (1999-2012). O processo de monitoramento se concentra no desenho de políticas públicas para a seleção dos instrumentos que constituem o sistema de Gestão das Finanças Públicas (GFP) através de uma tipologia de recursos estatais de informação, autoridade e organização do tesouro. Durante este processo, a regulação constitucional do nacionalismo extractiva agiu como o gatilho para a mudança na política fiscal, através de quatro entidades que incluem a criação de um sistema de GFP altamente centralizado, o controle do Banco Central, a reforma do regulamento de petróleo, e controle da empresa petrolífera nacional PdVSA. Estas reformas convergiram para a eliminação ou a manipulação dos instrumentos de prestação de contas, o que levou a gestão discricionária das receitas do petróleo e afetou a capacidade do governo de reagir ao colapso dos preços do petróleo, culminando na atual recessão econômica.

**Palavras-chave:** crise econômica, política fiscal, despesa pública, combustível fóssil, recursos naturais

## **Cómo el nacionalismo extractivo impide el desarrollo: las raíces institucionales de la recesión económica en Venezuela**

Este artículo analiza cómo las instituciones permiten a los gobiernos enfrentar grandes variaciones en las rentas petroleras y cómo estos factores afectan las instituciones públicas. Argumentamos que una alta dependencia por el petróleo, combinada con una baja rendición de cuentas políticas causa mayor vulnerabilidad a los choques externos. Amparamos este argumento al análisis de la política fiscal implementada en la administración de Hugo Chávez (1999-2012). El seguimiento de proceso se enfoca en el diseño de política pública por la selección de instrumentos que constituyen el sistema de Gestión Financiera Pública (GFP), mediante una tipología de los recursos estatales de información, autoridad, tesoro y organización. Durante este proceso, la regulación constitucional del nacionalismo extractivo actuó como el detonante del cambio de política fiscal, a través de cuatro entidades que incluyen la creación de un sistema muy centralizado de GFP, el control del Banco Central, la reforma de la regulación petrolera, y el control de la empresa petrolera nacional PdVSA. Estas reformas convergieron hacia la eliminación o la manipulación de los instrumentos de rendición de cuentas, lo cual conllevó al manejo discrecional de las rentas petroleras y afectó la capacidad del gobierno de reaccionar ante el derrumbe de los precios del petróleo, lo que culminó en la actual recesión económica.

**Palabras clave:** crisis económica, política fiscal, gasto público, combustibles fósiles, recursos naturales

## Introduction: The current crisis in Venezuela

In 2015 and 2016, oil prices reached hardly half their average level of the 2000-2014 period. Contrary to previous episodes of sharp decline observed during the past three decades, the current trend is confirming the end of the commodity super cycle, due to expected long-term increasing supply and slowing-down demand for oil and other minerals (BAFFES *et al.*, 2015; GAYI; NKURUNZIZA, 2016; DE GREGORIO, 2015). The first mechanical effect of this price slump is to increase the fiscal deficit in oil exporting countries, particularly in those highly dependent on oil exports where current prices are below the fiscal break-even price, such as Venezuela (AREZKI; BLANCHARD, 2015; FITI *et al.*, 2016).

Since the 1940s Venezuela's politics and economy have been influenced by the existence of huge oil reserves. As of 2014 this country registered the biggest proven reserves worldwide (298.3 billion barrels, which represents 17.5% of the global supply), before Saudi Arabia (267 billion barrels), Canada (172.9 billion barrels), Iran (157.8 billion barrels) and Iraq (150 billion barrels) (BP, 2015). Three quarters of those reserves come from the Orinoco Belt and are actually made of unconventional hydrocarbons that have been included to the world reserves since 2006. As such, they are far more costly to extract than the light crude from the Persian Gulf. Yet this gives Venezuela a certain leverage on OPEC's policies and makes their diplomacy quite influential in times of skyrocketing prices (HEIDRICH, 2016; HELLINGER, 2016).

Venezuela is not only part of the Latin American exception (ROSS, 2012: 85) it is also a paradigmatic case of the "institutional" resource curse (CORRALES; PENFOLD, 2011: 72). As such, it shows how the effects of commodity price cycles on macro-economic performance depend on existing democratic institutions (VERA, 2015). Hence, Venezuela has been for long characterized as a Petro-State and a rentier economy, whose fiscal profile has been generally weak and exhibits a long history of indiscipline and pro-cyclicality (MORENO; SHELTON 2014; TALVI; VEGH 2000; OCHOA 2008; PUENTE *et al.* 2006; ZAMBRANO SEGUÍN, 2010). Yet, this country is a case of oil endowment having contradictory effects regarding economic development and democracy. While early works have emphasized the negative effects of the rentier state on democratic institutions (KARL, 1997; ROSS, 2001), more recent studies have shown that oil rents might as well underlie democracy, at least until the 1990 crisis (DUNNING, 2008; Ross, 2012).

A closer look at the relationships between institutional change and oil price variations should explain why such contradictory interpretations prevail on a single case, without twisting reality through data manipulation. Most scholars working on the resource curse thesis posit a relationship between the abundance of natural

resource rents and the weakness of political institutions, due to negative economic feedbacks of these rents<sup>1</sup>. However, existing institutions should either help governments or constrain them in order to control for the exogenous effects of price shocks and rent booming. How exactly do existing institutions allow a government to manage dramatic variations of oil rents, and how do these exogenous factors affect existing institutions is the twofold problem addressed by this article.

The following sections explain how the institutional reform of the oil sector and the fiscal policy during the period preceding the fall in oil prices (1999-2012) caused the Venezuelan economy to plunge into the current recession. First we explain why Venezuela is a case of resource nationalism, in line with recent works on the resource curse thesis. Then proceed with a description of the method of policy analysis, based on causal process tracing and instruments mix, before presenting the collected data. Section four presents and discusses the main research findings regarding the institutional reform, the discretionary takeover of oil rents by the Executive power, and their consequences on political accountability and economic development. The final section presents conclusions on the consequences of resource nationalism in Venezuela and discusses traditional policy recommendations based on the resource curse thesis.

## Background and literature review

### The resource curse thesis revisited

Some of the most recognized works on the resource curse thesis came after the double oil price shock of 1973 and 1979. They mainly focused on the paradoxically negative consequences of oil endowment for development, since many oil exporting countries experienced lower growth performance than their oil-devoid counterparts (GELB *et al.*, 1988). This counterintuitive observation partly contradicted the basics of neoclassical economics on comparative advantage as a determinant for international trade and development path. Further studies on mineral economies confirmed the negative relationship between resource abundance causing high variations of mineral rents, and economic development (AUTY, 1993; KARL, 1997; ROSS, 2003). The rationale of the resource curse thesis is that when mineral rents exceed a certain fraction of GDP, public spending and total exports, they tend to unbalance the fiscal equilibrium by over-stretching public spending and by artificially reducing taxes, either directly (through tax reduction) or indirectly (through subsidies). Things go wrong when rents shrink—for price variations or stock exhaustion—, due to the low elasticity of public

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<sup>1</sup> For a review of the literature on the resource curse thesis, see Rosser, 2006 and Ross, 2012.

spending and the negative effects of the Dutch disease on commercial balances and terms of trade.

A subsequent generation of scholars interested in resource endowment identified a negative correlation between mineral abundance and democracy, sometimes coming along with a positive correlation with violent conflicts (ROSS, 2001; BANNON; COLLIER, 2003). On the one hand, mineral rents finance public spending or support the accumulation of external debt, while alleviating fiscal pressure on citizens. On the other hand they provide governments with extraordinary resources for patronage and actors engaged in illegal activities with huge sources of extortion and corruption. Although the causality between mineral endowment and authoritarianism is still a controversial issue in quantitative research (HABER; MENALDO, 2011; DUNNING, 2012), it cannot be completely discarded. As a matter of fact, many features of authoritarian regimes and populism —such as lack of accountability and discretionary resource allocation used by the incumbent— do benefit from the increase of mineral prices and reserves. Likewise, many features of illegal armed groups —such as the control of strategic areas, access to point resources and high capacity to stress security infrastructures— are dramatically accentuated by commodity cycles.

This brought out yet another generation of studies, interested in explaining how institutions are affected by the effects of mineral boom and bust cycles, and how they allow governments to mitigate those effects (HUMPHREYS *et al.*, 2007a; 2007b). The research agenda shifted from economic development to democratic governance, hence questioning the role of governments on development beyond the mere effects of production factors on development (KARL, 2005; COLLIER, 2010; AUTY; GELB, 2011). Scholars now commonly acknowledge that natural resource endowment is hardly a curse in itself but rather comes from the existing political system regulating the economy, as well as the relationships between the state and society are what can doom development prospects (KARL, 2007; STIGLITZ, 2007; KOLSTAD *et al.*, 2009; BHATTACHARYYA; HODLER, 2011; AYTAÇ *et al.*, 2016). Moreover it is the volatility of commodity prices, rather than their absolute value, what constitutes a major challenge to any state because of its adverse effects on macroeconomic balances and political institutions (ROSS, 2012; TIMMERMAN, 2012; OMGBA, 2015). But the general argument of the institutional version of the resource curse thesis is that commodity cycles have stronger effects on development and democracy when occurring in contexts of weak or unstable institutions.

Recent trends in the research on natural resource endowments have underscored the importance of institutional capacity to “escape the resource curse” (HUMPHREYS *et al.*, 2007a). Based on this relatively common assumption, five

recommendations have been made, neither of which is exclusive. The most radical policy recommendation is the non-exploitation of natural resources until institutions are sufficiently strong (HUMPHREYS *et al.*, 2007b; SACHS, 2007). Given the extreme difficulty and political risk implications of such a scenario, scholars have explored the benefits of direct distribution of the resource (RODRÍGUEZ *et al.*, 2012; SEGAL, 2012). Another solution is to create stabilization funds that would allow the state to save during windfalls the money they may need in times of resource scarcity or prices downfalls (KOLSTAD *et al.*, 2009). Conversely, governments are advised to reduce subsidies when commodity prices go down, in order to reduce public spending and correct anomalies for further windfalls (DI BELLA *et al.*, 2015). Finally the minimalist agenda for policy change consists in increasing accountability and civil society control over resource rents (KARL, 2007; ROSS, 2012).

However, expecting that institutions would solve the resource curse raises more questions than it brings out answers for policy implications (STEVENS; DIETSCH, 2008). Institutional change is actually a wicked problem, generally incremental and highly context-dependent. According to the context and the policy at stake, “ideational” factors are supposed to act either as critical environmental variables or as motivations at both the individual and the collective levels to shape policies (BERMAN, 2013). Yet we do not know how, since it turns out ideas are a catch-all concept, extremely difficult to observe and measure empirically, if not by narratives, discursive analysis and thick descriptions. A crude taxonomy of ideas combining these dimensions helps distinguishing policy paradigms from programmatic ideas, frames and public sentiment (CAMPBELL, 1998: 385). Still, it does a poor job at explaining how ideas actually work on policy change, why some have no effect on it and others do, which ideas do change over time and which do not.

This eventually led to examine the role of governments in the management of commodity cycles and in particular the emergence of “resource nationalism” (HASLAM; HEIDRICH, 2016a). During the 2000s’ oil windfall, especially in Latin America (DE CASTRO *et al.*, 2014), the resurgence of resource nationalism was a reaction to globalization and neoliberal policies of previous decades (VELTMEYER, 2012; GRUGEL AND RIGGIROZZI, 2012; WEITZMAN, 2013; KOIVUMAEMI, 2015), as a way for governments to increase mineral rents through the control of the extractive sector (HOGENBOOM, 2012; WEIJEMARS, 2015). It is not another word for nationalization, since it can rely on a minimum participation of the sector by the state through joint-ventures and association contracts or on a full control through direct exploitation by state-owned companies (HASLAM; HEIDRICH, 2016b; GHANDI; LIN, 2013). Neither is it a consequence of fast-growing oil prices (MAHDAVI, 2014; CHEON *et al.*, 2015), since resource nationalism was initially a way to compensate for low prices by increasing

the government-take in oil rents, occasionally through a higher control over the volume of production (BERRIOS *et al.*, 2010). However it was arguably fostered by the late oil boom, due to the high leverage capacity acquired by the state in oil-exporting countries *vis-à-vis* multinational corporations and traditional OECD importing countries, as a result of the growing demand from emerging economies such as China and India (VIVODA, 2009; 2016).

### The Venezuelan paradox

Natural resource endowment can arguably make things easier or harder for governments, according to commodity boom and bust cycles, so it can be interpreted in very different ways, depending on the period examined. When focusing on the 1958-1980 period, oil rents may have been decisive to the exceptionally resilient Venezuelan democracy (DUNNING, 2008: 155) and the two-party system established by the “Punto Fijo pact”<sup>2</sup>, while many other Latin American countries were experiencing dictatorships. Yet considering the 1981-1998 period, when debt crisis, political instability and social conflicts emerged as a result of the counter-shock, oil rents may as well have been the source of all evils behind the rentier state or “Petro-State” (KARL, 1997: 85). Moreover, considering the 1999-2013 years, during which resource nationalism experienced a rebirth under *chavismo*, enhanced by exceptionally steady high prices, oil may as well have been the necessary condition for the rise and consolidation of a hybrid regime featuring a combination of hyper-presidentialism and “vintage clientelism” (CORRALES; PENFOLD, 2011: 16 and 25).

Whether the post-2014 period might be a remake of the 1990s twofold crisis depends on many factors impossible to frame in this paper, but it will be determined by the current institutional system which gives an unbalanced configuration of power in favor of the executive (still under control of *chavismo* with President Nicolas Maduro) compared to the legislative power (won by the opposition coalition in 2015) (KOTT, 2012; MONALDI, 2014; 2015). Unless a new institutional reform takes place —which would imply a makeover of the Constitution— resource nationalism is likely to remain strong in Venezuela, bolstering the unfolding economic crisis currently observed.

Beyond the mere objective of increasing control over oil rents, the Venezuelan resource nationalism shows features specific to *chavismo*. At the core of this ideology

<sup>2</sup> Initially, the Punto Fijo Pact included three political parties: *Acción Democrática* (AD), *Comité de Organización Política Electoral Independiente* (COPEI) and *Unión Republicana Democrática* (URD). However, in practice, the political system of Venezuela was overwhelmingly controlled by the two dominant parties AD and COPEI. Since the pact was signed in 1958, out of 9 elected presidents, 6 were affiliated to AD, 2 to COPEI and 1 to *Convergencia Nacional*, an emerging association resulting from the fragmentation of traditional political parties in 1994.

there was a strong anti-globalization and anti-neoliberal sentiment (MOMMER, 2002). The use of oil rents was soon defined as a way to recover national sovereignty and fight US hegemony around the world, even at the cost of a “reprimarization” of the economy (VELTMEYER, 2012: 68). This gave way to a series of programs that were given consistency afterwards, when coined as the “21st century socialism” (KIRSCHKE, 2013) during the 2002 political conflict that ended in President Chávez firing thousands of employees from the national oil company PDVSA (*Petróleos de Venezuela Sociedad Anónima*). These programs included the re-nationalization of the oil sector, the implementation of oil-led social policies against poverty and indigence, a diplomacy and international trade based on oil to foster cooperation among OPEC or non-OPEC countries (through national oil companies associations, infrastructure programs, oil swaps for services and consumer goods, etc.) (HELLINGER, 2016). Oil-backed loans, such as the Chinese Fund signed in 2007, or the energy cooperation agreement of Petrocaribe signed in 2005 involving 17 countries from the Caribbean and Central America, are some of the most salient policy efforts to build political alliances in the region and beyond through the unrestricted use of oil resources. Most of these agreements and other domestic and foreign programs financed with oil resources were initiated as of 2003 once the executive power had taken absolute control over PDVSA.

During the oil windfall of the 2000s, Venezuela became more dependent than ever on the oil industry, with oil reaching 96% of total exports between 2008 and 2014, compared to 60-70% in the late 1990s (MONALDI, 2015). Today Venezuela is undergoing one of the most severe economic, political and social crisis of its Republican history. After slowing down at 1.3% in 2013 (compared to 5.6% in 2012, an election year) the GDP growth rate went negative at -4% in 2014 (ECLAC, 2015). In January 2016, the Central Bank of Venezuela (hereafter BCV) released official economic indicators for 2015 mostly confirming the country had entered into recession, with inflation rates soaring to 180.9% and a -5.7% output contraction (Bcv, 2016).

Currently, domestic production is virtually paralyzed which turns the country more and more dependent on imports to meet basic needs (VERA, 2015). Yet cash limitations due to declining income flows, soaring deficits and very rigid public spending levels (OECD, 2014) have seriously restricted fiscal leeway and the possibilities to increase or even meet pre-crisis import levels. The combination of waned domestic production and restricted imports have triggered major shortages of consumer goods (including agricultural products as well as staples), which in turn have prompted food rationing along with time-consuming and permanent queues outside supermarkets and stores. Meanwhile, crucial services related to health and education have almost been suspended for lack of resources.

In the meantime, the oil industry has progressively deteriorated both in its productive capacity and financial health (FIOROTTI CAMPOS, 2015). Total production has consequently diminished, and maintenance efforts have been minimal (ESPINASA, 2012; BALZA; ESPINASA, 2015). Debt levels have also been increased to cover massive social projects and governmental expenditures in various areas, unrelated to the oil sector (MONALDI, 2010; MONALDI, 2015; BALZA; ESPINASA, 2015; VERA, 2015). Moreover, despite little official disclosure on public finances performance, dispersed official publications, leaks or calculations on the overall financial situation have unveiled the increasing trend of public debt both by the central government and PDVSA at more expensive levels. All in all, the situation points to a crippled financial capacity and credibility that limits the possibilities of obtaining further financial support at reasonable conditions (OECD, 2014), which have put into question the actual possibilities of default and social upraising faced by the country in the very near future.

## **Analytical framework**

### **Rationale**

We contend that the dismantling of the democratic institutional framework during the 1999-2012 period caused the current dramatic Venezuelan economic and fiscal crisis. The impact of the oil price slump was actually aggravated by the existing hierarchical governance mode (AUTHOR 2011), seeking to control directly and unrestrictedly oil rents and public resources, which fostered inconsistent public policies and poor accountability mechanisms. Hence, high dependence on oil combined with low political accountability caused more economic vulnerability to external shocks.

As of 1999 through the coming of a radical left-wing political regime headed by the recently elected President Chávez, Venezuela started a sweeping reform process across most policy sectors that established a clear preference for centralizing policy-making decisions and circumventing or substituting the existing institutional structures (NILSSON, 2013; EATON, 2014). These new conceptions over the management of oil rents driven by “resource nationalism” (HASLAM; HEIDRICH, 2016a) actually created the institutional frailty that weakened political accountability and consequently unfolded the current crisis.

The manipulation of informal institutions, through highly populist redistributive policies aimed at granting legitimacy to the charismatic leader, was a necessary condition for ideas to alter formal institutions and sustain the regime’s socialist

orientation. State institutions were transformed by the government in order to secure control over oil rents, through a series of reforms aimed at installing a “competitive” or “electoral authoritarianism” (KORNBLITH, 2013; WEYLAND, 2013; MAZZUCA, 2013) through cautious “autocratic legalism” (CORRALES, 2015).

In particular, a new financial architecture was devised with hardly any regulatory controls over public spending decisions. Such a wrecking of the institutional settings progressively set in motion the collapse of the existing Public Finance Management (PFM) system. The lack of political accountability caused by this strategy prevented any corrective measure, even before oil prices would go down, when Dutch disease effects limited the domestic capacity of production and created shortages in the supply chain of consumer goods (VERA, 2015). By mid-2014, when oil prices started to crumble, Venezuelan public finances were already handicapped and on a steady course to a breakdown.

## Method

We sustain our argument through the analysis of the fiscal policy implemented under the Chávez administration (1999-2012), which covers three successive governing periods. Fiscal policy is strategic for the government, since it constitutes a major interface for oil rents seeking and resource distribution. To that extent, it is at the center of any master plan of economic development. Our process tracing focuses on the policy design through the selection of instruments embedded in the PFM. Each element is an insufficient but necessary part of an unnecessary but sufficient (INUS) condition of the outcome to be explained. This means no individual part is sufficient but only when taken together they constitute a causal mechanism, a system of interacting entities that produces the observed outcome (BEACH; PEDERSEN, 2013: 29).

The causal mechanism linking resource nationalism to the economic crisis scaling-up works as follows. The *constitutionalization* of the resource nationalism acted as a trigger to change the fiscal policy regime, through four entities including the creation of a highly centralized PFM (E1), the takeover of the BCV (E2), the reform of the oil legal framework (E3) and the takeover of PDVSA (E4). All of these reforms converged towards the elimination and/or the manipulation of political accountability instruments (E5), which allowed the discretionary management of oil rents (E6) and hampered the government’s ability to react to external shocks (E7), leading to the scaling-up of the economic crisis (policy outcome).

## Data

The empirical observables that prove the actual causal effect of the mechanism are identified through the instruments of the fiscal policy regime. They are

classified according to the state's resources of information nodality, legal authority, treasure and administrative organization (HOOD, 1986; 2007). Taken together, these instruments constitute the core of the policy design through which political ideas turn into policy outcomes through institutional change (HOWLETT, 2011; PETERS, 2015). The combination of these four kinds of instruments indeed covers the overall spectrum of the fiscal policy regime, and their typology constitutes a source book of information processed during the research.

Beyond the Public Accounting System reformed in 2002 and 2005, there are very few nodality instruments during the observed period to trace development plans and social policies financed by oil rents. The most popular information instruments used are the so-called "missions" aimed at implementing social programs, and the plans of emergency aimed at solving problems of farming roadways and irrigation systems, structural funds, agro-industrial sanitation, etc. Instruments of authority are the cornerstones of hierarchical governance and therefore they constitute our main sources of information. Since the adoption of the new political Constitution in 1999, many organic laws were adopted on the economic, political and social domains as well as on the hydrocarbons sector, planning, accounting, decentralization, public contracting, social audit, etc. Instruments of treasure are essentially made of specific funds, dedicated to social spending, national development, macroeconomic stabilization, bilateral cooperation, and other even more peculiar areas such as reconstruction, electrical infrastructure, etc. Finally, instruments of organization include national agencies, such as the Central Bank of Venezuela, the Vice-presidency, PDVSA, and the Central Planning Commission, in charge of managing the "missions" implemented by myriad of semi-public foundations or quangos (for quasi-non-governmental organizations).

## Results and discussion

### The institutional reform

Immediately after the election of Hugo Chávez, decisive steps were taken to fully transform the country's political, economic and social landscapes. The political movement he had created under the name of the *Bolivarian Revolution* (which would later come along with the concept of the 21<sup>st</sup> Century Socialism), contemplated the construction of a new Republic, the Fifth Republic, which would justify a deep institutional makeover and anti-*status quo* political trend. This movement can be qualified as a "*radical effort to transform state and society into a vision worthy of Bolívar, a beacon of democracy, socialism, and enlightenment*" (CARROLL, 2013: 15).

President Chávez soon found support from the Supreme Court to organize a consultative referendum to reform the Constitution of 1961. Once the referendum was approved in April 1999, Chávez managed to assemble a majoritarian governmental coalition with 93% of the positions (CORRALES AND PENFOLD 2011: 19) in the special and temporary assembly that would write the new Constitution for the Republic. The final version of the text was ready in December 1999, and introduced a new political regime and the opening key to the subsequent institutional transformations that would progressively unfold in the years to come.

Overall, a new political regime was launched in 1999 with the adoption of a new Constitution that consented a straight movement toward the concentration of power by the President, by strengthening his position *vis-à-vis* the previous federal order and favoring the establishment of a hegemonic political regime. The constitutional reform introduced new conceptions about the role of the State in economic and social areas, and in particular about the role of the State in the oil industry and in the management of oil rents. Basically, the redistribution of oil wealth and other riches moved from a cooperative mode of governance, to a hierarchical one in which policy-making processes would be centralized, while accountability mechanisms would be restricted to allow a more discretionary management of oil rents on behalf of the people (AUTHOR 2011; VERA, 2015: 549).

This required the design of a “new financial architecture” aimed at having direct control over public spending decisions by the President, through a highly centralized policy-making system and plenty of room for rent seeking behavior. In essence, the prevailing policy paradigm of “sowing the oil” was displaced by a model of direct distribution of oil rents through a centralized spending system (OCHOA, 2008). The aim was to fully capture and control at the executive level the oil rents generated by the oil industry, and conquer full discretion over their use through public spending strategies. To do so, a new fiscal scheme was needed: a new financial architecture highly centralized with little controlling mechanisms over public management decisions.

The first reforming step towards the construction of a new financial architecture came with the enactment of the new Constitution in 1999 that demanded the full renovation of the Public Financial Management (PFM) system. Hence a series of amendments would centralize governing and administrative functions over the management of public finances, and a new law on fiscal management, on the monetary authority and on the extractive sector were adopted. These initial reforms were key for the construction of a new management model that would still see further adjustments and future unblocking.

A new fiscal management law was accordingly enacted in September 2000 as part of the new regulatory framework for the PFM system, the organic law

on financial administration of the public sector (LOAFSP, for *Ley Orgánica de la Administración Financiera del Sector Público*). The enactment of this law propelled institutional change with a new fiscal regime. On one hand, all major fiscal rules that were previously regulated through dispersed legal ordinances were integrated and harmonized into this one single legal text (BADELL & GRAU 2011; VERA COLINA *et al.*, 2009). On the other hand, all fiscal subsystems were placed under the control of the Ministry of Finance, which was designated as the central institution to coordinate and supervise the different fiscal entities as the primary rector or governing fiscal body of the PFM system.

Later on, additional institutional structures were created to assume central fiscal responsibilities, eventually duplicating those of the Ministry of Finance. For instance, in 2004, the Ministry of State for Financing Development was created to formulate and coordinate sectorial policies for development, assuming public spending decisions on parallel to the budget process undertaken by the Ministry of Finance. Likewise, in 2007, a Central Planning Commission was created to elaborate strategic plans for development, under the direct authority of the Vice-President of the Republic also duplicating budgetary decisions that would otherwise be conducted only by the Ministry of Finance's Budget Office. Both agencies were created to plan fiscal action, including discussions on financial needs and budgetary requirements to fulfill them. Therefore, existing institutions like the Ministry of Finance and the National Budget Office would be undermined by their organic role compared to the new agencies'.

Additionally, the Central Bank of Venezuela (BCV) was significantly reformed in 2001, in order to adjust the main instrument of authority for the monetary policy to the new constitutional provisions. This agency was given a constitutional rank, which meant it was formally defined as a separate legal entity within the public sector, with technical, functional and financial autonomy to exercise its responsibilities (BADELL; GRAU, 1999; MARTÍNEZ DALMAU, 2002; VERA COLINA *et al.*, 2009) on monetary policies (money supply, regulation of credit volumes, interest rates, federal reserves, and so on).

The new law also considered reorganizing the internal structure of the BCV, in particular its governing body and its relationships with other institutions of the PFM system and the executive power. The new law replaced the General Assembly with a Directory Board, in which the President would have a bigger room for interfering in policy decisions since he (or she) would appoint five out of seven directors. The National Assembly would play a new controlling role by becoming an official overseer of the monetary authority (RODNER, 2002).

Therefore, despite the newly empowered position of the BCV (granted by its constitutional rank), the 2001 law gave the President and the Ministry of Finance

wider attributions for interfering in the decisions of the monetary authority. This reconfiguration proved to be successful in decisions over the use of public funds and, more importantly, on creating fine tuning instruments needed to further unlock the fiscal restrictions that were still in place.

Among other relevant changes of the PFM system, it is worth mentioning the creation of the National Development Bank (BANDES, for *Banco Nacional de Desarrollo*), as the main financial instrument within the new fiscal scheme (created in 2001), and the Treasury Bank (*Banco del Tesoro*), created in 2005 to further attend to the financial needs of the central government.

The BANDES played a strategic role in financing and routing resources to the numerous parallel funds created during the studied period and representing a financial and operational platform for the extra-budgetary pieces of the newly developed fiscal scheme. This entity was initially linked to the Ministry of Finance, before being transferred to the Ministry of Planning, then appointed to the Ministry of State for Financing Development, and eventually assigned back to the Ministry of Finance in 2005.

On the other hand, the creation of the Treasury Bank was envisioned as another central financial agency, parallel to the financial structure already in place. This bank was supposed to directly manage public debt servicing and amortization, as well as general international obligations of the nation (GUERRA 2008). Later on it would become a regular piece of the public financial infrastructure, holding general accounts for public employees and for local needs not related to public debt in any way. Additionally the institution would actually manage internal public debt titles, collect some internal taxes, make payments instructed by the Treasury Office and operate a special fund for macroeconomic stabilization called (FEM, for *Fondo para la Estabilización Macroeconómica*) (Art. 1 of the Law that regulates the FEM) (Bcv, 2005).

### **The takeover of the oil rents**

The third element of the initial block of reforms resulting from the 1999 Constitution was related to the extractive sector. In November 2001 a new hydrocarbons organic law was approved to replace the former version enacted back in 1943. The 2001 version secured a greater involvement of the state in all primary extractive activities and, among other modifications, altered the weights of fiscal contributions generated by the oil industry. Royalties increased from 16,6% to 30% of the total production, whereas income taxes decreased from 67,7% to 50% of net profits<sup>3</sup>. This new legal design increased the control of the government

<sup>3</sup> See Organic Law of Hydrocarbons enacted in November 2001 (Official Gazette No. 37323) and partially reformed in August 2006 (Official Gazette No. 38493).

over the petroleum sector, by imposing a minimum 51% state ownership in all oil-related activities. Through the so-called “mixed oil companies”, the enforced “oil sovereignty” was consistently aligned with the hierarchical mode of governance.

Beyond the fiscal impact of the changing structure of oil revenues, the reform expanded the strategic stance taken by the state within the extractive industry and restricted PDVSA’s bargaining capacity (NÚÑEZ; PAGLIACCI, 2007). The way this legal instrument limited the role of the company in the negotiations of new investment projects, was of major interest to the government, as it would further centralize and reinforce control over oil rent generation and public spending decisions, while providing more opportunities for rent seeking behavior. It was also a strategic element of the new financial architecture including less policy space and actors to negotiate decisions on public spending and resource allocation.

The reforms that followed were also decisive in transforming the country’s fiscal scheme, yet they were originated in these initial set of changes introduced earlier and presented above. As a matter of fact they could not have been possible without the first block of reforms initiated with the Constitution of 1999, and in that sense, both initial and subsequent reforms are interconnected parts of the same causal mechanism. The sequenced and interlinked nature of the different reforms and amendments to the fiscal scheme taking place during the period under assessment is consistent with our argument of causality.

These radical changes taking place once the new Constitution was enacted soon started to face critical resistance and defiance, prompting political tension and social turmoil. A failed *coup* in April 2002 was followed by a national strike that paralyzed PDVSA and the national oil industry, from December 2002 to January 2003. The critical situation gave the government an opportunity to push for greater reforms and further dismantle the company’s organizational structures. In 2003, two major changes would disrupt the previous fiscal order: on one hand the government decided to take direct and total control over PDVSA; on the other hand it imposed strict economic control through a fierce exchange regime system.

The takeover of PDVSA was the result of a long struggle and public rivalry between PDVSA’s directory board and the government over the control and direction of the industry. Obviously the executive power had a different vision on how oil rents and assets should be managed, and what role the government should play in their management. Further, the election of Hugo Chávez introduced a new notion on the role that oil rents should play in the economy and specifically regarding the role that oil rents should play in his political strategy. These views were not completely shared by PDVSA’s board of directors, who represented a company that had developed important levels of political and economic leverage over the past decades before the election of Hugo Chávez.

Tensions between the government and PDVSA were no novelty (CORRALES; PENFOLD, 2011: 76). As a matter of fact, since the nationalization of the petroleum sector, in 1976, the formulation of oil policies had been an arduous task grounded on efforts to align the interests of the national oil company with those of the government (NÚÑEZ; PAGLIACCI, 2007). All in all, designing oil policies was never a smooth process, but the situation had worsened with the large number of reforms taking place and the greater pressure by the executive on the company. Apparently, there was no easy transition to the new ideals of the recently established political regime, as suggested by the consecutive replacement of presidents directly appointed by the chief of the executive (four assigned in less than three years) (NÚÑEZ; PAGLIACCI, 2007). In February 2003, after the 60-day “oil strike” Chávez appointed a new Directory Board and dismissed most of the company’s employees and cadres (CORRALES; PENFOLD, 2011: 78), overtly breaking up the prevailing tacit independence agreement (NÚÑEZ; PAGLIACCI, 2007).

The last straw came over a year later (in November 2004), when the Minister of Energy and Petroleum, Rafael Ramírez, was appointed as President of PDVSA to hold simultaneously both positions. This highly strategic arrangement would last for almost a decade. From then on, both the formulation and the implementation of oil policies would be the sole responsibility of the same directory unit, with PDVSA becoming a functional instrument of the executive’s will, regardless of their technical and strategic knowledge of the petroleum sector. This move ended with the horizontal accountability granted by the separation between the government and the national oil company (NÚÑEZ; PAGLIACCI, 2007: 37).

This ended ensuring the government larger control over public spending, through what would eventually become an extra-budgetary instrument of planning. On one hand it limited the actions that PDVSA could take on their own, regarding investment and maintenance projects not aligned with the government’s interests. On the other hand, it provided the government with unrestricted access to the most important source of public revenues, ready to finance both domestic and foreign policies. Hence by controlling PDVSA President Chávez managed to align, and actually merge, the policy aims of the executive with those of the national company, easing all strategies to come, regarding the generation and use of a particularly important type of national public income: oil rents.

Oil rents could then be fully assigned with a new fiscal role under PDVSA’s responsibility. In 2003 numerous social programs called “Missions” became a significant part of the company’s financial responsibilities. Up until 2014 these would add up over 9 billion USD, according to PDVSA’s financial records of 2011 and 2014 (PDVSA, 2011: 158; 2015: 36). Moreover, complete control over PDVSA allowed

the government to create many quangos to carry on different activities, all directly financed by oil rents but not related to the core oil business. For instance, PDVSA was in charge of public supermarket chains at the national level, infrastructural programs, sports sponsoring, cultural activities, and so on.

A new role was assigned to PDVSA in the implementation of public policies in economic and social areas. The new strategic guidelines and social co-responsibility consigned to the domestic oil industry implied that new public spending roles were actually considered as part of the company's operational costs (NOGUERA 2004). This in turn affected the financial results from which income taxes and dividends were calculated for budgetary ends (GERENCIA DE INVESTIGACIÓN ECONÓMICA, 2005a; GERENCIA DE INVESTIGACIÓN ECONÓMICA, 2005b).

Finally, once the oil strike had been controlled, in 2003, the government established a fierce exchange control regime to be operated by the Commission of Administration of Foreign Currencies (CADIVI, for *Comisión de Administración de Divisas*), a new agency separate from the BCV and attached to the Ministry of Finance. This decision constituted a blunt change in economic policies and provided the central government with a new instrument to control public resources, new financing mechanisms and a clear advantage over the management of the public debt. Further, an officially fixed exchange rate, directly managed by the Ministry of Finance, gave room to a differential spread between the official and the parallel exchange markets, which the government took great advantage of (ZAMBRANO SEGUÍN, 2010) by restricting or facilitating the access to foreign currency and turning the process into a political instrument to retaliate or manipulate the private sector, dissenters and the opposition in general.

### **Political accountability and economic development**

The 2001 hydrocarbons law and the 2003 takeover of PDVSA, along with the new spending roles that were assigned to the oil company, allowed the executive power to directly manage oil revenues without having to negotiate spending patterns or allocation decisions with any of the traditional budgetary actors. Thus an "indirect centralism" (Aponte Blank 2010) was specially devised with this new institutional arrangement, as PDVSA would progressively assume public spending responsibilities traditionally undertaken by the government.

At this point, the PFM system was highly centralized and the government largely controlled the monetary authority, the BCV, PDVSA and the exchange regime system through the CADIVI. However, in order to increase the discretionary power over public spending and over the use of oil rents, additional reforms were needed to further unlock fiscal restrictions. Such ambitions became real in 2005 through

the third block of fiscal reforms modifying the BCV's regulatory framework. This new reform was decisive in formally disbanding institutional limitations over the use of oil rents and institutionalizing extra-budgetary mechanisms for oil-related funds allocation.

Foreign monetary reserves typically accumulated and managed by the BCV would be partially transferred to the National Development Fund (FONDEN, for *Fondo de Desarrollo Nacional*), created that same year. Beyond a certain amount, the accumulated foreign monetary reserves would be transferred to this extra-budgetary fund. To determine the amount to be held by the BCV, a new discretionary concept was created as a decision-making parameter: that of a "reasonable" or "accurate" level of foreign monetary reserves (Articles 75 and 114 of the Partial Reform of the Law of the BCV of 2005). The task of defining this "accurate" level was ambiguously assigned to the Directory board of the BCV (controlled by the government), and it was left in very broad terms regarding the methods of calculation.

Additionally, this complementary reform generated a new dynamic in the interplays between PDVSA and the BCV. For the first time since its creation (in 1976), PDVSA could bypass the BCV for the traditional exchange of foreign currency obtained through oil exports. The new fiscal arrangement stated that PDVSA could officially keep part of the revenues coming from oil exports and deliver the remainder to fiscal agencies such as the FONDEN. As a consequence, from 2005 onwards PDVSA would only exchange a fraction of oil-related revenues in foreign currency to the BCV: the one corresponding to budgetary obligations, according to the estimations over oil prices for the budget formulation. The rest would directly go to the FONDEN (Bcv, 2005).

The FONDEN is one of the most notorious off-budget recipients of direct transfers created during the studied period. It was created as a special fund to directly invest in the economy and as an instrument for the "New Economic and Financial Strategy of the Executive power" conceived to leverage a real and productive economic recovery, increase the levels of social investment and alleviate public debt management. All, in parallel to the main short-term fiscal tool: the Federal Budget.

With the creation of FONDEN, many other separate funds were created to channel oil and non-oil fiscal resources in a discretionary fashion. So far it remains unclear how many of those funds are still operating, the amount of resources they handle, the regularity of such allocations and (more importantly) the functions they carry on in the fiscal regime and other policy areas. However as an indication of their importance, suffice it to report that from 2005 to 2010 FONDEN received 29,9 billion USD from PDVSA and 37,9 billion USD from the BCV (Bcv, 2010; PDVSA, 2011).

## Conclusions and policy implications

Our research shows simultaneously that institutional factors are the independent variable of the economic crisis in Venezuela today, and how these factors were manipulated by the government in order to comply with the ideas of the new political regime. From 1999 to 2012, this country's political regime was deeply altered, modifying the overarching governance mode. The country transformation particularly affected the national system of fiscal institutions and the oil sector, by and large the most important sector of the economy. The causal mechanism of the economic crisis was identified as a sufficient though unnecessary condition that can be traced through the selection and transformation of policy instruments by the government.

The new financial architecture was basically assembled with punctual and exceptional rearrangements. A new Constitution commanded the centralization over the control and direction of public finances, in particular to channel oil rents. The undermining of the Central Bank through a series of reforms to its legal structure allowed the executive power to directly interfere and control the monetary authority, granting the use of monetary policy to the fiscal ambitions of the central government. Consequently, the full takeover of PDVSA and the creation of a number of parallel financial institutions to control and direct public resources allowed full discretion over public spending decisions and over the management of oil rents, shifting budgetary exercises from public and political scrutiny to murky and sealed practices with fewer policy makers.

These changes redirected the decision-making process from dispersed specialized agencies to a central system closely subordinated to the President and the Vice-president of the Republic. In particular, decisions on the allocation and distribution of public resources would be generated by a narrower number of newly created commissions directly attached to the Presidency office or by the Ministry of Finance. Likewise, these changes diminished pre-established controls on public spending levels and allocation patterns while making the fiscal regime much more intricate to control by other agencies (including the National Assembly, the Comptroller's office, and civil society organization). The new financial system conveyed the causal mechanism to dismantle the previous institutional structure (with its fiscal rules, procedures and controls) to replace it with a new financial architecture more closely aligned to the new governance mode of the newly established political regime but it also made it less sustainable in the long run and much more susceptible to external shocks, such as commodity price swings.

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