

Dissertation on the institutional design of Venezuela

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What are institutions?

The deep, multidimensional crisis of Venezuela has given way to a broad development of ideas that seek to explain the debacle and failure of recent decades. In other cases, this discussion is not limited to reviewing the past and answering the whys but instead focuses on proposals to find a way out of the current national situation.

An unavoidable issue is institutionality, both political and economic. This article will be relatively biased towards the latter. Here are some general definitions of “institutions”:

- Institutions are repetitive patterns of interaction through which society undertakes certain functions.¹
- Institutions are the game rules in a society, or, more formally, they are the man-made constraints that shape human interaction. Therefore, they structure incentives

1 Roger King, *Farmers co-operatives in northern Nigeria*, PhD. dissertation (Reading, University of Reading:1976).

in human exchange, may they be political, social, or economic.²

- Broadly speaking: persistent groups of behavioral norms that serve collectively valued purposes or, in *stricto sensu*, a set of rules to facilitate coordination by allowing expectations to form.³

If we further restrict these concepts, economic institutions can be defined as the rules, norms, and organizations that frame economic activity. We can include formal institutions such as regulations, laws, and government agencies, as well as informal institutions such as traditions, customs, and other social norms.

Institutional quality is key to countries' development since it provides the solid foundations for a stable and flourishing economy. They allow countries to escape vicious circles of stagnation and impoverishment and enter virtuous cycles, generating prosperity.

An aspect that usually goes unnoticed is the impact these high-quality institutions, or lack thereof, have on individuals. This framework of norms and rules, together with the organizations that ensure and encourage compliance, creates the right environment so that each individual feels confident and has the incentive to develop and exercise their capabilities. As each individual can make their aspirations for wellness a reality, the economy as a whole will gain momentum, one that feeds off the healthy interaction of all its actors.

2 D. C. North, *Instituciones, Cambio Institucional y Desempeño Económico*. (México, Fondo Cultura Económico:1993)

3 Nabli, M. K. & J. B. Nugent, *The New Institutional Economics and its applicability to Development*. (World Development, 17 (9): 1989): 1333-1347.

Similar to this idea, Ludwig Erhard states:

“As such a minister, I have to fulfill a specific, perfectly delimited task... It consists of getting the national economy so much strength and performance that people can live free of care and troubles, that men can acquire property and become independent, thus gaining human dignity, since in this way they do not need to depend on the grace of others, not even on the grace of the State.”⁴

To summarize this idea: the individual, their independence-autonomy and dignity at the center of economic policies.

However, not all institutionality has a positive or virtuous connotation. Acemoglu & Robinson⁵ argue that not all institutions are healthy. The authors classify institutions as inclusive, with characteristics that have the same spirit as the previous paragraphs –as in, institutions focus on citizens and on generating favorable conditions for growth and progress. They also define extractive institutions as those serving people in power that extract the nation’s wealth and remain in command indefinitely.

A true institutional framework does not allow some groups to impose themselves over others, nor the State over citizens, nor citizen groups over peers.

The role of elites and political institutions

In an ideal and unreal world, institutions would be created through a purely democratic and widely participatory process. In

4 Ludwig Erhard, *Bienestar para todos*. (Madrid, España, Unión Editorial:1989).

5 Daron Acemoglu y James A. Robinson, *Por qué fracasan los países*. (Barcelona, Deusto: 2012).

practice, that is not the way it is. Political and economic elites are in charge of designing and operating institutions, often not in the best way.

Marcos Morales states:

“The elites who hold political power are the ones who write the country’s constitutional and legal script. Therefore, political institutions configure the space within which economic institutions are designed and created.” [Own translation]⁶

The economic elites do not directly interfere in the design of these institutions; instead, they do so through their influence and support from certain political groups. These groups allow them to express their preferences and interests, which will be reflected, along with those of the political world, in the institutional arrangement that will govern life in the country.

The quality of this institutional design will go hand in hand with the characteristics of both elites. What are their ethical standards? How much importance do they place on the development of the individual? Do they seek revenue from the State or other social instances? These are some of the concerns that should be asked about their nature.

The other significant element that affects the formation of institutions is on the side of the nation’s citizens. Without a conscious, active, organized citizenry, elites will not feel pressured

6 Marcos Morales, “Democracia y regímenes autoritarios: análisis económico de las instituciones y de los factores de poder en el caso venezolano”, (Caracas, *Revista Nueva Economía*, Año XVIII, Nro 31: 2010): 113-147.

to move towards inclusive institutional arrangements; instead, they will impose extractive ones.

The case of Peru

In the 1990s, following a prolonged period of poor economic performance and severe hyperinflation, Peru decided to make profound changes to its economic regime. The primary objectives were to strengthen economic institutions and establish an attractive framework for private investment.⁷

The measures they implemented revolved around four key principles:

- **Independence of the Central Reserve Bank of Peru:** The 1993 Constitution celebrated the institution's autonomy and prohibited any financing of the Executive Branch. This laid the foundations for fiscal discipline and monetary stability for the following decades.
- **Subsidiary role of the State:** This measure was also constitutionally supported, as stated in Article 60: "The State can engage in business activities on a subsidiary basis only when expressly authorized by law."⁸ With this provision, the State could only participate in economic activities that the private sector could not undertake.
- **Investment opening:** Investments began to have a solid legal basis that guaranteed security and stability to companies and people seeking opportunities in Peru.

⁷ Diego Macera Poli, *Estabilización macroeconómica: el caso peruano*, (Lima, Perú, I Encuentro Regional de Juventudes Venezolanas en el Exterior).

⁸ [Own translation].

Furthermore, the same constitution ensured equal conditions for national and foreign investments.

- **Freedom of contract:** Not only is the right to freedom of contract guaranteed, but the modification of contractual terms through new laws or provisions is also prohibited. The rules of the game are clear and stable.

The institutional changes in Peru draw attention due to their results. From 1991 to 2021, its Gross Domestic Product (GDP)⁹ per inhabitant more than doubled despite considerable political crises. There are some characteristics that stand out from this sustained growth that were precisely among the goals they sought to achieve with the economic reforms supported by institutional modifications. First, the stability of prices and its reference exchange rate allowed Peruvian citizens to progressively trust their currency and for that trust to be, in turn, a tool for growth. It also enabled them to have their own monetary policy. To achieve this, an autonomous Central Bank was essential, avoiding at all costs public spending to be financed through that institution, which today has great credibility. Second, an aggressive acceptance of both local and foreign investment. This had clear legal support that helped generate the minimum guarantees necessary to attract capital to the country. And thirdly, the commercial opening to exporting and importing. In the process, they did not resort to the protection of local businessmen through tariffs, but rather they reduced and simplified them so they competed with the rest of the world without privilege. Peru had and still has a favorable trade balance that allowed it to be the Latin American country with the highest international reserves.

9 Constant GDP per capita for Peru, FRED Economic Data, St. Louis FED. Disponible en <https://fred.stlouisfed.org/series/NYGDPPCAPKDPER>.

New institutional design for Venezuela

The new institutional arrangement must adhere to some basic principles by which to be governed. I will outline three of them:

- **Deconcentration of political power:** Institutional design and implementation is part of an ongoing process, rather than a specific event. General guidelines for this point include, firstly, the urgent need to eliminate indefinite re-election, which has disrupted incentives for responsible exercise of power. This is particularly important as the Venezuelan State discretionarily manages the country's main wealth. Secondly, election methods of the different branches of the government must be reviewed and modified. Today, important citizen institutions display a significant bias towards the Executive. Notable examples include the National Electoral Council (CNE) and the Supreme Court of Justice (TSJ). Thirdly, there must be a transition from a presidential system to one with a greater Federal character. The transfer of power to governorates and municipalities, a process initiated in the 1990s, has yet to be completed.
- **Deconcentration of economic power.** Peru can serve as a prime example in regard to the economy. The autonomy of the Central Bank of Venezuela (BCV) is crucial in limiting the monetary abuses perpetrated by the Executive over recent decades. This autonomy must be accompanied by the prohibition, not only on paper but in practice, of any financing from the Central Bank of Venezuela to the government. On the other hand, the principle of subsidiarity should limit the role of the State as an entrepreneur and its functions would be focused

on creating a conducive environment for individuals and companies to generate prosperity. After multiple years dealing with the detrimental consequences of price and exchange controls, the State's power to implement them should be limited. Market prices play an essential role in revealing citizens' preferences, which is why the defense of a market economy, with transparent rules for everyone, is one of the objectives of a functional State. Finally, it is of utmost importance to contain the potentially harmful effects of oil activity not only on the economy but on the life of the country. To do this, a framework needs to be created to limit the government's discretionary use of oil revenues. This topic is of paramount importance, so it will be addressed further on.

- **Venezuelan citizens at the center of such an arrangement.** Today, Venezuela's institutions serve the interests of those in power, rather than the citizens themselves. They have two essential functions: facilitating wealth extraction and the perpetuation of those in power. Within a proposal for inclusive institution-building, in addition to the guidelines for the deconcentration of power already proposed, we can list other institutional changes that would positively impact the lives of Venezuelans. First of all, a functioning judicial system that resolves conflicts between economic and social actors, safeguards all kinds of (especially property rights), is credible for society, and treats all individuals equitably. In short, a guardian of the rule of law. Secondly, freedom of expression and supervisory bodies as options to counterbalance society against State power. Society, other institutions, and powers of the State must have freedom of action, preventing the concentration of power, whether economic, political, or social, within

any specific group. Thirdly, the definition of standards and the formation of institutional organizations are not enough. Creating and strengthening institutions that ensure regulatory compliance represents a key element for this new institutional design to be effective and in citizens' favor.

Making a new institutional design a reality, whatever it may be, will require conscious political leadership and economic elite, who prioritize the greater good over their personal interests. The same applies to the rest of society, who may not have a direct role in the exercise of power but who are a vital means to counterbalance and exert pressure on those in power.

Towards a new fiscal contract

Venezuela is a "petrostate", a key consideration to be had when proposing a new institutional design. The previous design failed to limit the damage associated with the abundance of natural resources. One of those negative consequences was having a dysfunctional Citizen-State-Oil relationship. We were trapped in a perverse cycle with elite groups aiming to access to wealth, a political world competing for power by offering better income distribution, and citizens' expectations focused on what that income distribution would be like under the illusion that we were a wealthy nation. Productivity was relegated to a secondary role when it should have played a leading role.

Oil will no longer be the main source of energy on the planet; that is a fact. The question is when and how it will happen. There are likely a few decades left of transition, and Venezuela must make the most of that time window. Thus, addressing how to

manage revenue derived from the country's oil and other natural resources is a pertinent and important issue.

Rodríguez Pardo & Rodríguez Sosa (2012)¹⁰ address the problem of income allocation and highlight a fundamental point: the damage caused by the discretionary distribution of income by the Venezuelan State up to the present day. The authors highlight four general guidelines for ideal income allocation:

1. Limit State discretion.
2. Increase, or avoid negatively impacting, citizen productivity.
3. Promote a fiscal contract that reshapes the Citizen-State relationship so that the latter depends on the income of the former and not vice versa.
4. Consider the adverse effects that a resource of this nature can have on country dynamics.

The authors propose the establishment of a Venezuelan Heritage Fund (*Fondo Patrimonial de los Venezolanos*), which would be funded by profits from oil activity, income tax applied to the sector, among other sources. Dividends from PDVSA would also contribute to this fund. In turn, the Venezuelan Heritage Fund would be managed through individual trust accounts for each Venezuelan of legal age. The accumulated money would be completely available at the time of retirement, yet prior to retirement, each person could partially use those funds and

10 Pedro Luis Rodríguez Sosa y Luis Roberto Rodríguez Pardo, *El Petróleo como instrumento de progreso*, (Caracas, IESA:2012): 125-142.

allocate them to specific expenses such as health and education. The account balance and its transactions could be tracked similarly to a bank account, including the tax payments that citizens must make as beneficiaries of that income. This mechanism ensures transparency, with citizens effectively financing the State, not vice versa.

This proposal was drafted in 2012. One would have to wonder if it remains relevant in the wake of the oil production and economic crises. Regardless, discussing how to manage oil or any other revenue cannot be postponed.

My intention behind these lines is to continue the debate and contribute ideas regarding institutional reforms in Venezuela, a topic which I believe deserves more attention. After a historical crisis like the one we are experiencing, there is still fertile ground for this discussion to be relevant and adapted to the times of change that Venezuelans demand.