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# Venezuela: can its collapse be explained by the institutional theory?

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# INTRODUCTION

How did Venezuela, the richest country in the world in petroleum reserves, end up being one of the poorest countries in the world?

This dissertation finds its main contribution in a renowned theory of economic literature, proposed by Daron Acemoglu and James Robinson in *Why Nations Fail*. The institutional theory is presented to explain the root of difference and inequality between countries in the world. It focuses on political institutions as the core of inequality: it analyzes how and why they change, and how they reflect on economic institutions and determine the prosperity (or decline) of a nation.

Venezuela, even before the pandemic broke out, was already experiencing economic, humanitarian and healthcare crises. To understand how it happened, I focus on institutions, political and economic, and analyze how they shaped the country during the last century.

Taking into account the institutional theory and the resource course school of thought, I discuss how both extractive institutions and oil led to Venezuela's collapse. Acemoglu and Robinson describe extractive institutions as one social class that extracts wealth from another. Power is concentrated in the hands of a few, and the immense revenues are used to furtherly strengthen their position: the Venezuelan government elite is an evident example. Since natural resources generate extraordinary wealth, they can create extractive institutions more easily than agriculture and manufacturing can. Furthermore, once institutions have the power to appropriate the nation's wealth, they would continue to do so, opposing any kind of liberalization of the economic and political sector. The process of creative destruction would not be allowed to take place, and the country could not experience long-run sustainable growth.

In order to achieve nation's economic and social growth, institutions should be made more inclusive: with some degree of centralization, but pluralistic and democratic. A contingency of events can sometimes form a critical juncture that the country can seize to become more inclusive, but existing institutions have to allow it.
In the past several decades, critical junctures such as wars and diseases have shaken societies, disrupting existing political and economic balances. Likewise, an event such as the COVID-19 pandemic highlights and deepens the fractures of our society, acting both as wake-up call and catalyst.

In three chapters, I cover the following topics: in Chapter One, I argument the history of Venezuela throughout the century. In Chapter Two, I analyze the institutional theory and the resource curse approach. Lastly, in Chapter Three, I look at the country's history in light of the institutional theory, and I try to provide a correlation between the two approaches.

The overall goal of this thesis was to pursue the path of Venezuela, by studying its institutions and resources, analyzing the causes that left the country in decline.
Finally, I argue how both Venezuelan extractive institutions and its immense natural wealth made the country collapse. As a result of a long evolutionary process, political power is now more concentrated than ever, and the Gini coefficient (which measures income inequality) and the Rule of Law (influence of law on society) reached extremely negative levels. The country has been trapped in a vicious cycle for decades, and if political institutions are not made more inclusive, it will further collapse.

I wonder if a critical event such as COVID-19, combined with the strengthening of opposition forces, will be able to reverse the decline of the country, or just carry it deeper into the crisis.

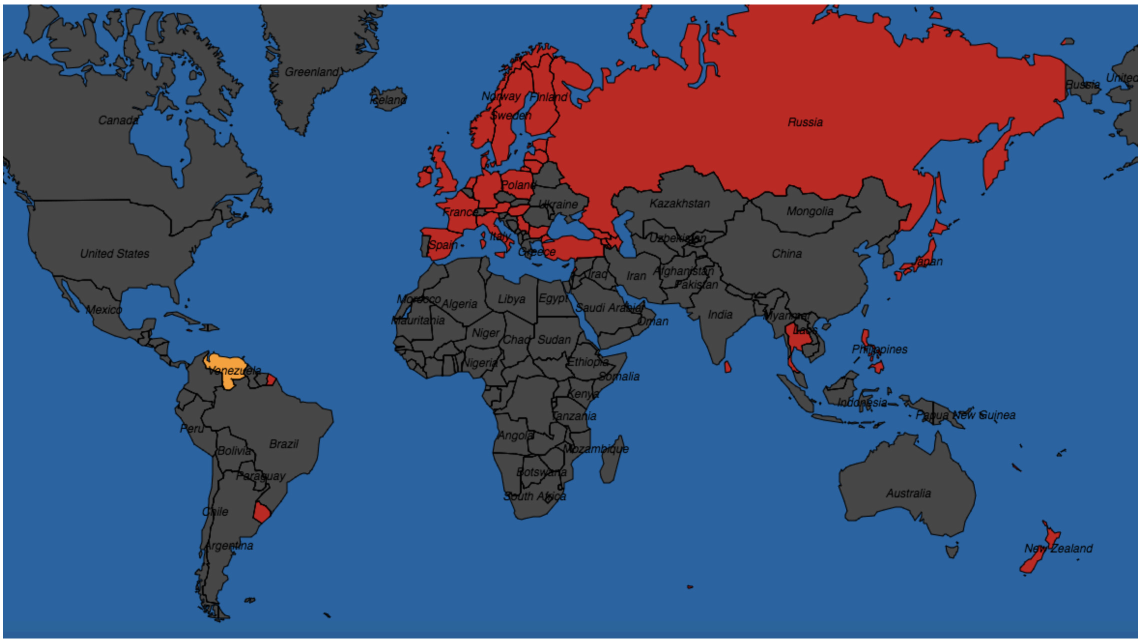
# CHAPTER ONE: HISTORY OF VENEZUELA

Venezuela history, during the first century as an independent nation, was characterized by coups d'etat, dictatorships and long periods of chaos. The country's democracy is conventionally represented as a long evolutionary process, which started after dictator Juan Vicente Gomez's death in 1935 and the beginning of civil liberties under Generals Contreras and Medina. However, only in 1958 the idea of democracy acquired specific content, with the promise of a democratic system that would offer people the right to participate in the political system and benefit from the nation's immense wealth.

Since we are going to discuss the relationship between economics and institutions, we cannot overlook the beginning of this process of democratization, and the chain of event that led to the liberalization of the political system.

## 1.1 TRIENIO ADECO

The political parties' history and the first democratic elections date back to the *Trienio Adeco* (1945-48). In 1947, the major party Democratic Action (AD), led by President Rómulo Gallegos, won the first democratic elections. The path towards universal elections was established in Venezuela earlier than in eleven other Latin America countries and shortly after Italy and France (Coronil 1997). Despite being abrogated by Jiménez shortly after and reintroduced in 1958, it is something worth saying. Graph 1 below shows the countries with universal suffrage in 1947.




Graph 1: Universal suffrage in 1947 in the world.

The *Trienio Adeco* was characterized by economic and social growth. To boost economic growth, AD invited foreign capital to participate in the nation's development through nonpetroleum mineral concessions (for instance, iron deposits). Over the oil sector, instead, they formulated a policy of "no more concessions" to foreign companies. The Minister of Development Juan Pablo Pérez Alfonzo assured investors that there would not be either expropriations of existing concessions nor nationalization of the sector, since "It is in [the country's] best interest to permit development of its oil petroleum resources under the present arrangement of foreign capital and technicians" (Salas 2005, p. 151). Furthermore, opponents of nationalization insisted that Venezuela lacked the refining capacity, an adequate system of transportation, and a marketing network. By 1947, 94 percent of Venezuela's oil was still being exported as crude, and AD leaders feared the drop in production and revenues that would have followed nationalization (Salas 2005). Finally, the parties decided to impose the 1948 oil law, which imposed the equal sharing of profits between state and oil companies. For some, "the new code was a triumph of nationalistic rhetoric" (Coronil 1997, p. 137), or else a "wise nationalism" (Pérez Alfonso 1974, in Salas 2005, p. 153). Surely, as Mommer (1987) has shown, the new law reduced the power of the state to capture all surplus profits.

Venezuela was the largest oil exporter in the world, and the only nation in Latin America that allowed private companies to carry on large-scale production without any restrictions on the dollar outflows. Hence, it started acquiring strategic political and economic importance for world-wide companies (Ellner 2006). Especially after Mexico and Bolivia nationalized their petroleum industries (in 1937-1938), the U.S. government considered Venezuela a keystone of its petroleum production needs: that is why the U.S. also helped President Gallegos derail several coup attempts.

With regard to agriculture and industry, policies were implemented to encourage the expansion of businesses through low-interest loans by the Venezuelan Development Corporation (CFV)[1]. Social groups started developing, such as the Peasant Federation and the Confederation of Workers, and trade unions increased by 300 percent (Alexander 1965).

## 1.2 JIMÉNEZ DICTATORSHIP

Unfortunately, because of the fragility of relations between the military and AD and since its leaders did not rely on massive popular support, the streets were empty for the military troops when the conspirators gave their coup in 1948. A popular government was overthrown for lack of popular resistance by an all-military three-men junta: Marcos Pérez Jiménez, Luis Llovera Páez and Carlos Delgado Chalbaud. U.S. support of AD did little to ease the government's internal opposition, and President Gallegos blamed them and U.S. President Truman; on the other hand, the military had many allies in conservatives and wealthy businessmen (Salas 2005).

The long Jiménez dictatorship followed, and it started to progressively dissolve the congress, municipal councils, the national electoral council, and most trade unions. A military regime which wished to restrict the role of parties in politics and to destruct the peasant and labor movement was consolidated. Furthermore, revenues from the 1950s[2] were used for extraordinary spending and corruption, provoking a major fiscal crisis. This period represented an economic and social setback in the country's history.

The dictatorial regime depended greatly on oil profits. The closure of the Suez Canal in Egypt (1956-57) boosted production and revenues in Venezuela, and Jiménez opened new concessions to oil companies. However, as soon as the canal reopened (during late 1957), there was an overproduction crisis in international markets. Furthermore, increased competition in the Middle East and in Latin American countries had scared Jiménez and the elite in power, and it had pushed them to initiate a dialogue between oil-producing nations in 1949 and to make special trade agreements with the U.S[3]. Despite these attempts, Venezuela ceased being the world's leading oil exporter: its share of global oil trade dropped from 46 percent in 1948 to 33 percent in 1958 (Salas 2005).

In 1957 Jiménez tried to extend his rule via a plebiscite, but the opposition reacted calling for his removal. This critical juncture involved the formation of the Patriotic Committee, composed of AD, COPEI (Social Christian Party), URD (Democratic Republican Union), and the Communist party. They asked for the constitution to be acknowledged, in order to have presidential elections and restore a democratic government that would respect civil liberties. In 1958 they called for a general strike, and when Pérez Jiménez turned to the military and discovered he did not have its support, he fled the country.

## 1.3 PROMISE OF DEMOCRACY

The Patriotic Committee knew it was important to reassure U.S. investments would be protected, especially because of the latter's fear in response to the Cuban revolution and how it could have influenced the Latin American landscape. The U.S. immediately recognized the legitimacy of the Committee: as Salas (2005) cites from the U.S. State Department Bulletin, the Assistant Secretary of State expressed "satisfaction and pleasure when people of any country determinedly choose the road to democracy and freedom" (p. 164). In light of the events in Cuba and Mexico, they supported the election of Rómulo Betancourt, instead of the ad-interim President of the Committee Wolfgang Larrazabal, because of the latter's too radical approach.

The military rule that had characterized the country since independence came to an end, and from 1958 forward a promise of democracy took form, advocated by those parties which succeeded in bringing the first democratic elections. The parties signed a pact called *Pacto de Punto Fijo*, in which they agreed to share power and oil wealth: from that moment forward, AD and COPEI became protagonists of the political arena, and they would remain so for more than thirty years.

Leaders Betancourt (AD) and Rafael Caldera (COPEI) managed to avoid conflicts, as per pact, to preserve the democratic regime. They used to consult on important policies about defense, foreign affairs and oil industry, and decisions were usually taken upon general consensus. The parties were inspired by the Leninist principle of democratic centralism, which combines elective democracy and free discussion supported by centralized executive direction and political discipline. This meant that when policies were discussed and decisions were taken, every member was to adhere to this "party line". Moreover, party influence was maximized because the electoral law provided for a system of proportional representation by party that encouraged its control over legislation.

Even though it involved fair elections, some aspects of the regime were not so democratic. It was in fact described by many as a "partyarchy", where the parties' meddling in every field debilitated its legitimacy. Coppedge (1994) said that "if democracy is government of the people, by the people, for the people, then partyarchy is government of the people, by the parties, for the parties" (p. 2); by having control of the electoral and legislative process, and by interfering with politically relevant organizations, they tarnish the image of democracy itself.

Labor unions and private organizations were penetrated and controlled to avoid threats and disorders. Private associations such as Fedecamaras (Venezuelan Federation of Chambers of Commerce and Production) benefited from subsidies, low taxes and protective tariffs. New

equipment and improved standard of living were given to the military in exchange for them to accept to be apolitical, obedient and nondeliberative, and the Church was given more independence and many devote party members (Levine 1977).
In conclusion, parties' interference in every part of the social system was clear. It provoked, in the various years of regime and especially during oil crises, increasing disillusionment towards the partisan establishment.

Economically speaking, the period following the *Pacto de Punto Fijo* elevated the country as one of the richest countries in Latin America and one of the twenty richest countries in the world, with a per capita GDP higher than Spain, Greece, and Israel (Hausmann and Rodriguez 2011).
When Betancourt became President in 1959, he implemented reforms on land distribution and industrialization. Lands were distributed within peasant families, both to increase their living standards and to improve productivity to cover the deficit of agricultural products.
Economic development was taken on by giving large funds to the Venezuelan Development Corporation and the Industrial Bank, both government institutions, in order to aid private entrepreneurs who wanted to expand or establish new businesses. Industrialization processes enabled the country to become self-sufficient in textiles and to better their pharmaceuticals, foods, metallurgical and building products (Alexander 1965).

As a consequence, Venezuela experienced the fastest rate of urbanization in Latin America. Table 1 illustrates the Population Distribution, 1936-1971, in percentages.

| ***Year*** | **Rural (%)** | **Urban (%)** |
|---|---|---|
| 1936 | 71 | 29 |
| 1941 | 69 | 31 |
| 1950 | 52 | 48 |
| 1961 | 37 | 63 |
| 1971 | 27 | 73 |

Table 1: Percentage of population in rural and urban areas. Source: Karl 1987 [Levine 1978]

It is noted that an agrarian reform was also a key component of the President's plans for the future. AD stated in 1962 that they wanted to increase the domestic market and develop a national industry and agriculture (Karl 1987). However, as most of oil producing countries, means of production used in the oil sector cannot be easily transferable to others: this hinders the development of alternative export industries. When Venezuela will be hit by oil crises during the 1970s and the 1980s, it will be a liability to its recover.
Furthermore, high oil profits and increasing industrialization hurt the domestic market for agricultural products, and their international competitiveness of traditional exports declined. There were no incentives to revitalize the agricultural sector because the oil one represented an easier way. Fostered by petrodollars, a new exceptionally large middle class was born.

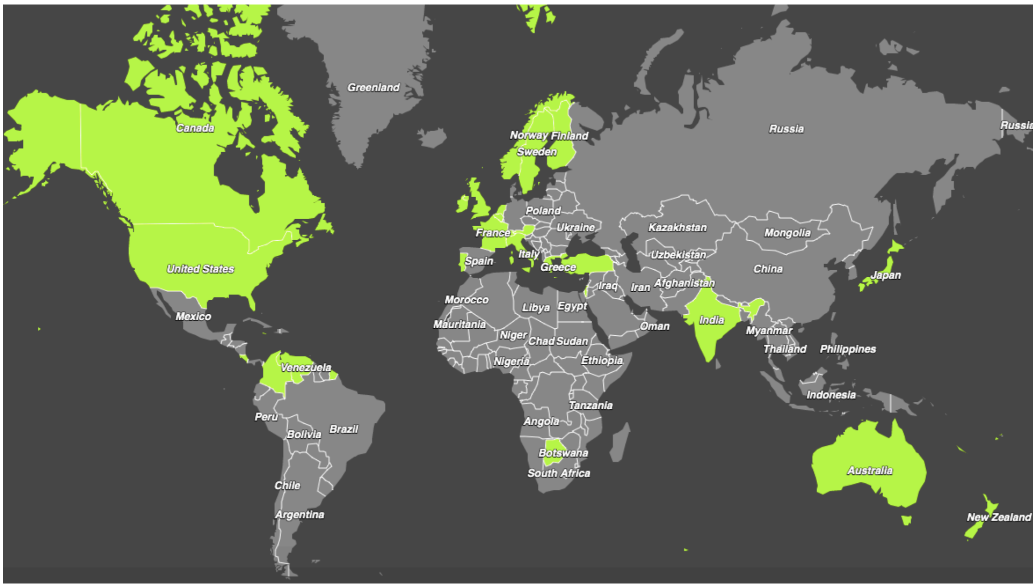
During his mandate, President Betancourt had demonstrated that it was possible to have a formally democratic regime and social and economic development. The following thirty years were managed by the alternation in power of AD and COPEI. Table 2 below illustrates all types of governments: from the dictator Gomez, to General Medina, the *Trienio Adeco*, the Jiménez dictatorship and up until the late 1990s, where a critical fracture in the parties' hegemony will change the political path.

| President | Mandate | Party | Election | Coup | Economic Policies |
|---|---|---|---|---|---|
| Juan Vicente Gomez | Three mandates: 1908-1913 1922-1929 1931-1935 | Military dictatorship | | | • Promotion of foreign investments over the oil sector<br>• Land reforms |
| Eleazar López Contreras | 1935-1941 | Indipendent | | | • Founding of the Central Bank of Venezuela (1939)<br>• Fiscal policy to increase government revenues |
| Isaías Medina Angarita | 1941-45 | Venezuelan Democratic Party | | | • Hydrocarbons Law to gain control over oil revenues |
| Rómulo Ernesto Betancourt Bello | 1945-1948 | Democratic Action, AD | | 1945 | • “Wise” nationalization: profits split 50/50 between state and companies<br>• Policy of no more concessions over the oil sector |
| Rómulo Gallegos Freire | 1948 | Democratic Action, AD | First fair elections in 1947 | | |
| Carlos Delgado Chalbaud | 1948-1950 | Military dictatorship | | 1948 | • New concessions to foreign companies over the oil sector to increase revenues |
| Germán Suárez Flamerich | 1950-1952 | Indipendent | | | |
| Marcos Pérez Jiménez | 1952-1958 | Military dictatorship | | | |
| Wolfgang Larrazábal | 1958 | Indipendent | | 1958 | |
| Edgar Sanabria | 1958-1959 | Indipendent | | | |
| Rómulo Ernesto Betancourt Bello | 1959-1964 | Democratic Action, AD | 1958 | | • Foundation of OPEC<br>• Agrarian reform<br>• Industrialization reform<br>• Neither nationalization of oil industry, nor complete liberalization [4] |

| | | | | | |
|---|---|---|---|---|---|
| Raúl Leoni Otero | 1964-1969 | Democratic Action, AD | 1963 | | • Promotion of agricultural and industrialization policies |
| Rafael Caldera Rodríguez | 1969-1974 | Social Christian Party, COPEI | 1968 | | • Increased state control over the natural gas industry<br>• Stopped petroleum concessions |
| Carlos Andrés Pérez Rodríguez | 1974-1979 | Democratic Action, AD | 1973 | | • Nationalization of iron and petroleum sector |
| Luís Herrera Campíns | 1979-1984 | Social Christian Party, COPEI | 1978 | | • Devaluation of currency through exchange rate policy<br>• Austerity measures to stop capital flight and reschedule foreign debt |
| Jaime Lusinchi | 1984-1989 | Democratic Action, AD | 1983 | | • Adoption of austerity measures. However, parallelly, increase in public spending to maintain support |
| Carlos Andrés Pérez Rodríguez | 1989-1993 | Democratic Action, AD | 1988 | | • 'Great Turnaround': Liberalization program and austerity measures |
| Octavio Lepage Barreto | 1993 | Democratic Action, AD | Ad interim President | | |
| Ramón José Velásquez | 1993-1994 | Independent | Ad interim President | | |
| Rafael Caldera Rodríguez | 1994-1999 | Independent | 1993 | | • 'Venezuelan Agenda: Liberalization program and austerity measures |

Table 2: All regimes from 1908 to 1999.

During the same period that saw the consolidation of Venezuelan democratic institutions, older Latin American democracies ended abruptly in violent coups. Between 1964 and 1976 the democratic regimes of Brazil, Ecuador, Peru, Uruguay, Chile and Argentina fell to the military. Although this process was reversed in the following years, Venezuela represented an exception of this authoritarian phase (Coronil 1997). Graph 2 below shows the democratic regimes in 1977.




Gaph 2: Countries with democracy in 1977.

The legitimacy of the Venezuelan formula was further supported by the creation of the Organization of Petroleum-Exporting Countries (OPEC) in 1960: it was established to provide greater stability and protect oil-producing countries from price fluctuations. As Karl (1997) said, "it succeeded in bringing about the most radical transfer of wealth ever to occur without war" (p. 3): oil prices skyrocketed from 3$ to 10$ per barrel, eventually reaching 40$ during the 1980s. This immense wealth could be used to "buy" support and produce vast economic growth. However, it could also be used for corruption and extraordinary overspending, causing increases in inflation.

Despite organizations such as OPEC, world oil prices are volatile. Events such as low investments, nationalization and fixed OPEC quotas provoke huge effects on production and revenues. This volatility reflects on the Venezuelan economy, especially since its high dependence on oil, as Chart 1 below shows. During the 1970s, oil made up an average of 90 percent of total exports, 60 percent of total revenue and 70 percent of total GDP (Manzano 2007, based on calculations from MEM and IMF 2004). In general, from 1955 to 2002, it is possible to observe that things did not change much: oil has always been fundamental for the Venezuelan economy. With respect to the volatility of its prices, Graph 3 provides the trend.

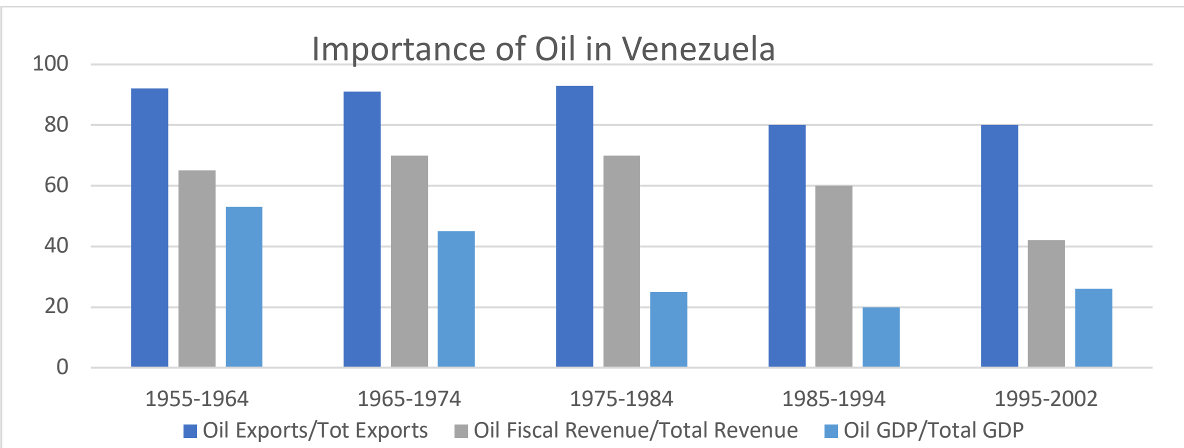
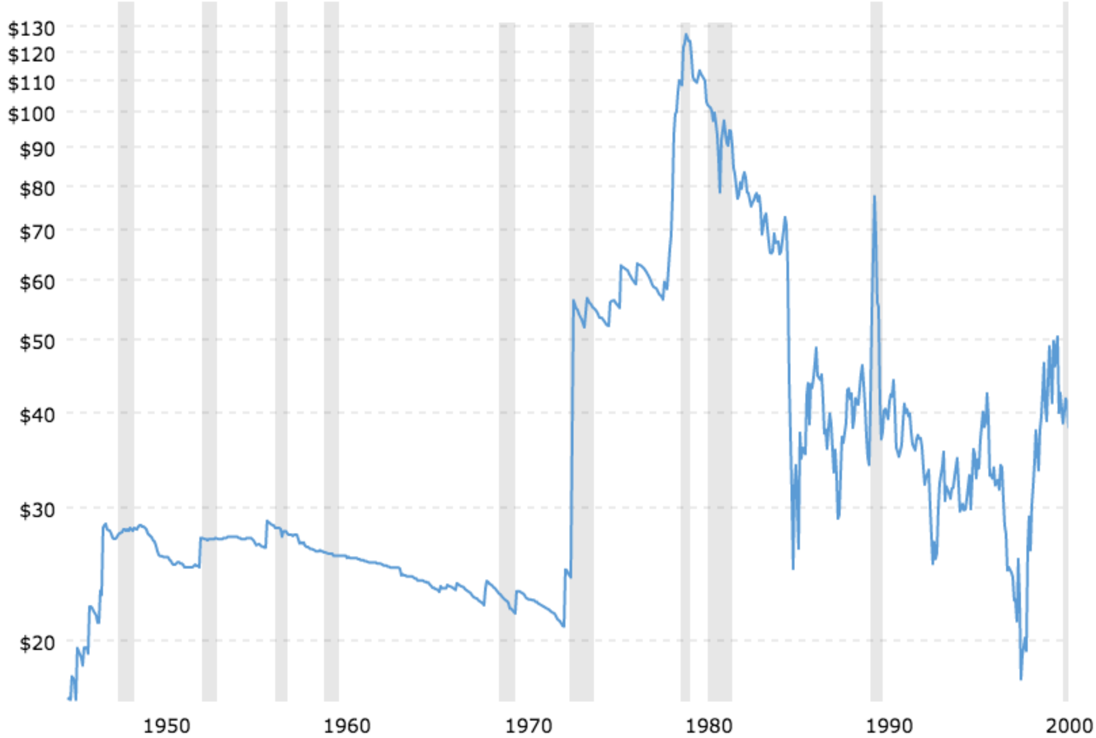



Chart 1: Importance of oil in Venezuela, from 1955 to 2002.

Crude Oil Prices in the world



Graph 3: Crude Oil Prices adjusted for inflation, from the 1950s to 2000. Data: Macrotrends.

It is thus clear that the resource also reflects on the political arena. Some economists, such as Haussman and Rodriguez (2011), argued that oil can fuel factionalism, since many groups aim at capturing some of its immense wealth, in an economy where the state is more and more present. Coppedge (1994), on the other hand, focused on how extraordinary oil profits make party members stay in the "party line" for fear of being expelled.

During the 1970s there was increasing factionalism in AD, divided between those who wanted to limit state power in the economy, and those who wanted to enhance it: the respective leading exponents were Betancourt and Carlos Andrés Pérez.

When Pérez became President in 1974, he focused on state-owned enterprises in his industrialization strategy. He nationalized the oil industry in 1976 and enhanced the role of the state in others so-called 'strategic' sectors of the economy (iron ore, steel, petrochemicals, hydroelectric power, bauxite, aluminium). This represented an important disruptive game changing: while before the state aimed at facilitating private investments through tariff protection and subsidized long-run credit, now it challenged it (Haussman and Rodriguez 2011). His administration benefited from massive oil revenues, which quadrupled during his presidency, making it possible to "buy" support, give subsidies to consumers and increase currency value and wages (Coppedge 1994).

### 1.4 80s CRISIS

During the 1980s, the country started experiencing a profound crisis. Together with a fall in oil prices, the parties' establishment was less and less able to manage the situation. Policy goals advocated in the 1960s by AD had already been implemented (nationalization of oil, land reform, increase in wages and employment, etc.), and new policies had not been proposed since 1964 (Coppedge 1994). Furthermore, extraordinary revenues from the 1970s had increased corruption, leading parties towards the extremes of infighting and staying in the "party line" to avoid expulsion.

Conflicts and factionalism in the parties started causing a huge capital flight crisis, which was aggravated during Luís Herrera Campíns administration because of raiding of investment funds of PDVSA (the national oil industry). Parallelly, non-oil private and public sectors were proving to be inefficient (in terms of profitability): in 1983 external debt was enormous, and 70 percent was state-owned. The 18th of February 1983, known as the Black Friday, the government could no longer maintain the exchange rate that was fixed in 1961, and it thus devaluated the currency by 40 percent (Di John 2009). A multiple exchange system emerged, together with currency and capital controls. The government allowed private debts to be repaid at the old parity, and capital flight meant huge tax evasion: hence, few firms repaid what they had to, and the Venezuelan external debt remained immense. The government was forced to increase savings and reduce public and social spending, causing a contraction in economic growth and real wages. Inflation, which had been historically low since the 1960s, reached more than 20 percent in the 1980s (Di John 2009).
Surveys made in 1984 and 1985, taken up by Templeton (1992) and rediscussed by Coppedge (1994), showed that the population believed bad administration, corruption and decline in moral values to be responsible of the country's foreign debt and its economic crisis.

When Pérez was re-elected in 1988, he had to deal with an economic recession, and he did so by adopting IMF austerity measures (increasing prices) and by undertaking a loan. He saw this macroeconomic program as the way out of the economic and fiscal crisis; however, this meant a huge shift from his electoral promises not to side with neoliberalism (López Maya 2002). The people that elected him in the hope he would somehow return Venezuela to the boom it had enjoyed during his first government, ended up organizing in 1989 the social riot that was always going to be remembered as the *Caracazo*.
According to López Maya (2002), "the Caracazo was a turning point in Venezuela's political history, producing an irrevocable change in the relationship between state and society, above all in the way Venezuelans gave expression to their demands and feelings of malaise" (p. 202). Coronil (1997) describes it as the largest and most violently repressed revolt against austerity measures in Latin American history, since Pérez reacted by declaring a state of emergency and sending the army onto the streets.
The country has experienced the worst economic performance since the Great Depression that year: production dropped by 8.3 percent and inflation increased to over 80 percent (Coppedge 1994).

These events led to increasing instability in the political system and its control of society. Wages were falling and inequality was rising. The oil sector was covering only 5 percent of total employment, and the Gini coefficient, which represents income inequality and goes from 0 to 1, was oscillating around 0.5[5] (Freije 2011; Di John 2005).

On the economic field, Pérez was a pioneer: his plan 'Great Turnaround' was to liberalize the economy through devaluation of the exchange rate, trade liberalization, privatization, freeing of interest rates, elimination of nearly all restrictions on foreign investment, and the introduction of tax reforms, including the introduction of value-added taxes (Hausmann 1995; Di John 2005).
International agencies like the World Bank, the IMF, and the Inter-American Development Bank greatly supported neoliberal reforms throughout the region. Trade liberalisation for industry was the most rapid and profound in Latin America at the time: "The maximum tariff

was reduced from 135%, one the highest in the region, to 20% by 1992. By 1993, average tariffs declined further to 10%, one of the lowest levels of trade dispersion among Latin America's major liberalisers" (Di John 2005, p. 110-111).
However, social conditions and increasing disillusionment towards the parties can explain the 1992 coups and the following impeachment of President Pérez. The abandonment of the AD and COPEI establishment benefited independent politicians who took advantage of the situation: some, such as Octavio Lepage Barreto and Ramón José Velásquez took the presidency for a couple of years, appointed by the Congress. Then, another politician became, paradoxically, the beneficiary of the anti-establishment sentiment: founder of COPEI, signer of the *Pact of Punto Fijo* and former President, Caldera. It is worth noting how this happened: after having performed a passionate speech against Pérez policies in 1992, he left his party in order to candidate himself as independent, under a coalition called National Convergence. This abrupt break won him the elections in 1993. In those elections, votes for the AD and COPEI establishment were drastically low with respect to the past: the bipartisan hegemony was breaking up, while parties such as the Movement Towards Socialism (MAS) and The Radical Cause (La Causa R) were acquiring support.

## 1.5 RAFAEL CALDERA

The situation Caldera had to deal with was an unprecedented one, since for thirty years politics had been dominated by the parties. He did not have the support of the main parties; on the contrary, he had a strong opposition in those who controlled a majority of the seats in the Congress. Furthermore, there was decreasing confidence in the elections, a weak and divided military, difficult relations with organized labor, and an uneasy private sector (Coppedge 1994). The first two were the result of an evolutionary process, one caused by increasing disillusionment within the population, the other by growing division within the military and resentment towards the President authority. As for the workers, even though Caldera was the author of the Labor Law (which granted job stability by imposing dismissal only for just cause, compulsorily explained to a mediation apparatus), he could not do much since revenues were falling, and he could not limit disappointment of unions since he had no institutional connection to them. Lastly, the firms in the private sector had grown dependent on protectionism, state subsidies, and political connections, and they found it difficult to survive in an open market economy where they had less political influence (Ellner 1999).

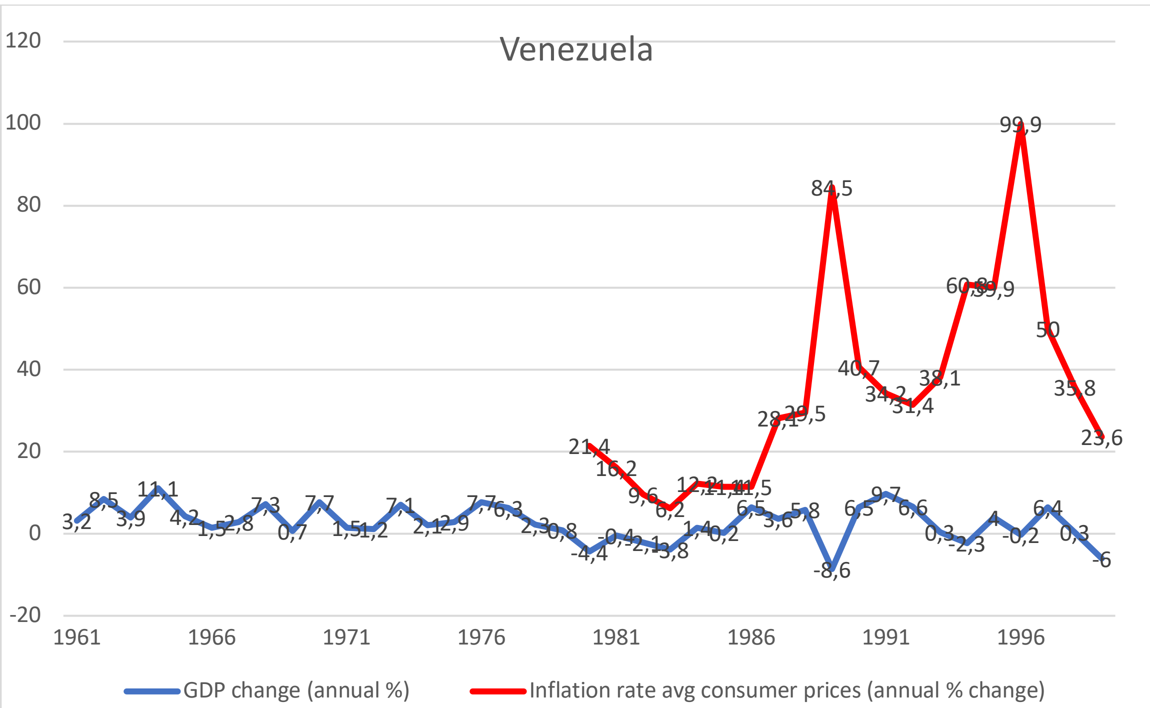
In the early 1990s, the country's economy had been growing due to neoliberal reforms supported by IMF and rise in oil prices; however, oil prices started to decline once again, and the economic crisis was aggravated by failure of Banco Latino in 1994. Built upon political connections and unsustainably high interest rates, the bank was the second-largest one in the country, and it had become the largest holder of government treasury bonds. The huge Ponzi scheme hit small depositors, PDVSA[6] pension funds, armed forces and insurance deposits, causing uncertainty and fear to spread. Economic activity fell by 3 percent, and inflation reached 70 percent by end-December (Coppedge 1994).

Caldera, despite having opposed the austerity measures adopted by Pérez in his electoral program, ended up doing the same thing, realizing the importance of letting a real market economy to take place (Ellner and Hellinger 2003). He adopted in 1996 the so-called 'Venezuelan Agenda': it consisted in liberalizing the economy and privatizing the inefficient public businesses (in that period, public debt was major). The government sold almost the entire telecommunication company CANTV, and the state-owned steel company SIDOR. Privatization and increased foreign participation were able to boost investments and improve competition and supervision in the financial system (IMF 1998). Caldera also promoted the *apertura petrolera*, that is to partially open the oil sector to foreign investments: however, parties such as Causa R strongly opposed this on nationalistic grounds.

The economic liberal program consisted of increasing domestic fuel prices, liberalizing interest rates and unifying exchange rates (causing devaluation of the bolivar), abolishing controls on capital transactions and prices, and start strengthening the social safety net (IMF 1996). The IMF stated in 1996 that the success of Venezuela's ambitious economic program depended on its successful implementation and maintenance and on the strengthening of institutions able to react effectively and rapidly to changing developments.
Foreign investments, greater discipline in public spending and increase in oil prices allowed the economy to recover in 1997. Inflation, which had reached 135 percent in 1996, decreased to 36 percent in 1998 (IMF 1998). Unfortunately, this period of prosperity did not last long: the *apertura* had boosted production over the agreed OPEC quotas, and that, combined with a simultaneous decrease in international demand, caused world oil prices to fall in 1998. Caldera agreed to cut production, but it did little to ease falling prices.

Economic and social conditions were deteriorating, and the population lost faith in the parties and in the neoliberal policies adopted by Pérez and Caldera (especially because they were not what the candidates had promised). Furthermore, especially under Caldera, innovations and policies were usually blocked from the Congress: as Ellner and Hellinger (2003) report from El Universal (2001), the consequence was that “poverty increased more rapidly in Venezuela than in any country in the region” (p. 123).

Since the macroeconomic indicators of GDP and inflation are usually used to describe the Venezuelan framework, and since this moment (late 1990s) is considered a critical period in the country’s history, Graph 4 below provides the trends from the 1960s until 1999.




Graph 4: Data from The Word Bank and IMF.

## 1.6 POPULIST BREAK

The social, economic and political process that has been developing until now had created a scene for a populist break. Let us recall the *Caracazo* as the rupture between the population and the neoliberal politics, and as key to understanding the vast discontent and the antidemocratic and antipopular reaction of the government (because of the fierce repression ordered from Pérez). Moved by discontent, many social and political groups started organizing coups: one of them was the clandestine organization called Bolivarian Revolutionary Movement-200 (MBR-200). One of its leaders, Hugo Rafael Chávez Frías, appeared for the first time in national tv during the 1992 coups, giving face to the revolt. All insurgents were imprisoned, but when Caldera was elected, he decided to free them, allowing them to form a legitimate national political organization.

The MBR-200 was born in the 1980s and it advocated nationalism, military values and fight to corruption. Their vision of revolutionary changes made by leftist civilians and the military was supported by parties such as the Party of the Venezuelan Revolution (PRV), the Radical Cause party, the Red Flag and the Socialist League (López Maya 2003). The structure of the party was the following: at the bottom, there were the Bolivarian circles, which were small local groups who took the oath to be hardworking, honest, humble, and show solidarity (MBR-200 1994, cited by López Maya, 2003). Then there were the Bolivarian coordinators, and at the top the National Directorate; it was composed of Chávez, Luis Alfonso Dávila (future Minister of Foreign Affairs) and some policemen and civilians. The party used nationality symbols, figures such as Zamora, Rodríguez and Bolívar: hence, the movement was represented by a "tree with three roots", characterized by popular, patriotic and revolutionary ideas.
When Chávez decided to participate to the elections in 1998, he did so with a new party called Fifth Republic Movement (MVR). The new party was to be more adaptable, and it included all people who supported Chávez as President[7]. He finally won with 56.2 percent of the votes: "once again the image of a failed government and a society on the edge of an abyss favored strong electoral support for the option of change" (López Maya 2003, p. 73).

## 1.7 HUGO CHÁVEZ

Chávez became President in 1999, advocating a participatory democracy, abandonment of neoliberal policies and elimination of corrupt parties. He was the only candidate to address specifically those who had suffered from the inequality over the last decades: the poor, the unemployed, the excluded. Parallelly, he used nationalistic emblems and symbols to appeal them.
The first thing he did was a popular referendum to elect a constituent assembly: the referendum passed, and his alliance won 125 deputy seats over 6 of the opposition, gaining him extraordinary influence (López Maya 2003). The assembly wrote a new constitution that was approved in a national referendum that same year. The new *Magna Carta* enhanced civil rights, protected and strengthened the military, reconstructed and weakened the judicial system while reinforcing the executive branch (increasing concentration of powers in the President), and aimed at a democracy by direct participation. Furthermore, it changed the name of the country into Bolivarian Republic of Venezuela.

The economic landscape was still characterized by recession: in 1999 real GDP fell by 7.2 percent, and unemployment reached 15.4 percent, the highest in four decades (Costa and Olivo 2008). Chávez blamed the parties for the country's recession, highlighting the corruption and clientelism behind them.

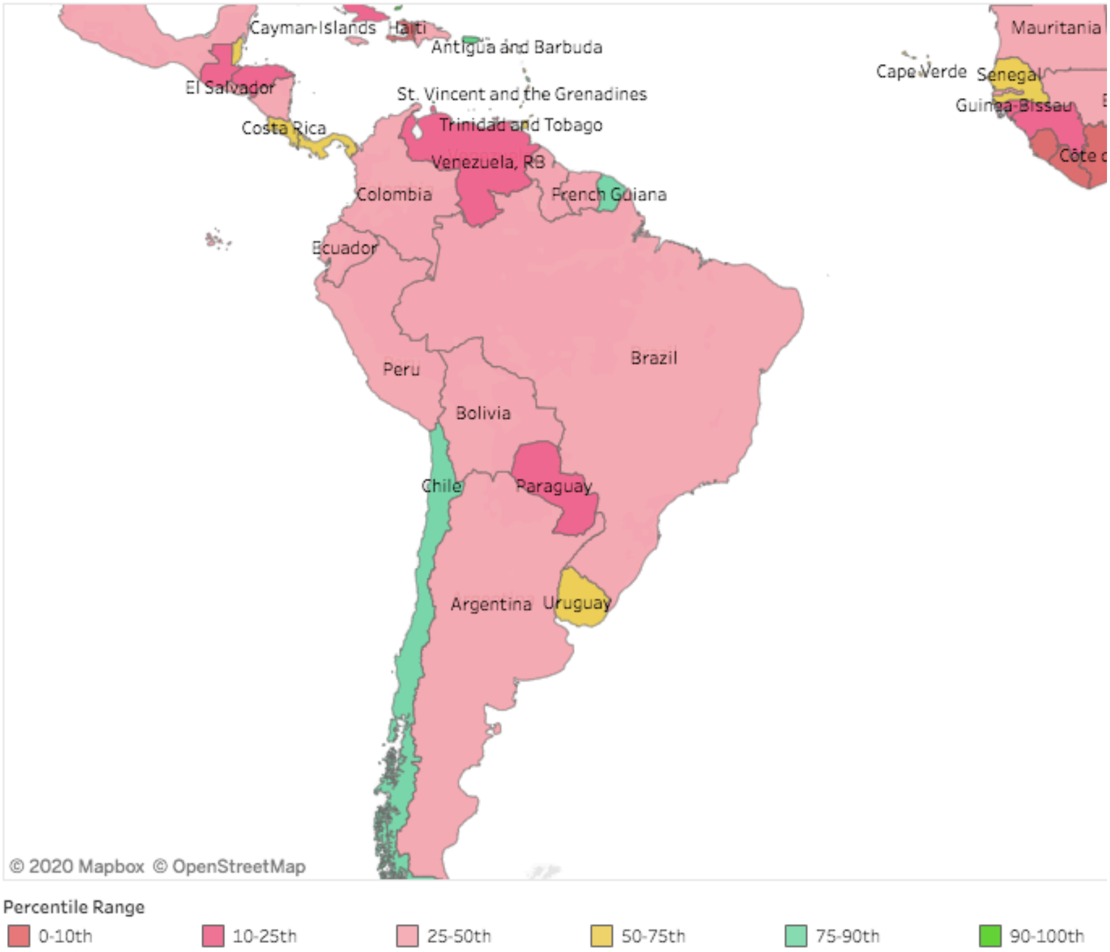
He reacted by strengthening oil prices through OPEC fixed quotas and by starting to reverse the privatization of the oil industry. At first, the government was adopting a mixed policy: it "neither reverted to the traditional left-wing policy of controlling strategic sectors nor opted for the wholesale privatization of state assets recommended by the liberals" (Buxton 2003, p. 124). In a second moment, however, he started expropriating private businesses and nationalizing all strategic sectors.

To avoid extremely high exchange rates and inflation, and to decrease interest rates, Chávez was able to save some of the revenues from the 1999 and 2000 peaks in oil prices, putting them in a macroeconomic fund (Ellner 2001). He also lightened the state fiscal participation by modifying tax collection in the oil sector, increasing royalty revenues and decreasing fiscal participation: between 1980 and 1989, it had averaged 70 percent, and by 2001 it had dropped to 30 percent (Dachevsky and Kornblihtt 2017). Consequently, GDP grew to 3.7 percent in 2000, and inflation dropped to the lowest in fifteen years, at 14.2 percent (World Bank; Lopez Maya 2003).

With regard to foreign policy, the new government opposed the U.S. on different issues such as Cuba events, Colombian guerrillas and drugs controls (Ellner 2001). Chávez wanted to be less dependent from the U.S., and he ignored their plan of creating a free-trade zone in North America for fear of increasing international competition. Because of his anti-U.S. and authoritarian tendencies, he preferred making agreements with the authoritarian government of China. This was possible because of China's increasing industrialization, which rose demand and prices of Latin American countries' raw materials: from 2000 to 2013, Chinese trade with Latin America rocketed from $12 billion to over $275 billion (Reid 2015). Moreover, with respect to the IMF or financial markets, China had less restrictions on loans and was thus preferred.

As authoritarian governors do, Chávez's administration aimed at increasing the power of state and military and at changing the judicial, economic and political system. The President's authority was strengthened in the 1999 constitution: the term was extended to six years, and he could summon referendums. Furthermore, the Senate was eliminated and public financing for the parties was withdrawn, weakening the opposition. As Monaldi and Penfold (2006) describe it, "whereas in the Punto Fijo period the center of the democratic system revolved around political parties; in the Chavista era, the center of gravity of the system is the President" (p. 19).

In order to understand the authority and influence of law in the society, especially seen as constraints on individuals (such as the President) and institutions (such as parties), it is worth looking at the Rule of Law indicator. The World Bank provides Graph 5 below, indicating the respective percentile of the indicator in Latin American countries in 2002: Venezuela reaches extremely low levels, falling into the second-lowest percentile.
Taking advantage of this lack of constraints, the executives could use oil income as they wished, without having to provide any transparency (another governance indicator from the World Bank, so-called Control of Corruption, puts again Venezuela in 2002 in the second-lowest percentile).



Graph 5: Percentile ranges of the Rule of Law in Latin America in 2002.

The oil sector had been nationalized in 1976, but through the *aperura* it had acquired some degree of autonomy from the state. However, Chávez started to progressively increase state control over the PDVSA company, acquiring more and more power over oil wealth. Profits were used for his economic and social objectives, furtherly empowering his position.

By shifting powers in the hands of one person, the presidential system reversed the partisan system initiated in 1958. This line of actions provoked growing polarization in the social and political field: political parties, businessmen, military and the society at large felt threatened by the President. The spreading discontent finally culminated in three general strikes, one attempted coup and many street riots.

The relationship between the President and the private sector was already hazy and instable, due to many popular reforms, government restrictions and expropriations. Some business groups, such as Fedecamaras and Venezuelan Workers' Confederation, led strikes in 2002-2003, and the President reacted by firing the majority of workers and by making alliances with other business groups (including Bolivarian Federation of Cattlemen and Agriculturalists, Fegaven, and Fedeindustria), promising them preferential exchange rates. Furthermore, in 2003 Chávez prohibited the possibility to transform revenues in dollars and send them abroad, showing his anticapitalistic and socialist inclinations (Ellner 2019). These attacks towards the private sector provoked further decreases in investments and, together with the strikes, they caused a worsening of the economic condition: GDP fell to -9.6 percent in 2002 and inflation reached 27 percent in 2003 (World Bank).

Social programs, called missions, had been implemented to deal with health, education and housing. This was done in light of Chávez's electoral promises in order to maintain popular support: the MVR advocated for social objectives over economic ones, opposing itself to neoliberalism. Between 1998 and 2001, social expenditures as a proportion of GDP rose from 8.4 percent to 11.3 percent, but many critiques were made regarding the social reforms (Parker 2005). For instance, in the health field, presence of Cuban doctors was criticized because not accompanied by preparation of national doctors, and the reform of food distribution seemed to be counterproductive in that it preferred cheap imports over national products (Ellner 2019).

In the 1999 constitution, the President had already banned the financing of political parties in order to weaken the opposition, and in 2006 he moved a fierce attack against the media. Without opposition parties, it is clear how television and press represented the next target. Chávez did not renew the license of Radio Caracas Televisión (RCTV), the most viewed TV network, even if it was not to expire until the next year. This move was condemned by most international countries and organizations as a massive breach of democracy (organizations such as the socialist Spanish government, the European Parliament, the French Socialist party, the Brazilian and Chilean senates, Reporters without Borders and Amnesty International). Later on, in 2007, he actually nationalized the entire telecommunication sector.

In 2007 a new constitution was drafted, and it "constituted the most radical blank check on presidential powers in the democratic history of Latin America" (Corrales 2011, p. 85). It extended the President's term by one year (as he did in the 1999 constitution), it made the President the only candidate of indefinite reelection and gave him power to appoint the communal councils and vice presidents, further increasing the extent of his authority. The state had now the power to expropriate any private property, to control the Central Bank, and to concentrate powers in the executive branch. A public opinion poll conducted before the vote reported dissatisfaction to these changes, and he finally lost the following referendum for the first time (DeShazo 2007). Fearing the decrease in popular support, when elections of 2008 came up, the government excluded many people from candidacy, but the opposition, who had reacted by abstaining in 2001-2004, started campaigning and unifying.

On the economic side, Chávez's government preferences for local capital (over foreign) and public sector (over private) extremely decreased investments. Moreover, great government spending was followed by high inflation, providing a bleak picture. To fight inflation, it was decided to impose price controls, which made production unprofitable and produced a shortage of supply: scarcity grew along with poverty and inequality.

Chávez, as many "pink-tide" governments, always refused to adopt neoliberal policies during an economic crisis. Contrarily, he strengthened the presence of the state in the economy, pulling away foreign corporations. As Ellner (2019) discussed, disinvestment from the private sector continued to generate economic and political instability.

### 1.8 NICOLÁS MADURO

Nicolás Maduro Moros had been a member of MVR at first, and of the PSUV party (United Socialist Party of Venezuela) later on. He had been the Minister of Foreign Affairs from 2006 to 2013 and Vice President of Venezuela from 2012 to 2013. Finally, he won the 2013 elections, for Chávez had presented him as his successor before his death. In those elections, the strongest opponent party was Justice First, whose leader Henrique Capriles

Radonski lost by a 1.5 percent difference (Angosto-Ferrández 2019; Corrales and Penfold 2015). This extremely close win shows that the opposition was strengthening and gaining support (Ellner 2013).

Being chosen by Chávez, Maduro's campaign was tied to his legacy. He advocated nationalistic and populist values, and the need to fight corruption of businessmen and party members.
However, the economic recession that he had to face was extreme. Inflation was high and increasing, due to lack of foreign investment in the non-oil sector, monetary disorder and exchange rate fluctuations. Maduro's policies could not reverse this process: actually, his extraordinary spending worsened the situation, and his Law on Fair Costs and Prices drove further away domestic and foreign investors, causing increases in prices and inflation (Vera 2015). Corrales and Penfold (2015) supported the idea that "factionalism and electoral insecurity prevented Maduro from taking the necessary economic correctives" (p. 172).

As former Minister of Foreign Affairs, Maduro promoted Latin American unity, especially with Colombia, Brazil and Argentina. Colombian support of Maduro was due to trade and national security reasons. Brazil was important because its exports to Venezuela had increased by 533 percent from 2003 to 2013 under the Chávez administration, and Argentina was the largest market in Latin America (Corrales and Penfold 2015). With respect to other Latin American countries, in 2014 Venezuela's inflation was six times the average, and GDP growth was three times smaller, falling by 3 percent (Comparative Economic Studies 2015). However, the international environment seemed somewhat favorable to the rise of the Maduro administration: peace with Latin American neighbors, allies such as China and regional international organizations (Corrales and Penfold 2015).

Speaking of the international environment, it is observed how the relationship with the U.S. had grown terribly worse during the Chávez and Maduro administrations. In 2014, President Obama publicly declared Venezuela a threat to U.S. national security, furtherly diminishing investments (Ellner 2019). Inflation reached three digits, and as real wages fell, companies went bankrupt. Extreme overvaluation forced the government to decide who would have access to a cheaper dollar: this caused increasing value of the parallel dollar, relative to the official one. While the former rose to 880 bolivars by the fourth trimester of 2015, the latter remained at 6.30 (Dachevsky and Kornblihtt 2017). This meant that only those who operated with the preferential exchange rate could generate revenues.

In 2017 and 2019, the U.S. imposed financial and oil sanctions, provoking further major consequences. Financial sanctions included asset freezing, visa restrictions, excluding the country from U.S. financial markets (2017) and blocking U.S. companies to do business with Maduro's government (2019). Others were about Venezuelan power to issue and use digital currency, prohibition of purchasing of the country's debt and its gold. In addition, all property and interests of PDVSA in the U.S. were blocked. The E.U., starting in 2017, also imposed sanctions on arms import, travel bans and assets' freeze.

Since Venezuela is a petro-state, sanctions on the oil sector reverberate on the overall economy. While in old regimes the oil industry was controlled through royalties and taxes, during the Bolivarian revolution the mechanism of revenues distribution was changed. For instance, the manipulation of the exchange rate in order to channel oil rents was introduced. Furthermore, extrabudgetary funds obscured accountability and contributed to the centralization of power in the President, since oil wealth was in fact primary used to support the government (Bull and Rosales 2020).

Due to contraband, scarcity of goods and hyperinflation[8], disproportions between official prices, exchange rates and market ones kept increasing. Maduro lacked a defined economic policy: as he rejected Chavistas extremisms, neither did he follow economic liberalization advocated by moderates (Nelson 2019). The gap between the prices also hurt the oil industry, since it was obliged to sell dollars to the central bank at the official exchange rate, even though paying salaries and materials in an increasing inflationary context (Bull and Rosales 2020). The more oil prices fell, the worst were the distortions. Maduro failed to unify the exchange rate, and the U.S. sanctions already put in jeopardy the country's position of net oil exporter. In fact, production plummeted to the lowest in at least twenty years.

In reaction to U.S. and E.U. sanctions, in 2018 the government launched its own cryptocurrency, the *petro*. Its use was incentivized by the financial restrictions on money, domestic controls over exchange rate and lack of cash. The *petro* was backed by oil, diamond, gold and gas reserves; it aimed at arresting the bolivar slide, and at obtaining dollars, now that the country was excluded from international markets. Nonetheless, it further obscured national accounting and transparency, and it did not attract many investors (Bull and Rosales 2020).

Regime crisis peaked in 2018-2019, when presidential elections would be considered illegitimate and the National Assembly would not recognize Maduro's re-election. In fact, Juan Guaidó, president of the National Assembly, accused Maduro of having manipulated the results and, as the Constitution states, the head of Parliament can replace a disabled President. Most European nations and the United States recognized Guaidó as legitimate President, while Maduro had the support of Russia and China. Russia had become an important ally to the government in power, due to its desire to extend in America and due to U.S. sanctions targeting Russian oil production as well (Buxton 2018). Maduro and the PSUV eventually survived, accelerating the anti-democratic process. The electoral system was so tarnished that it was no longer possible to imagine conducting free and fair elections using the current system (Corrales 2020).

The IMF in January 2020 reports lower inflation in Venezuela, due to growth containment measures in money supply. Still, the country is experiencing hyperinflation. In the last five years its economy contracted by 60 percent, and polarization reached extreme levels, as 80 percent of the population is in extreme poverty. The IMF expressed little hope that the actual government could recover its situation, as they highlight the migration phenomenon towards the countries nearby.

### 1.9 COVID-19 IMPACT

During the last years, health care services collapsed, and old diseases re-emerged. Lack of investments in the health sector provoked shortages of equipment and drugs, and the US Centers for Disease Control and Prevention noticed how diseases including diphtheria, dengue, pneumonia and HIV were spreading. Parallelly to acute shortages of medical supplies, specialists were missing as well (Dickinson 2016).

Due to the current economic and humanitarian crises, countermeasures are difficult to implement, and the impact of COVID-19 will be devastating (Buxton 2018).

# CHAPTER TWO: WHY NATIONS FAIL

Daron Acemoglu and James A. Robinson, in their book *Why Nations Fail* [9], propose to explain why there is inequality between nations in the world. To do so, it is necessary to go back and study the societies of the past, examining all those critical junctures in history which caused divergences in institutional paths (for instance, the colonial period, wars and plagues, and many others).

Several theories have been proposed to explain the source of inequality in the world: among these there are the geography, the culture and the ignorance theories. Acemoglu and Robinson call into question the validity of these theories by analyzing some countries' differences in history.

The geography theory finds a correlation between inequalities and geographical differences, and it explains the poverty of Africa, Central America and South Asia by pinning it on their position between the two tropics of Cancer and Capricorn. A modern version focuses on tropical diseases and soils, which are said to impede growth. Acemoglu and Robinson strongly opposed this theory by examining the empirical evidence of countries such as Korea (North and South) and Germany (West and East before the fall of the Berlin Wall), whose internal differences cannot obviously be explained by geographical differences. They also reconduct tropical diseases as a consequence of the government unwillingness and inability to undertake health measures, and the productivity of the soils as depending on how it is organized the ownership of the land and on which incentives are given to the farmers by the institutions. Hence, they observe that the geography theory cannot explain inequality in the world, which does not depend on the productivity of the soil, but rather on the uneven dissemination of technologies. "This technological gap persists today and reproduces itself on a bigger scale" (p. 53), and it depends on the country's (or rulers') ability (or desire) to seize transformative changes.

The culture theory is based on differences in religion, values and ethics. While Acemoglu and Robinson recognize the connection between social norms and institution, they do not think that this connection is enough to explain inequality all over the world. They once again oppose to this theory the iconic example of the two Korea, which before 1945 had homogeneous cultural values. However, after that, differences between North and South Korea became enormous. The theory cannot explain the poverty of non-oil producers in the Middle East either, as they can be found in the consolidation of exploitative and authoritarian regimes that have always characterized them (from the Ottoman rule, to the European rule, to independent extractive elites). Finally, China's poverty and prosperity alternated in accordance to its leaders' different approaches (not because of changes in culture). The country has always been characterized by authoritarian regimes, and in the mid-1900s it was one of the poorest countries in the world. Then Deng Xiaoping came to power, and he started a process of economic transformation (reform markets and incentives, enforce property rights, expand international trade, reduce control over prices, etc.), which led the country to a much greater prosperity. It follows that Acemoglu and Robinson do not recognize the validity of the culture theory, and rather found the reason of inequality in the different types of institutions (for instance, authoritarian regimes usually do not come with inclusive institutions that stimulate growth).

The ignorance theory finds the root of inequalities in the decisions of rulers. It is the theory held by most economists, where countries are poor because of market failures that economists cannot get rid of. Acemoglu and Robinson refute this theory, and alternatively find the origin

of failure in the different institutional constraint and incentives that the leader faces. For instance, in Ghana, the government of Nkrumah of the 1960s had been advised by many economists, who knew the adopted policies to be bad (between those, an advisor was Sir Arthur Lewis, Nobel laureate and famous development economist). However, Nkrumah had them implemented not so much for ignorance, as to buy political support to back his undemocratic regime. Hence, they sustain that the main obstacle to the implementation of "good" policies that encourage economic growth is not ignorance, but the constraints and the incentives (political and economic) that rulers face in their societies.
The main difference between this theory and the others (the institutional one included), is to be found in the presence of an "easy" solution. That is, it is possible to engineer prosperity under enlightened policy makers and rulers. The IMF usually propose policies aiming at stabilizing and improving some macro and microeconomic factors (capital account liberalization, freeing of exchange rates, privatization, anticorruption measures etc.). Anyway, Acemoglu and Robinson discuss that "attempts by international institutions to engineer economic growth by hectoring poor countries into adopting better policies and institutions are not successful because they do not take place in the context of an explanation of why bad policies and institutions are there in the first place, except that the leaders of poor countries are ignorant. The consequence is that policies are not adopted and not implemented, or are implemented in name only" (p. 447). Hence, it is difficult to apply valid changes if the institutions are the root of the problem.

## 2.1 THE INSTITUTIONAL THEORY

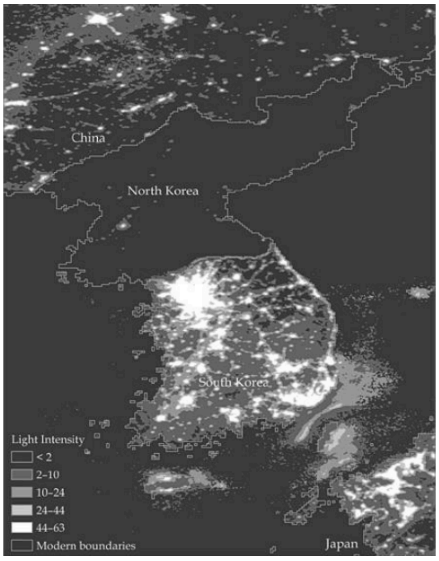
As for Acemoglu and Robinson institutional theory, different institutions play a vital role in explaining the root of inequality in the world. Political institutions shape economic institutions, which affect the incentives of businesses, individuals and politicians and determine the country's prosperity (or poverty). The patterns of these institutions have to be traced back in history to understand their development and how they created inequalities that persist to this day.

There are two types of institutions, *inclusive* and *extractive*. Extractive institutions are called so because one social class aims at extracting incomes and wealth from another class. General characteristics of extractive political institutions are concentration of power in few hands and incentives for the elite to continue to divert wealth and resources for their own gain, to further strengthen their grip on power. These institutions create and sustain extractive economic institutions, which harm markets, discourage technological innovation and do not incentivize people because of lack of property rights. The process of creative destruction, which replaces old technologies and ideas with new ones and is key to economic progress, is allowed to happen only under inclusive political and economic institutions. The main obstacle is to be found under extractive institutions, where the elites fear to lose their political and economic power and thus act to impede the process to develop.
An iconic example of extractive institutions is North Korea, where after the war in 1945 Kim Il-Sung proclaimed himself as dictator, supported by the Soviet Union. A command economy (rather than a market economy) was introduced, and the concept of private property was eliminated. Productivity fell, progress could not take off and the country rapidly collapsed.

Inclusive political institutions achieve a certain degree of political centralization which allows for a secure system of law and order and the protection of property rights to take place, and which allows distribution of political power in a pluralistic manner. Inclusive economic institutions are in turn characterized by enforcing of civil and property rights, encouraging of

investments and innovations and freedom of exchange in a level playing field. The creative destruction process finds its place here.
An example to be noted is that of South Korea, which after the war was led by Syngman Rhee, and later by General Park Chung-Hee, under the U.S. sphere of influence. Despite the authoritarian nature of their regimes, economic institutions were allowed to become more inclusive, stimulating growth and drifting the two Korea further and further away.

Acemoglu and Robinson provide a map (p. 72) to show the difference in living standards and the economic gap between the two parts of Korea: the image uses data on the intensity of light at night, seen by satellite.




This profound difference cannot be explained by either geography, culture or ignorance of the ruling class. Institutions, especially political, are the core of inequality and the heart of the institutional theory.

### 2.2 EXTRACTIVE AND INCLUSIVE INSTITUTIONS OVER THE CENTURIES

The book proceeds by examining various extractive and inclusive institutions over time, studying their characteristics and how and why they consolidated, or were transformed.

China has always been characterized by a centralized authoritarian regime: the monarchy reigned supreme and such a thing as a Parliament did not exist. Even though the country had been a major naval power and involved in international trade before Europe, Ming emperors in the late 1400s and early 1500s feared the process of creative destruction that could stem from increasing international trade. They first monopolized it, and then directly banned it. This reaction deeply influenced the institutional path of the country. Extractive and instable regimes followed, and the economy was to be stagnant during the $19^{th}$ and the early $20^{th}$ centuries. When the Industrial Revolution burst, Chinese revolutionary forces were too weak, and extractive institutions persisted unchanged. Hence, the country could not benefit from the industrialization process (yet another critical juncture). “Whether a country did embark in industrialization was largely a function of its institutions” (p. 299), and the creative destruction power that springs from it would change the paths of the countries who could seize it. That is exactly why extractive rulers feared these transformative processes, because they were scared to lose grip on power.

Parallelly, in Japan in the 19th century there was a society similar to those of medieval Europe, characterized by extractive institutions and poverty. However, in the south, there was a domain called Satsuma, that the rulers could not control (thus the degree of centralization of power was less than that of China, allowing for a more pluralistic nature). It wanted to expand trade and build a modern state in all Japan. A process of transformation of institutions started to take place, allowing Japan to become the primary beneficiary from the Industrial Revolution in Asia. Consequently, more inclusive political institutions followed, allowing it to be the first Asian country to have a written constitution, which stipulated the presence of an elected parliament and an independent judiciary. The seizing of the Industrial Revolution made China and Japan progressively diverge, thanks to Japan's inclusive institutions that allowed the country to benefit from this process.

From this comparison, Acemoglu and Robinson highlight how different degrees of state centralization interact with the nature of their institutions. While China had too high a level of centralization (to the point of resulting in absolutism and dictatorship), and thus could not give space to other forces to develop and divert the country's path, Japan had a slightly less centralized state, and Satsuma's transformative forces could develop and impact the whole country. Neither too low a level of state centralization is advised, since there is not a central authority to enforce order and property rights (as in many African states).

The China of Mao, the Cambodia of Khmer Rouge, the North Korea of Kim Il-Sung and the Soviet Union under Lenin and Stalin, were all governments inspired by Marx's idea, who envisioned a system that would generate prosperity and greater equality. However, these countries were characterized by highly extractive institutions, which concentrated the power in the hands of the Communist parties, without posing any constraint to it. In such a way, these movements led to dictatorship, violence and poverty.

Extractive political institutions generally concentrate power in the hands of the few, and few constraints are posed to the extent of their power. The reason why rulers would decide to take on extractive institutions is to extract wealth from the mass; the reason why they would keep them on is because of fear of creative destruction. As a matter of fact, economic growth is a transformative and destabilizing process, which threaten rulers because it involves a process of redistribution of income and power which could leave them worse off. Inclusive political institutions, on the other hand, allow the creative destruction process to happen. In order to do so, they need some degree of centralization, which still allows a pluralistic system to take place, and with it, greater political rights and equality.
As a moderate degree of centralization allowed England to experience inclusive institutions, an excessive centralization of power tends towards absolutism and dictatorship.

England is widely used as example of progress. Taking advantage of critical junctures in the 17th century such as the English Civil War and the Glorious Revolution, it developed a more inclusive, pluralistic society, both in politics and economics. It encouraged investment, trade and innovation, and property rights and law and order were enforced. Prosperity grew, paving the way to the Industrial Revolution (which thus started in England not by chance, according to Acemoglu and Robinson).
The Industrial Revolution, as a strong transformative process, highlighted the world inequality between countries who were developing and those who were not. Different reactions depended

on the institutions which were in place at the time, which were shaped by their institutional history throughout the centuries.
For instance, Spain and France in the 17th century were still governed by powerful monarchies. Trade was monopolized and opposers had very little power to change things, hence the countries could not benefit from the Industrial Revolution in the same measure. Eastern Europe was even more backward: serfdom was still legal, and a quasi-feudal system was still in place. These comparisons show how "there are formidable barriers against gradual improvements, resulting from the synergy between extractive political and economic institutions and the support they give each other" (p. 106), and these barriers impede the countries to fully benefit from critical junctures such as the Industrial Revolution.

With regard to incentives, the heart of the Industrial Revolution in England was the introduction of a new patent system in 1623, which was promptly adopted by the United States. This allowed the country to become the most economically innovative country during the 19th century, characterized by an extensive banking system with great capital, high competition and low interest rates. This was possible because of the inclusive nature of U.S. political institutions: politicians were subject to elections, and greater political rights ensured equal access to finance and loans.

This obviously did not happen in countries such as Mexico, where "the exploitation of indigenous people and the creation of monopolies, blocked economic incentives and initiatives of the great mass of population" (p. 32). Mexico was characterized by low competition, high interest rates and preferential treatments. These were consequences of the extractive institutions that have been developed over time, that posed few constraints on those with power and few political rights for the rest of society.

### 2.3 GROWTH UNDER EXTRACTIVE INSTITUTIONS

Much is known about extractive institutions, which concentrate the powers in few hands and are based on the exploitation of an entire class. However, studies show that growth under extractive institution is possible, even though not sustainable. It can emerge "when elites allocate resources to high-productivity activities that they themselves control" (P 91), like governments of the islands of Barbados, Cuba, Haiti and Jamaica undertook massive production of sugar to trade. However, when it was needed to shift to other economic activities, the elite feared the redistribution of incomes and power, and the economy started to decay. Another vivid example is that of the Soviet Union; Stalin started to divert resources from agriculture to industry, following his plan of industrialization, which generated some degree of growth. However, incentives were being strongly reduced and the elites feared technological change, hence the economy began to stagnate.
When there is a certain degree of political centralization under extractive institutions, some growth emerges because the ones with power have incentives to generate wealth to extract (as in the Caribbean and the Soviet Union). However, extractive institutions "do not foster creative destruction and generate at best only a limited amount of technological progress" (p. 150). Furthermore, infighting and instability are inherent feature of these institutions, and as such they cannot generate sustained growth for long periods of time.

### 2.4 CRITICAL JUNCTURES, AND VIRTUOUS AND VICIOUS CYCLES

Different institutions all over the world have been shaped by many critical junctures. One of these was the plague, or Black Death, which had huge effects. While in Western Europe

it was able to shook the foundations of the feudal system and started a process of liberalization towards an inclusive labor market, in Eastern Europe it helped landlords to acquire even more power, since they were more powerful and peasants were fewer and unable to organize a real protest movement. In the $16^{th}$ century, a Second Serfdom was instituted in the East, and it was clear how East and Western Europe were taking very different paths. The plague is "a vivid example of a critical juncture, a major event or confluence of factors disrupting the existing economic or political balance in society… Understanding how history and critical junctures shape the path of economic and political institutions enables us to have a more complete theory of the origins of differences in poverty and prosperity" (p. 101).
Another critical juncture was the Glorious Revolution in England, which opened the way to a pivotal juncture, the Industrial Revolution. As the authors have explained, the capacity of the countries to benefit from it lied in the nature of their existing institutions.
Finally, the world trade expansion and colonialism also provoked great divergences in the patterns of institutional change. For instance, Africa and Latin America, under Spanish and British colonialism, suffered through centuries of extractive institutions; many states could never change the nature of their institutions, as if trapped in a vicious cycle.

The vicious cycle depends on the fact that extractive institutions support further extractive institutions: those who extract can buy support through armies or judges, power is unchecked, and corruption lies in it. Furthermore, "extractive institutions, by creating unconstrained power and great income inequality, increase the potential stakes of the political game. Because whoever controls the state becomes the beneficiary of this excessive power and the wealth that it generates, extractive institutions create incentives for infighting" (p. 344). Hence, the struggles would not be over creating more inclusive institutions, but over who would want to capture more power at the expense of someone else.
An example of the vicious cycle can be found in Sierra Leone (as in many other African, Latin America and Middle East states). Extractive institutions had been in place since British colonialism, and even after independence, African politicians substituted themselves at the top of the chain, maintaining the extractive nature of the institutions to support their (usually undemocratic) regimes.

Analogously, inclusive institutions tend to persist over time for the logic of the virtuous cycle. It "stems partly from the fact that inclusive institutions are based on constraints on the exercise of power and on a pluralistic distribution of political power in society, enshrined in the rule of law". "Once pluralism and the rule of law were established, there would be demand for even greater pluralism and greater participation in the political process" (p. 308-309). Furthermore, inclusive political institutions tend to uphold inclusive economic institutions, which develop inclusive markets. Power becomes less central, leading the country towards a gradual path to democracy (with many obstacles along the way, whose consequences are considered to be contingent).

Acemoglu and Robinson sustain that nations fail because of the extractive nature of their institutions, which tends to repeat itself as trapped in a vicious cycle. They also sustain that this cycle could be broken, and that institutional drift is possible: what is needed is some contingent elements and strong opposition forces that counter extractive regimes.

Botswana, for instance, became independent in 1966: it was one of the poorest countries of the world at that time, and it was surrounded by the hostility of the white regimes of South Africa. Nonetheless, it became one of the fastest growing countries in the world, and it is today the richest one in sub-Saharan Africa. This was possible because of the implementing of inclusive institutions after independence, with democracy and stability in both markets and politics. Differently from other neighboring countries such as Sierra Leone, it had some degree of state centralization and rather pluralistic tribal institutions that survived colonialism. When they discovered the presence of diamonds, they changed the law to vest their value onto the nation (not the tribe) to avoid inequalities and injustices. In this way, they could use the revenues to build state bureaucracy, infrastructures and invest in education; contrarily to other African nations, diamonds did not provoke civil wars, but they became good for the nation. In education, only two languages were taught, and this contributed in making Botswana more homogeneous, as it still is now. The Botswana Democratic Party led the country towards more and more inclusive institutions, allowing the state to enter into the virtuous cycle. This could happen because they seized a critical juncture, postcolonial independence, to improve their institutions; it was also due to the contingency of history, that provided the country with far-sighted leaders.

China is another example of those countries who experienced growth even after centuries of extractive institutions, because of the introduction of more inclusive economic institutions. Mao Zedong and his Communist Party exercised a strict control on everything: property rights were inexistent, state monopolies were stronger and stronger, and land was nationalized. Political control was exercised through violence and exploitation. When he died, there was a "power vacuum". Deng was put in power through a coup in 1977: he did not want to abolish the communist regime, but he understood the need of developing more inclusive economic institutions (clearly not so inclusive as to threaten his power). He wished to reform markets and incentives, introduce private property, and expand international trade. Enterprises were given more authority and prices control was relaxed; agricultural productivity skyrocketed, followed more slowly by the industry. All of these moves towards inclusive economic institutions led the country to a sharp rise in prosperity.
However, many elements of the economy are still today under the party's command and protection. "Even if Chinese economic institutions are incomparably more inclusive today…the Chinese experience is an example of growth under extractive institutions. Despite the recent emphasis in China on innovation and technology, Chinese growth is based on the adoption of existing technologies and rapid investment, not creative destruction" (p. 439). Property rights are not entirely secure and could be subject to expropriation, labor mobility is strictly controlled, and businesses supported by the party receive a preferential treatment. The Communist Party "controls the entire state bureaucracy, the armed forces, the media and large parts of the economy. Chinese people have few political freedoms and very little participation in the political process" (p. 440). Hence, the extent of creative destruction is heavily curtailed and as long as political institutions remain extractive, growth will be inherently limited. To ensure sustained growth, political institutions should follow economics ones towards being more inclusive.

Finally, Acemoglu and Robinson's institutional theory aims to provide "a useful and empirically well-grounded explanation for a range of processes, while also clarifying the main forces at work". The theory distinguishes two types of institutions, inclusive and extractive, and how their characteristics influence the prosperity of a country. Then it proceeds in reconstructing their institutional path, analyzing how they interacted with critical junctures and how they succeeded in entering and exiting the virtuous and vicious cycles. "While the first level of our theory is about an institutional interpretation of history, the second level is about how history has shaped institutional trajectories of nations" (p. 429).

## 2.5 CRITIQUES AND DEBATES

*Why Nations Fail* has been cited countless times (more than ten thousands on Google Scholar) and has stimulated a debate that still influences today's economists. It has been widely reviewed and it was on the short list for the 2012 *Financial Times* and *Goldman Sachs Business Book of the Year* prize.

Those in favor of this book have generally emphasized the richness of the historical reconstruction and the insights of the authors regarding the relationship between political institutions, economic institutions and economic growth. "Good" institutions are those that incentivize people, protect them through the enforcement of property rights, control inflation and allow a market economy to take place. Political institutions are the ones that shape economic ones, which determine the prosperity of a country. They must be centralized and inclusive, in order to attract investors and innovators: allowing the process of creative destruction described by Schumpeter to take place, they are more successful than extractive institutions. Aid policies are not particularly useful if not aimed at strengthening the roots of inclusiveness themselves: democratic changes can happen only when there is a transformation in the institutional structure.
Bentley MacLeod in the *Journal of Economic Literature* (2013) makes many observations. He agrees with the way the authors speak of critical junctures, and how they can have different effects depending on which institutions are in place. Furthermore, he highlights how Acemoglu and Robinson use the rational choice assumption, which is "at the core of modern economics" (p. 128). It assumes that individuals make choices for their private interest and institutions affect how much private and public interests coincide; "inclusive institutions should lead to more resources for all, and ultimately more prosperity" (Bentley MacLeod 2013, p. 128). Finally, many argue that the book provides the readers with a "simple" solution to why nations fail by focusing on one aspect, political institutions (even if, by doing so it risks being a too simplistic approach).

This book's criticisms bring to light a variety of insightful opinions.
One of the main objections raised to the thesis of Acemoglu and Robinson is their simplistic approach that focuses only on institutions and does not take into account many different aspects that could be crucial determinants of prosperity. This is the main problem for economists such as Diamond and Sachs. Diamond (2012), cited in the book as one of the main exponents of the geographical hypothesis, discussed it for *The New York Review*: he stresses how geographical aspects as topography and natural resources have to be included in the framework to understand the development of a country. For instance, he supports Sachs' vision on how tropical areas are condemned because of diseases and low-productive soils; workers' reduced life-span and common diseases are important factors to consider. Furthermore, natural resources can be a curse, as characteristics of diamonds and oil promote corruption and civil wars: this approach is called the resource curse, or paradox of plenty, where a country rich in certain natural resources tends to have less economic growth, less democracy and worse outcomes for development[10].

While Acemoglu and Robinson think that it is the institutions that determine whether it is a curse or a blessing (as in Botswana vs. Sierra Leone and Angola), the resource curse school of thought would focus on the resource's nature. But, as they say (2012a; 2012d), the institutions that were in place when diamonds were discovered determined where the new wealth was to be directed: whether in the hands of the elite, or distributed to the nation itself. Sachs (2012) opposed this approach in his review for *Foreign Affairs* as simplistic, since it is too easy to link democracy with prosperity and absolutism with unsustainable growth; there are too many other factors to take into account. For instance, in his opinion, Africa underdevelopment is not due to its history of colonialism, the presence of absolutist states or the lack of centralized states; it is due to geographic conditions that did impede the formation of centralized states, urbanization and economic growth (few people, diseases, low-productive soil, lack of navigable rivers, shortage of coal, etc.). These aspects themselves made the country vulnerable to Europe invasion. Geographic conditions also affect the diffusion and development of technologies, in the sense that they influence production costs. The critic makes a comparison between Bolivia and Vietnam in the 1900s: the former had greater political and civil rights, but its economy grew more slowly because the country was characterized by mountainous territory. On the other hand, Vietnam vast access to the coast attracted foreign investments and the economy expanded, despite its less inclusive political institutions. All this to say that aspects such as geography cannot be excluded from the framework.

> Geography matters because it affects the profitability of various kinds of economic activities, including agriculture, mining, and industry; the health of the population; and the desirability of living and investing in a particular place… Geography has shaped not only the international division of labor and patterns of wealth and poverty but also the distribution of people and income within countries. (Sachs 2012; p. 8)

> The key to understanding development is to remain open to the true complexity of the global processes of innovation and diffusion and the myriad pathways which politics, geography, economics and culture can shape the flows of technologies around the world. (Sachs 2012; p. 10)

With regard to technology, Sachs (2012) moved a critique to Acemoglu and Robinson stating how authoritarian rulers can successfully promote the diffusion of foreign technologies, even though it could be much more difficult for them to encourage domestic innovation. He highlights how many latecomer states have grown thanks to imported technologies: China, for instance, even if absolutist, has been able to even accelerate its economic growth, as a result of the construction of vast and complex infrastructure which attracted foreign capital.
However, Acemoglu and Robinson (2012d) recalled their extensive discussion about growth under extractive institutions and their argument about how inclusive institutions are necessary for sustained innovation, while import of technology can take place (but also be blocked in extreme cases) under extractive institutions. They pointed out (2012c), in front of a similar critique by Fukuyama (2012), how the Soviet Union grew until the 1970s (and they were even richer, relative to the U.S., than China is today), but how the economy stagnated and could not produce sustained growth. The institutional theory would be invalidated, they say, only if China were able to achieve levels of income per capita comparable to those of Spain and Portugal, even though under extractive political institutions.

But most of all, they state once again their desire to provide a framework, whose very power is to focus on the most important elements. The role of geography is one of many factors of the complex reality, but it has been shown in many works that "once the historical role of institutions is properly factored in, geography doesn't seem to matter at all or much" (Acemoglu and Robinson 2012d).

In the same way they reacted to the critique of how inclusive and extractive institutions are poorly defined, and how it is not clear which are the many different components, how they individually affect growth and how they interact. This critique has been moved by Fukuyama

(2012), and Acemoglu and Robinson (2012c) replied that inclusive and extractive institutions are defined as extreme cases, as black and white, while it is obvious that most countries are in shades of grey, with certain degrees of inclusivity and extraction. In order to provide a framework, these concepts have to be defined, and it is then possible to proceed in analyzing the different shades of the institutions.

However, Sachs (2012) too expresses his doubts on the definition of these two categories and on the correlation between political and economic institutions. China, Singapore, Taiwan and Vietnam are some examples of how economic development has either preceded political reform, or it has not led to it; hence it is simplistic to think that since inclusive political and economic institutions are correlated today, the former surely caused the latter. Being based on historical analysis, carefulness is needed when attributing a causal implication to an observed correlation between institution and performance. But, as Acemoglu and Robinson themselves state, "we make no claims whatever about isolating a causal relation" (2012a; p. 319).

This is seen in a debate reported by Freeland (2012) on the *New York Times*. Some Western scholars discussed how in Russia the economy has flourished under the authoritarian government of Putin, as a consequence of sacrificing democratic factors to attain stability and growth. Acemoglu and Robinson strongly disagree: the reemergence of Russian autocracy under Putin has coincided with economic growth, but it did not cause it. High oil prices and the transition away from communism are worth the credit. In the same way, democracy in the 1990s did coincide with economic decline, but it did not cause it. The authors conclude with a forecast based on their understanding of institutions: Russia is oil-dependent, and as high oil prices can spur growth, low oil prices can hinder it. Leaders are more interested in maintaining their position of control over oil revenues than providing goods and services to the population, and because of that Russia is destined to stagnation and/or collapse. Growth under extractive institutions is possible, they repeat, but economists "must be careful in not being seduced by what are only temporary bursts of prosperity" (Acemoglu and Robinson 2012b). The Russian case is similar to that of Venezuela, and it will be analyzed in the next chapter.

China is another broadly discussed example: The Communist Party was able to monopolize power and mobilize capital in such a way to boost growth. However, as a nation with extractive political institution, this growth is not sustainable because it does not allow the process of creative destruction to take place, and that is key to innovation and prosperity. If China cannot foster creative destruction, it will not experience sustainable growth for long. In the article by Friedman for *The New York Times*, during the interview, Acemoglu points out how as example that a young dropout in China could never start a business that threatens a sector of state-owned enterprises financed by state-owned banks. However, Fukuyama's critique (2012) for *The American Interest* is based on the fact that China has been the fastest growing large country for more than thirty years, and he is skeptic about the institutional theory since, in his opinion, it cannot explain what he called "the most remarkable growth story of our time". Acemoglu and Robinson (2012c) responded by reminding the development of the Soviet Union until the 1970s: for the same reason that this example does not invalidate the theory, China's growth, as for now, cannot either.

On the other hand, critics such as Subramanian (2012) from *The American Interest* point out how India, despite having theoretically inclusive political institutions, has not even remotely achieved the level of growth of China. Acemoglu and Robinson (2012b) remember that it is not political institutions that directly determine the prosperity of a nation; those shape economic institution, which are in turn linked to growth. Furthermore, they state how electoral democracy in India is not index of the quality of the political system: in fact, the Congress Party dominates the political arena and the quality of democracy is poor. That explains why economic institutions are as well, and growth is hindered.

The final disclaimer of *Why Nations Fail* is that it is not possible to engineer prosperity: this is a vital point for the understanding of public policy debates. If nations are poor not because of ignorance of their leaders, or lack of resources, but because of their institutional structure, aid development policies are unlikely to have a transformative impact. For Acemoglu and Robinson, in order to achieve sustainable growth, the roots of institutions must be made more inclusive, as policies or resources alone are not enough.
This argument is closely related to modern foreign aids policies; sometimes they helped stimulate growth, while other times they did not have the desired effect. In the interview for *The New York Times* conducted by Friedman, Acemoglu said that U.S. aid policies to Egypt should aim a strengthening the roots of inclusiveness by giving the possibility to more sectors of the society (instead of focusing on the military sector) to have a say in politics, so that the society led by a wide committee could decide where to divert the aid. Acemoglu says that foreign help can only be a force multiplier, meaning that where there is a background for inclusive institutions it is possible to enhance them, but it is impossible to create them ex novo.

Similarly, in a 2003 paper, Subramanian and Rodrik had also raised serious questions about the IMF and the World Bank aid policies. Since institutional change is slow, these programs should last much more than three to five years because "when the underlying institutions are not being changed in the appropriate way, conditionality on policies is often ineffective" (Subramanian and Rodrik 2003; p. 34).

Democratic changes can only happen and prosper due to key changes in the institutional structure. Acemoglu and Robinson advocate that institutional changes can explain a nation's failure or prosperity, while lack of knowledge cannot. They thus discredit the ignorance hypothesis: leaders of extractive institutions do not successfully implement aid development policies because they are pursuing their own interest, not because of ignorance. Foreign advisers should recognize that under extractive institutions, leaders' and people interests do not match up. In an interview by Freeland for *The New York Times*, Acemoglu uses the example of Venezuela; President Chávez's objective is not that of enriching the nation, he says, and that is why markets are not working. Extractive political institutions create gains for elites while impoverishing the society as a whole.
Bentley MacLoad (2013), contrarily, opposes this rejection of the ignorance hypothesis by recalling the rational choice model of Savage, where "individuals are both rational, and yet mistaken in their beliefs regarding the world" (p. 129). Acemoglu and Robinson say that lack of knowledge cannot explain national failure, while in the complex reality, says Bentley MacLoad, we do not understand the consequences of our actions.

To conclude, the main critiques to Acemoglu and Robinson are the uni-causal nature of their institutional theory and the lack of solutions when they say it is not possible to engineer prosperity. As for the first, the authors tried to provide a framework to understand the inequality in the world around us and found out that institutions were the key. Through a rich historical reconstruction, they show how inclusive economic institutions promote growth, and how political institutions determine them. In their latest book *The Narrow Corridor: How Nations Struggle for Liberty,* they maintained the same central thesis: "it is the way the state and society interact and control each other that determines the capacity of our state, the policies of our government, and our resilience, prosperity, security, and ultimately, liberty" (Acemoglu and Robinson 2019; p. 2). The book investigates how more inclusive political institution are created. An equilibrium must be found between state and civil power, which have to be strong but not too powerful, and it makes it possible to enter the narrow corridor towards liberty.

They know very well that every country will follow its own path and there are other ways to achieve liberty, but they stress the importance of the simultaneous strengthening of both powers.

> For liberty to emerge and flourish, both state and society must be strong. A strong state is needed to control violence, enforce laws, and provide public services that are critical for a life in which people are empowered to make and pursue their choices. A strong mobilized society is needed to control and shackle the strong state. (Acemoglu and Robinson 2019; p. 7)

The pandemic is going to be a critical juncture in our history, and countries will react in different ways faced with these events. Acemoglu and Robinson seek to reconstruct what futures there are and how it is possible to influence them.

# CHAPTER THREE: VENEZUELA'S ECONOMY IN LIGHT OF THE INSTITUTIONAL THEORY

If we were to interpret Venezuela's history in light of the institutional theory, it is institutions we should look at, especially political ones. Since 1935, the country had followed a long evolutionary process towards democratic elections, not without obstacles in its way. Together with the beginning of civil liberties under General Medina in the 1940s, less than a decade later the first democratic elections took place, long before the majority of countries in Latin America. The *Trienio Adeco* (1945-1948) saw the establishment of political and social groups, trade agreements and foreign capital investments. Unfortunately, the liberalization process was reversed by the 10-years dictatorship which took power via coup in 1948. The dictatorship lived off oil revenues, and it did allow its economic institutions to have some degree of inclusivity, for instance by continuing to trade with the U.S. How Acemoglu and Robinson would say, extractive political institutions can indeed generate some growth, and even promote it when they are themselves the beneficiaries.

In 1958 the opposition had strengthened and united in the Patriotic Committee, demanding for the reintroduction of the constitution. The newly reinstated democratic regime was dominated by the two main parties (AD and COPEI). While political institutions were being made more inclusive, economic institutions followed: the country's growth was favored by foreign concessions, a law which limited the power of the state on oil revenues and policies that facilitated the expansion of private businesses. This period saw the strengthening of both democracy and economic growth, as in a virtuous cycle, allowing Venezuela to become one of the twenty richest countries in the entire world.

The parties dominated the political arena, but not only. They were also interfering in the economic process, giving preferential treatments to some business groups, penetrating social groups and labor unions. In the years, this approach was going to provoke social discontent that will make the citizens lose faith in the parties' capacity to lead the nation.

## 3.1 INSTITUTIONS FROM THE BEGINNING OF DEMOCRACY

It is clear how the core of Venezuela's economy is oil. Because of oil being the first source of income, the country was greatly liable to oil prices shocks, and the desire of diversification and of strengthening of the national markets was spreading. Betancourt, AD leader and elected President in 1959, tried to adopt land and industry reforms. However, oil sector's means of production are not easily transferable, and industrialization was drastically reducing the percentage of rural population. The President tried to provide stability by joining the OPEC, but fixed quotas were usually not respected by all oil-producing countries. The lack of stability, however, Acemoglu and Robinson would say, does not depend on the nature of oil itself, as much as on the nature of political institutions that can distribute its wealth, or rather concentrate it in their hands (let us remember the opposite examples of Botswana and Nigeria). Contrarily, some economists focus on how some characteristics of oil and minerals can indeed hinder democracy, as I will report later on.

In the first decades of fair democratic elections, politicians always dreamt about nationalizing the oil sector. Hence, while political institutions were made more inclusive, they shaped economic institutions in a more exclusive way, in order to increase state control on the nation's wealth. This process was reversed in the 1990s through the liberalization of the petroleum industry, but maybe it was too late to change course. Extreme politicians in the 2000s completely reversed the liberalization process, tightening their iron grips on wealth and power.

AD during the *Trienio Adeco* could not do nationalize the oil industry due to the mainly crude production of the country, while in 1976 President Pérez finally did. Along with it, the first state-owned petroleum company PDVSA (Petroleum of Venezuela S.A.) was born to dominate the industry. The main consequences of nationalization were the use of extraordinary revenues by the government, and the inefficiency of PDVSA in the world globalized economy. During the late 1970s and the early 1980s, oil prices where high but, unfortunately, they were volatile, and when a country is too dependent on them, economic growth is volatile as well. Hence, in the 1990s a new approach was chosen: the *apertura*, based on a market economy free from the state. Acemoglu and Robinson would have agreed to this "freeing" of markets, arguing that an economy where the government plays a central role is not that inclusive, as they showed in various examples how it could lead to giving special and strategic concessions to supporters (it does ring a bell).

During his second mandate, Pérez adopted a neoliberal program that he called the 'Great Turnaround', and Rafael Caldera did so too in his 'Agenda Venezuela'. They both turned to the IMF for loans, trying to set free the economy by privatizing some sectors and allowing new competitive businesses to take on. Trade liberalization followed, increasing foreign participation, improving competition and supervision in the financial system. Price and capital controls were lifted, and interest and exchange rates were liberalized.

Nevertheless, the fiscal austerity measures contained in the IMF structural adjustment program provoked, in the short run, decline of economic growth, which was aggravated by the fall in oil prices and by the going bankrupt of one of the main banks in the country. Social indicators were getting worse, and the population was tired of trusting the same corrupt parties and politicians. These sentiments allowed a critical juncture to take place: Chávez, advocating the need to fight corruption and his desire to prioritize social objectives over economic ones, won the elections in 1998.

## 3.2 INSTITUTIONS IN THE LAST TWENTY YEARS

This is where I lay the end of the democracy by parties that we had known since 1958. From this moment forward, Chávez will aim at increasing power of both state and military, reversing a 40-years history of parties' hegemony.
He indeed applied many social programs to maintain popular support: called missions, they were mainly addressed to health, education and housing. However, many of these programs were criticized because they lacked long-run solutions.
Additionally, even though he advocated the need of fighting corrupt parties, he took advantage of the macroeconomic imbalance between official and non-official exchange rates to provide chosen groups with preferential dollars and subsidies, as many before him.
He moved attacks against the media, causing the wrath of the international community. Acemoglu and Robinson would surely condemn this as a breach of democracy, advocating how free press is fundamental. Political control over the media tarnishes the principle that people can be informed and aware of what is happening, being empowered to allow the virtuous cycle of inclusive institutions to continue.

In order to emphasize the role of pluralism of powers and media in the empowering of the virtuous cycle, I report an example used by Acemoglu and Robinson in *Why Nations Fail*, that

of America in the late 1800. After the Civil War, strong businesses started to progressively monopolize the market; for instance, Rockefeller with his Standard Oil Company in 1890 controlled 88 percent of the refined oil flows in the U.S. Inclusive institutions enabled the rest of the society to stand up against this behavior, and they united into the Populist Movement. The first important success was the Interstate Commerce Act in 1887, which regulated industry development, followed by the Sherman Antitrust Act of 1890, still an important part of U.S. antitrust regulation. The Progressive movement was created as a heterogeneous reform movement, opposing political corruption, as Roosevelt advocated. The strong businesses were progressively dissolved to leave space to new ones. Inclusive economic institutions do not just need markets, but also a level playing field of opportunities for everyone, and this can be obtained by regulations to ensure that the markets remain inclusive. “The US experience in the first half of the 20th century also emphasizes the important role of free media in empowering broad segments of society and thus in the virtuous cycle” (Acemoglu and Robinson 2012a, p. 324): as they were free to expose the injustices on the market, the public was informed and politicians were induced to take action. Under extractive and absolutist institutions, this freedom is lifted because of fear of opposition forces.
When Roosevelt proposed his New Deal program, the Supreme Court contested, and thanks to the power of the virtuous cycle, Roosevelt could not do anything about it. Oppositely, in Peru and Venezuela, “President Fujimori and Chávez appealed to their popular mandate to close uncooperative congresses and subsequently rewrote their constitutions to massively strengthen the powers of the president” (Acemoglu and Robinson 2012a, p. 329).
In 2007, Chávez wrote a new constitution which tried to furtherly extend his powers: the democratic regime that had been in place was collapsing in the hands of one man.

Lack of pluralism and concentration of powers in few hands create a vicious cycle where usurpation of power cannot be opposed by an organized movement (for lack of information) and where the rule of law deteriorates. The government of Chávez, even though democratically elected, attacked political opponents, fired them from public jobs (see 2002-2003 strikes), controlled the media, and expropriated private properties. All these characteristics indicate that the roots of this democracy lie in an extractive regime. Acemoglu and Robinson (2012a) say that because of persistent inequality, people tend to vote for extreme politicians; moreover, the underlying extractive nature itself of the institutions appeals to strongmen, rather than effective parties. Despite democracy roots lie in 1958, political power was never enough pluralistic. Corrupt parties and conflicts lived on, to the point where the people were willing to vote for strongmen such as Chávez, seeing in him the only hope against corrupt elites (Acemoglu and Robinson 2012a). However, he progressively set up a dictatorial regime, concentrating powers in his position and shaping institutions in a more extractive way.

As political institutions were made less inclusive, economic ones followed. As Ellner (2019) discussed, disinvestment from the private sector continued to generate economic and political instability. Inflation was high, and overvaluation of the currency caused increasing division between official and parallel exchange. The oil sector had been reformed in 2007-2008 to strengthen the state power over the national company, increasing their share of profits. However, PDVSA’s prices could not be competitive enough in the world economy and, since the domestic market had been neglected and it was greatly underdeveloped, dependence from oil revenues was still vital for the economy.

As the vicious cycle empowers itself, extractive regimes continue to attract authoritarian rulers. Before dying in 2014, Chávez chose Maduro as his successor. Maduro advocated most of Chavista ideals, including the fight for corruption and the desire to strengthen the role of the

state. The situation he had to face was characterized by hyperinflation, diverging exchange rates, shortages of commodities and popular discontent.
He promoted the so-called Enabling Law, where the National Assembly gave him decree powers (opposers criticized the act as a further concentration of power in his hands, while he argued he needed them to fight corruption). His first decree furtherly pulled away private investments, in a time when foreign investment was blocked by U.S. and E.U. sanctions.
The 2019 presidential crisis showed how obscure and confusing the political arena had become: the National Constituent Assembly was created by Maduro himself and filled with his supporters, and still it had the power to call for elections, even though it was not recognized by either the National Assembly nor the international community.

In light of the institutional theory, I would focus on how Chávez and Maduro inverted the democratic process by concentrating powers in their hands, creating political and economic extractive institutions which made inequality more profound than ever, making a country collapse despite its being rich in resources and having had many years of democracy.

But maybe, some economists would say, is the "being rich in resources" the reason why institutions were extractive in the first place and the country finally failed. Let me report some approaches to the so-called *resource curse*, which pins the underdevelopment of the country on the nature of oil itself. The resource curse highlights five dimensions: resource-rich countries do not invest enough in education, are at risk of civil wars, have difficulties in establishing and consolidating democracy, suffer from a corrosive effect on the quality of institutions and, lastly, they can experience slow or even negative economic growth. These factors have been discussed by economists such as Pegg (2010), Sachs (1995) and Ross (2001).
Ross (2001), in "Does Oil Hinder Democracy?", analyzes the mechanisms for which oil/minerals and authoritarian rule can be linked: the government uses extraordinary revenues to alleviate social tensions that could threaten their regimes, it increases favoritism and it enlarges the military to defense itself from conflicts. He thus finds a correlation between oil and antidemocratic effects, and he suggests the need of diversifying the economy with other primary sectors such as agriculture.

If I look at the history of Venezuela under this interpretation, I can observe that Chávez did embark on populist ideals to alleviate social tensions, he did strengthen the military, and the economy was still oil-dependent and not diversified. I could argue that all these decisions were made by political and economic institutions, but maybe the controversial nature of its main resource shaped in some degree the roots of the institutions themselves.

A study by the IMF (2011) brings a new interpretation by focusing less on natural resources and more on other sources of wealth, like human and social capital. Modern theories argue how many factors, interacting together, determine the development and growth of a country. Natural capital is not enough, and through good institutions it has to be converted into human and social capital in order to boost growth. To develop human resources, it is needed a stronger and more efficient labor force, educated, trained, provided with health care and social security. To develop social capital, roots of inclusiveness have to be consolidated: democracy, freedom, equality and lack of corruption. Hence, if efficiently managed, natural resources' wealth can indeed promote growth. Nonetheless, it does raise some difficulties in fiscal and monetary policies and in the need of diversification "away from excessive dependence on a few resources as well as away from narrowly based power elites" (IMF 2011, p. 11).
Indeed, Venezuela had an overvalued currency: it is widely known in economics how this hurts competing industries, and thus trade and growth. Furthermore, oil prices are such volatile that

exchange rates, export earnings, output and employment are as well, and effective policies are difficult to implement. Lastly, it lacks economic diversification: “The need for diversification is especially urgent in resource-rich countries, because they often face a double jeopardy: natural resource wealth that is concentrated in the hands of relatively small groups that seek to preserve their own privileges by standing in the way of both economic and political diversification, which would disperse their power and wealth.” (IMF 2011 p. 18). This reasoning is quite similar to that of the creative destruction force: extractive institutions would fear the process and hence oppose it. Maybe that could explain why Venezuelan institutions were never able to implement successful reforms on agriculture and manufacturing sectors.

Let me report the mechanisms of the narrower version of the resource curse, called Dutch disease, described by Pegg (2010). He exposes Botswana as a potential exception to the resource curse, since it breaks the belief that diamonds would imply extractive political institutions and underdevelopment. In the same way, Sala-i-Martin and Subramanian (2003) had said that the Dutch disease (narrow version of the resource curse) could not explain the economic failures of Nigeria. The Dutch disease operates through two mechanism: the first when capital and labor flow into the booming sector, driving away from the others. The second when the revenues are spent on domestic commodities, driving up prices: the problem could be that governments don’t adjust their spending even when national income declines, finding themselves in debt. Diamond prices are less volatile than oil ones, but both could initiate these mechanisms. Even though Botswana experienced periodic volatility of prices and slow growth, in the large picture it benefited from the coexistence of diamonds wealth and good governance, contrarily to what the Dutch disease would think. However, it did suffer from overvalued currency, a symptom of the disease, and this hurt other export commodities making them uncompetitive and impeding economy diversification.
Venezuela’s and Botswana’s main problem thus seems to be an overvalued currency and the absence of diversification. This could be an effect of the Dutch disease, but it could also be pinned on the government use of resource revenues: if they were addressed to the agricultural sector, for instance, the sector could have developed and started attracting foreign and domestic investments.

The World Bank (1997) supports the idea that natural capital is just one of the many factors which affect growth. Anyway, it does play an important role “in guiding the trajectory of economic development and structural change; in conditioning the accumulation of produced capital, skills and institutional capacity; and in helping to determine the efficiency with which both produced capital and human capital are deployed” (Auty 2001, p. 51). Natural capital is indeed important, but less than human capital, and it should certainly not obscure the role of institutions in policy making. In order for policies to be successful, a gradual process of institutional inclusivity has to be undertook, aimed at creating an institutional and legal system suited for managing policy effects. Nonetheless, in oil-producing countries such as Venezuela, volatility of resource prices makes fiscal and monetary policies yet more difficult. Modern economies that aim to thrive need a broad economic base (manufacturing, trade, services, etc.) and a broad power distribution.

### 3.3 CONCLUSIONS

I am led to believe that Acemoglu and Robinson offer a great insight on the Venezuelan collapse. Extractive political institutions in the country during the last twenty years had reversed the process towards democratization. State control has been strengthened in the economy, driving the country towards a command economy rather than a market one.

Parallelly, both institutions have been tarnishing democracy and liberalism, leaving the country broke. Power and wealth have been concentrated in few hands, which keep strengthening their grasp on them and oppose both economic and political diversification. Since Venezuela has always been mainly an oil-producing country, it is worth considering how the nature of oil itself can shape and affect the institutions. Oil generates an enormous wealth and tends to attract groups that wish to extract it; the more power they acquire, the more they would fear a redistribution of power and income. Indeed, the process of creative destruction requires inclusive political institutions in the first place. Because of its immense wealth, I can support the idea that oil can trigger extractive institutions more easily than a country based on agriculture and manufacturing can; there sure are some exception, as Botswana is, but there is a correlation between the resource curse and extractive institutions. Furthermore, the wealth extracted from the society generates increasing inequality, as well as incentives for some groups to capture it, causing infighting and instability.

Inequality, infighting and political instability are currently indeed characteristics of the region, that is going through a massive humanitarian crisis. The breakout of COVID-19 has only worsened the situation, but the government seems to have already been itself the biggest threat to the nation. Acemoglu and Robinson repeatedly highlighted the importance of critical junctures as turning points: catastrophes such as the black plague or COVID-19 can have huge effects on societies. The nature of these effects is shaped by pre-existing institutions in place when the critical juncture manifests itself: it can be seized to "embark upon a path to greater prosperity" (Acemoglu and Robinson 2012a, p. 123), or it can consolidate already existing extractive institutions. COVID-19 will shock the society, one way or the other.

To allow inclusive institutions to emerge, a series of factors should dampen the power of the elites, strengthen opposition forces and create incentives to form a more pluralistic society. Pluralistic institutions preserve the rule of law and make usurpation of power more difficult and, together with free civil unions and free medias, generate a virtuous cycle that empowers itself. Hence, for Acemoglu and Robinson, pluralism is the key. The overly centralized power of Venezuela should be distributed in order to exit the vicious cycle and enter into the virtuous one. The country should also be less dependent from its natural resource, allowing other sectors to develop, in order to try escaping the resource curse of wealthy powerful elites who oppose creative destruction processes.

As I finish writing my dissertation, an article from early September captures my interest (WSJ 2020). President Maduro is granting pardons to political activists and lawmakers; he is also inviting the US and the EU to observe the December (COVID-19 allowing) elections for the very first time. The opposition is diverging, in that some leaders advocate the need of foreign military intervention and electoral agreements, while the theoretically ad-interim President Guaidò wants to boycott elections for they would never be fair. But if we look at 2005, this meant losing opposition representation in the congress, and if we look at 2018, it secured Maduro another term. Henrique Capriles, prominent opposition figure banned from politics in 2017, supports elections and say that "the only way to save this country is by opening political paths" (WSJ 2020, September 2). This does sound promising… but will it be enough? Democratic elections are indeed fundamental…if fair. And still, the opposition seems shattered over current debates, while it could join together against the authoritarian regime of Maduro. If they did, maybe they could allow a more pluralistic society to take place.

# NOTES

1. Wholly owned by the government and founded in 1946, its scope is to give financial backing in the form of guarantees to projects designed to stimulate Venezuelan economic development.
2. Coppedge (1994) discusses data provided by Karl (1987) on how oil revenues earned during the period 1974-79 were 54 percent greater, in real terms, than those received by all previous Venezuelan governments back to 1917 combined.
3. The Truman administration negotiated with Pérez Jiménez on low U.S. tariffs, in exchange of reduced duties on American exports in Venezuela and strategic access to petroleum reserves. Creole, Shell and Mene Grande were the American industry leaders, while other smaller companies were emerging.
4. After the long dictatorship, Venezuela was deeply dependent from U.S. Firstly, because of its great amounts of capital invested in the country; secondly, because President Betancourt feared another anti-democratic coup and he needed their support. Even though a dream of AD was the nationalization of the oil sector, U.S. presence was fundamental to generate economic growth and preserve the new regime.
5. Nonetheless, it has to be kept in mind that it could be calculated on unsure data: for instance, from the last years of the 1990s most of earnings were not even reported (Di John 2005).
6. The state-owned oil company Petróleos De Venezuela, S.A. (PDVSA) was born in 1976 together with nationalization of the oil sector.
7. It was also necessary to change name because Bolívar is a national symbol, and as such it cannot be used for electoral objectives.
8. Annual inflation for 2017 was estimated at 2616 percent, the highest in the world (Reuters 2018).
9. Acemoglu, D. and Robinson, J. (2012) *Why Nations Fail,* New York: Crown Publishing Book. From this chapter on, I will make references to this book and its authors: from the beginning of chapter two, until paragraph 4, all page references concern this reference.
10. Sachs himself, with Warner, conducted an influential study called "Natural Resource Abundance and Economic Growth" in 1995, and in 2007 he wrote "Escaping the Resource Curse" together with renowned economists as Humphreys and Stiglitz.

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