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**Institutional failure in Venezuela:
the cases of spending oil revenues
and the governance of PDVSA (1975-2005)**

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Abstract

This thesis looks at the Venezuelan oil sector. The ‘oil economy’ represents the singular most determining variable in the political economy of Venezuela. The thesis challenges the view that oil, per se, has been some sort of a ‘curse’ over the country. Instead, this thesis aims to highlight the fact that other characteristics of the political system have influenced the way Venezuelans have dealt with their oil wealth. The thesis presents empirical evidence that the management of the oil industry and oil-related income in the three decades following nationalisation of oil in 1975 became politicised. Politicisation occurred despite the fact that the political elite was aware of the danger that this might happen. Political elites embarked upon designing institutions to try to prevent this outcome. The institutions themselves were not in principle badly designed, and the thesis shows that there was nothing so inherently wrong with their design that they were unworkable. What was lacking was the political will to make them work, and evidence of this can be seen across two dimensions. One relates to the fact that all institutional forms studied – the holding company PDVSA, the Investment, Stabilisation and Development Funds – all ended up politicised. The other relates to the fact that an essentially similar pattern of politicisation can be seen across a whole series of different Venezuelan governments. In this sense the Chávez government has been an exercise in continuity and not in rupture. The thesis analyses two concrete aspects of the relationship between the Venezuelan State and oil. It scrutinises oil policy in Venezuela over the three decades following the nationalisation of the oil industry in 1975. The research focuses on the institutional arrangements (i.e. the ‘rules of the game’) concerning, first, the spending of the revenue which the Venezuelan State obtains from oil exports and second, the exercise of political authority and the use of institutional resources to control PDVSA and define its policy guidelines. This thesis facilitates a deeper understanding of the politicisation that has occurred in Venezuelan political economy at critical points in the relationship between the State and the oil sector. These insights contribute, in turn, to a better understanding of contemporary Venezuelan problems.

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Abbreviations

Acelcar	Aceros del Caroní
AD	Acción Democrática
Alcasa	Aluminios del Caroní
Astinave	Astilleros Navales Venezolanos
Bandagro	Banco de Desarrollo Agropecuario
Bandes	Banco Nacional de Desarrollo Económico y Social
Bauxiven	Bauxita Venezolana
BCV	Banco Central de Venezuela
BIV	Banco Industrial de Venezuela
Cadafe	C.A De Administración y Fomento Eléctrico
Cavn	C.A Venezolana de Navegación
CCN	Cruzada Cívica Nacionalista
CNE	Consejo Nacional Electoral
Copei	Comité Político Electoral Independiente
Cordiplan	Oficina de Coordinación y Planificación
CTV	Confederación de Trabajadores de Venezuela
CVF	Corporación Venezolana de Fomento
CVG	Corporación Venezolana de Guayana
CVP	Corporación Venezolana del Petróleo
Dianca	Diques y Astilleros Nacionales
Diex	Oficina de Identificación y Extranjería
Edelca	Electrificación del Caroní
FCA	Fondo de Crédito Agropecuario
FDP	Frente Democrático Popular
Fedecamaras	Federación de Cámaras y Asociaciones de Comercio y Producción de Venezuela
Fides	Fondo Intergubernamental para la Descentralización
FIEM	Fondo Inversión para la Estabilización Macroeconómica
FIV	Fondo de Inversiones de Venezuela
Foncrei	Fondo de Crédito Industrial
Fonden	Fondo de Desarrollo Nacional
Fondespa	Fondo para el Desarrollo Económico y Social del País
Fondur	Fondo Nacional de Desarrollo Urbano
FUS	Fondo Único Social
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
IMF	International Monetary Fund
Interalumina	Interamericana de Alumina
ISI	Import Substitution Industrialization
MAS	Movimiento al Socialismo
MEM	Ministerio de Energía y Minas
MEP	Movimiento Electoral del Pueblo
Minci	Ministerio de Comunicaciones e Información
MVR	Movimiento Quinta República
OAEF	Oficina de Asesoría Económica y Financiera
OAS	Organisation of American States
Official Gazette	Gaceta Oficial de Venezuela
OPEC	Organisation of Petroleum Exporting Countries
OTAC	Oficina Técnica de Administración Cambiaria
PCV	Partido Comunista de Venezuela
PDVSA	Petróleos de Venezuela S.A.
PPT	Patria para Todos
SEC	Securities Exchange Commission
Seniat	Servicio Nacional Integrado de Administración Aduanera y Tributaria
Sidor	Siderúrgica del Orinoco
TSJ	Tribunal Supremo de Justicia
UNDP	United Nations Programme for Development
Venalum	Venezolana de Aluminio
Venemaica	Venezolana de Motores Aeronáuticos e Industriales

Chapter 1

Institutional failure and oil in Venezuela

'Fiscal abundance does not make Venezuela richer or more balanced...abundance of fiscal resources has been a mirage that has contributed to fool ourselves about the true Venezuelan society. For that reason I repeat, my government will administer this abundance as if we were administering scarcity'

Carlos Andrés Pérez, President of Venezuela, Inaugural speech on the 12 March 1974

'I wish to confirm on this historical occasion that Petróleos de Venezuela will not be subject to the contingencies of political life. It will be governed by the overall interests of the Nation, disregarding temporary situations or individual interests'

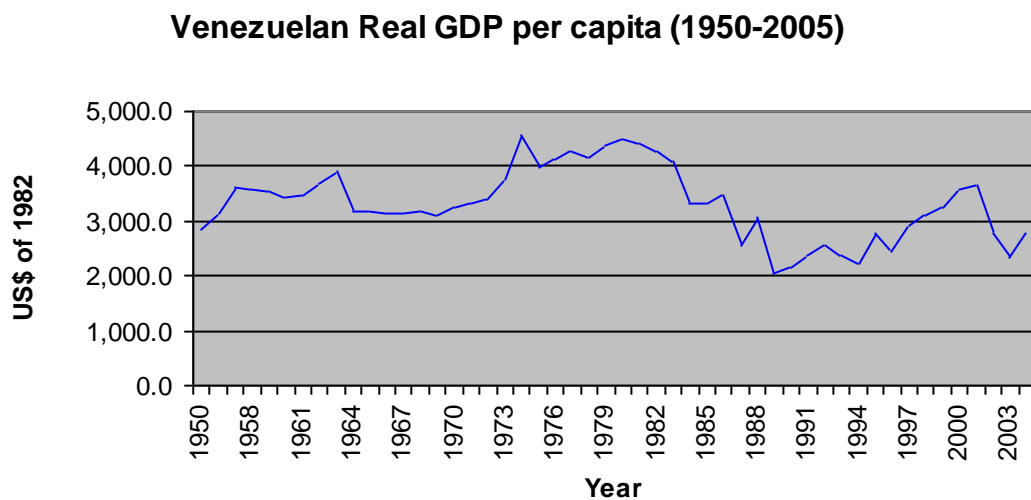
Carlos Andrés Pérez, President of Venezuela, Speech on the occasion of signing into law the Oil Nationalisation Bill on the 29 August 1975

Thirty years after these statements, Venezuela did not administer abundance as if it were administering scarcity nor did it keep Petróleos de Venezuela (PDVSA) free from political meddling and removed from non-public interests. This thesis addresses the disappointment of Venezuelans in failing to achieve what they set out to conquer with nationalisation of the oil industry in the middle of an unprecedented boom in oil revenues in 1975.

Venezuela's failure in these two respects, set by the President who presided over the historic step of nationalising oil, which was certainly the national consensus of the time, is part of a more general legacy of economic underachievement, political

discomposure and social unrest. Growth indicators of per capita income show a regression to 1950s levels (see Figure 1.1). The political system has been under severe stress since the late 1980s. Poverty and inequality have undermined a society formerly considered as relatively stable and free from the problems existing in many other countries of similar levels of development.

Figure 1.1



Source: IMF/ International Financial Statistics; US Bureau of Labor Statistics; Opec Annual Statistical Bulletin

Venezuela's travails are most puzzling since the country had been expected to perform better as a result of its immense oil wealth. Thinking about Venezuela has been dominated by the belief that oil wealth should have made Venezuela prosperous. Conventional wisdom dictates that Venezuela should be a rich country. The country has for decades been one of the most important oil provinces in the world. It has exploited oil for over eighty years and has reserves of over seventy seven million barrels. Venezuelans live above one of the largest oil reserves in the world.¹

Some decades later, the performance of both the economy and the political system, however, could not have been in starker contrast to what would have been predicted by those propitious conditions. The country has witnessed economic decline and

¹ According to OPEC annual statistical bulletin 2003. If the extra-heavy oil reserves are taken into account, Venezuela becomes the country with the largest oil reservoirs in the world.

political crisis instead of expected growth and democratic consolidation. Oil money has been squandered. Mismanagement of oil revenues, ranging from inept investment decisions, to poor implementation, to outright corruption, has diluted a vast external inflow of financial resources into the economy.

Venezuelan travails and oil

This thesis looks at the oil sector. The ‘oil economy’ certainly represents the singular most determining variable in the political economy of Venezuela. The thesis challenges the view that oil, per se, has been some sort of a ‘curse’ over the country. Instead, this thesis aims to highlight the fact that other characteristics of the political system have influenced the way Venezuelans have dealt with their oil wealth. The Venezuelan State has been highly patrimonial and politicised. Political elites, although perfectly aware of these characteristics, were not able to alter this state of affairs. The ‘oil sector’ was meant to be an exception to this trend. Elites sought to depoliticise the relationship between the State and the oil sector. Institutional forms aimed at bureaucratising this relationship have been attempted but, as this thesis will show, have failed to fulfil that purpose.

The cases studied in this thesis all represent efforts to bureaucratisate and depoliticise the Venezuelan State. By revealing how these efforts have been undermined by broader patterns of politicisation this thesis contributes to explain not only the persistence of that pattern but to illuminate the causes for similar failures in other institutional fronts.

The cases studied in this thesis, and the lessons derived from them, help to elucidate a similar set of problems in relation to broader politicisation of the State, the relationship between formal and informal institutions and regulatory practices. These problems were of particular relevance in Latin America during the decade of the 1990s when numerous countries in the region embarked upon a myriad of reforms usually advocated by multilateral organisations linked to the so-called ‘Washington consensus’. As the ‘reform exercise’ did not produce the expected outcome, a reflection about this divergence has since been in order. The cases shown in this thesis, although not directly related to the agenda of the reforms of 1990s, reveal

similar lessons that can be extrapolated to understand the limitations reformers have encountered in advancing the ‘reform agenda’. In this sense, this thesis will validate the notion that even well designed institutional blueprints are not enough for reform to take root.

1.1 Hypothesis

This thesis will present empirical evidence that the management of the oil industry and oil-related income in the three decades following nationalisation of oil in 1975 became politicised.² Politicisation occurred despite the fact that the political elite was aware of the danger that this might happen, as Perez’s words put it unambiguously. Political elites embarked upon designing institutions to try to prevent this outcome. The institutions themselves were not in principle badly designed, and this thesis will show that there was nothing so inherently wrong with their design that they were unworkable. What was lacking was the political will to make them work, and evidence of this can be seen across two dimensions. One relates to the fact that all institutional forms studied – the holding company PDVSA, the Investment, Stabilisation and Development Funds – all ended up politicised. The other relates to the fact that an essentially similar pattern of politicisation can be seen across a whole series of different Venezuelan governments. In this sense the Chavez government has been an exercise in continuity and not in rupture.

This thesis will demonstrate that there has been a pattern of politicisation that has persisted throughout the whole period since nationalisation. This period encompasses gradations in the ideological bias of policy decisions, different degrees of power legitimacy and functioning of checks and balances mechanisms, and different levels of oil dependency.³ The thesis will expose permanent mechanisms of politicisation, rivalling the opposite process of institutionalisation, that are retained in the conduct of

² Politicisation here is understood following the definition of ‘the politicized state’ by Douglas Chalmers, ‘The Politicized State in Latin America’ in J. M. Malloy, Authoritarianism and Corporatism in Latin America (Pittsburgh, University of Pittsburgh Press, 1977).p.25.

³ Different economic policies were attempted as well. For a summary of these policies see Ricardo Hausmann, ‘Quitting populism cold turkey: the “Big Bang” approach to macroeconomic balance’ in L.Goodman et al. (eds.), Lessons of the Venezuelan experience (Baltimore, The John Hopkins University Press, 1995), p.255.

crucial public matters even beyond significant changes of relevant political actors, notably across both the so-called Punto Fijo and Chavista regimes.⁴ If the oil sector, as this thesis argues, serves as a crucial indicator of broader Venezuelan characteristics, this thesis suggests that persistent short term management of vital aspects of both the economic and political system has become an entrenched feature of both systems.

This thesis builds on the abundant literature that has converged on the theme of institutional failure in Venezuela. It will offer, however, a detailed account of how political factors have stood in the way of institutionalising ‘rules of the game’ that were conceived to address the main concerns regarding the crucial State-oil relationship and that, in principle, did not exhibit any inherently flawed features that might have made them unfeasible.

By addressing how the oil industry and the oil money were managed, this thesis will add to valid insights offered by contemporary scholarly analysis on recent Venezuelan failures. The thesis will look into the engine of the Venezuelan economy and a central variable influencing political outcomes: oil. This approach expands on oil-centred analysis that commonly takes oil as the intervening variable. This thesis will examine oil institutions, set against political factors, attempting to cast light on the interrelation between the two. The findings of the thesis will underpin a fuller understanding of the failings of both the economic and political systems.

This thesis will focus on two key elements of the State-oil relationship: the governance of the state-owned oil company and the use of oil revenues. By showing how these two factors have operated since nationalisation of oil in 1975, up to 2005, the thesis aims to support the argument that ‘rules of the game’ did not inform the behaviour of relevant actors regarding these two matters. Successive attempts to regulate how to handle oil money either failed or faced distortion of their purposes.

⁴ ‘Punto Fijo’ regime refers to the political system established after dictatorship in 1958, called after the foundational pact signed by the main political actors (excluding the left) in a residence of one of the signatories named that way. ‘Chavista’ regime refers to the political system marked by the enactment of a new Constitution in 1999. The name derives from the fact that politics in this period has been dictated by the actions and decisions led by President Chavez.

Rules to achieve a stable governance structure of PDVSA were constantly ignored or distorted creating a dysfunctional relationship between the company and its political masters. The thesis will show that this malfunction followed the persistence of a pattern of politicisation that has prevented the institutionalisation of successive rules introduced, during the observed period, to regulate the oil industry and oil money.

1.2 Background

This section discusses five propositions, based on existing literature on Venezuela, that serve as points of departure for this thesis. The empirical evidence shown in this thesis will complement and modify some of the observations provided by these existing views of the Venezuelan case.

1) Venezuela was, in 1974, a relatively sophisticated and stable democracy, economically prosperous and with relatively functional institutions.

Venezuela was considered an exceptional case amongst Latin American and other developing countries in general, its prospects being considered unparalleled decades ago. Venezuelan's exceptionalism was commonly accepted.⁵ Using Levine's words: "For most of the last 30 years, Venezuelans and many of their Latin American neighbours shared a sense of Venezuelan exceptionalism. Abundant natural resources, great wealth, mobility and rising living standards, social openness and democratic politics, strong political parties, political stability and a military under control combined with the absence of deep linguistic or ethnic divisions to reinforce the notion that Venezuela had either solved the problems plaguing other Latin American countries or was somehow exempt in the first place. When Venezuelans' successes were set against regional tendencies to authoritarianism or civil war, satisfied, if not smug, feelings of exceptionalism became all the stronger."⁶ Oil resources were suggested as one of the factors that explained this 'exceptional' status.⁷

⁵ Steve Ellner and Miguel Tinker 'The Venezuelan exceptionalism thesis. Separating myth from reality', Latin American Perspectives 32:2, 2005, p.5.

⁶ Daniel Levine 'Goodbye to Venezuelan exceptionalism', Journal of Interamerican studies

The 1973 elections consolidated a two party political system, although the excluded left openly participated for the first time since insurgency in the 1960s. Power had passed to Acción Democrática (AD) in the 1973 election, following the administration of its rival Social-Christian Party (Copei), which in itself was considered a test for Venezuelan democracy since it was the first time an incumbent (President Leoni, of AD, elected in 1968) had been defeated. These events put together gave the Venezuelan elite and analysts alike the confirmation that political institutions were stable. Scholars such as Levine noted the ‘soundness and solidity’ of the political system.⁸ Others such as Jacome later noted that the Venezuelan elite learnt the sour lessons of the politics of the *Trienio*⁹ that led to ten years of dictatorship in the 1950s.¹⁰ On the other hand, economic growth had been sustained for years (see Figure 1.1) mainly responding to the ‘Import Substitution Industrialisation’ (ISI) policies¹¹ and the constant inflow of oil revenues. The enormous prospects offered by the positive shock of the oil price boom in 1974 only reinforced the propitious conditions prevailing at the time.

The starting point regarding oil institutions after nationalisation, this thesis will argue, was similarly auspicious. The oil industry was regulated efficiently by the Oil Ministry¹² and rent collection was deemed to be satisfactory. These initial favourable conditions for the post-nationalisation period support the argument that institutional design was not inherently flawed.

and world affairs 6 April 1994, p.149

⁷ R. Briceño-León, ‘Petroleum and democracy in Venezuela’, *Social Forces* 84:1, 2005.

⁸ D.Levine, *Conflict and political change in Venezuela* (Princeton, Princeton University Press, 1973),p.258.

⁹ ‘Trienio’ refers to the period of civilian rule from 1945 to 1948.

¹⁰ F.Jacome, ‘Venezuela: Old successes, new constraints on learning’ in J.McCoy, ed., *Political learning and redemocratization in Latin America: Do politicians learn from political crises?* (Miami, North-South Center Press, 2000).

¹¹ Import Substitutions Industrialisation was an economic policy paradigm at the time. It basically advocates protection to infant industries within a country until the industrial base was well established.

¹² The Oil Ministry was officially called ‘Ministry of Mines and Hydrocarbons’. The Ministry was later renamed twice: first, Ministry of Energy and Mines and second, Ministry of Energy and Petroleum. Hereafter, it is called Ministry of Energy.

2) There was a good understanding of the positive and negative impacts of oil wealth on Venezuela.

Oil plays a central role in much of the analysis and commentary about Venezuela. The effect of oil on the country's performance is mixed. A widely agreed view is that whilst oil wealth generates immense opportunities to boost a country's prospects, it also has the potential to bring problems. Oil wealth has been used to explain regime stability in Venezuela, both Gomez's dictatorship (1908-1935) and post-1958 democracy.¹³

Venezuela grew steadily until the late 1970s.¹⁴ In the first five decades of oil exploitation, oil wealth sustained both authoritarian and democratic rule (29 years of authoritarian regimes and 21 years of democracy). Until the early 1970s oil wealth was then considered to have had a positive net impact on Venezuela. The 1973 oil boom, however, resulted in a turning point in the country's performance. Paradoxically, the boom, after some years of improved conditions, was followed by a deterioration of standards of living that was not immediately acknowledged. The awakening to Venezuela's problems came only after the acute social unrest revealed in the Caracazo riots in February 1989.¹⁵

Oil wealth neglects other sources of taxation and the regulative capacity of the State

Oil wealth produces contradictory effects. In her seminal work, Karl identifies this as the 'paradox of plenty'.¹⁶ Jorge Olavarria, a Venezuelan historian, refers to it as the

¹³ Judith Ewell, Venezuela. *A century of change* (London, C.Hurst & Company, 1984); Daniel Hellinger 'Democracy over a barrel. History through the prism of oil', *N.A.C.L.A.*, March/April 1994

¹⁴ Venezuela is commonly referred as the fastest growing economy in the world during the first seven decades of the 20th Century. See 'Oil, missions and a chat show', *The Economist*, 14 May 2005.

¹⁵ 'El Caracazo' is the name given to the riots and looting that heavily afflicted Caracas and other parts of Venezuela for three days in February 1989, which were estimated to have caused several thousand deaths.

¹⁶ Terry Karl, *Paradox of plenty: oil booms and petro-states* (London, University of California Press, 1997).

‘Venezuela effect’.¹⁷ Oil revenues have given the State a strong financial position to assert its independence, extend its jurisdiction and to pursue autonomous goals. Dependency on oil income, however, made the Venezuelan State vulnerable to fluctuations in this income.

Declining oil rents caused negative effects magnified by a reluctance to address the harmful collateral effects that oil wealth carried with it. The abundant fiscal revenues obtained from oil underpinned a neglect of other sources of taxation. Both Karl and McCoy draw attention to the fact that generous oil revenues replaced traditional sources of taxation, precluding the Venezuelan State from developing an administrative capacity. In Karl’s words, “The State was robbed of the opportunity to benefit from the skills and talents that arise from the penetration of public authority to the far corners of a territory in search of revenues.”¹⁸ McCoy alludes to the same dynamics when she asserts that one of the vulnerabilities of the Punto Fijo system was neglecting the regulative capability of the State.¹⁹

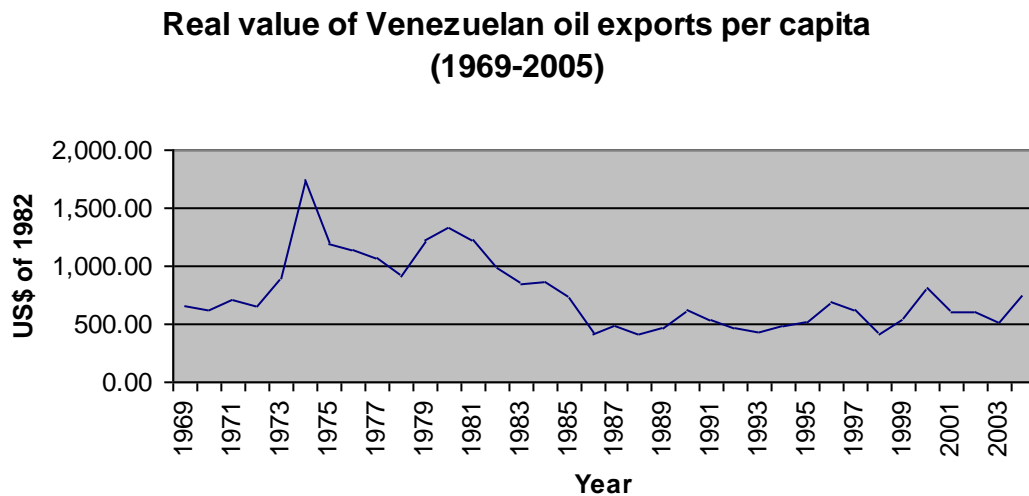
When oil income became insufficient, the absence of alternative sources of income on which the State could rely and its inability to reformulate policy according to new conditions fuelled economic and political crises. Oil wealth’s capacity to sustain the Venezuelan economy and public spending started to plummet steadily in the early 1980s. As Figure 1.2 shows, the per capita value of oil exports started to decline in 1981 after a brief period of recovery. The combination of sluggish oil prices, world inflation and a growing Venezuelan population resulted in the diminishing ability of the oil export sector to sustain, on its own, growth in the economy.

¹⁷ Jorge Olavarria, El efecto Venezuela (Caracas, Panapo de Venezuela, 1996).

¹⁸ Terry Karl, *ibid.* p.91.

¹⁹ Jennifer McCoy, ‘From representative to participatory democracy?’, in J.McCoy and D.J.Myers, The unraveling of representative democracy in Venezuela (Baltimore, The Johns Hopkins University Press, 2004), p.264.

Figure 1.2



Source: Opec Annual Statistical Bulletin 2004, US Bureau of Labor Statistics

Oil dependency

The declining value of oil rents impacted Venezuela in many ways. First, the patron-client²⁰ dynamic collapsed as the Venezuelan political system was “laying on the material base of international oil rent distribution through a clientelistic system”.²¹ “Heavy reliance on oil established a pattern of development in which the State became the great purveyor of employment, financial well-being and, through those two, political power.”²² Insufficient oil rent meant, as well, that the political system could not appease other important actors. As Roberts indicates, oil rent had facilitated “cooperation of labour forces, the Church, and the Military with the democratic

²⁰ In the Venezuelan context, ‘patron-client’ is used not only following the traditional usage of the term (i.e. to denote ‘clientelism’) but to stress that governmental elites maintain its political support by means of distributing the international oil rent through a myriad of mechanisms such as employment in a bloated public bureaucracy, cheap-financing the private sectors, widespread subsidies (petrol prices is a typical example) and overvalued exchange rate.

²¹ Daniel Hellinger, ‘Visión política general: la caída del puntofijismo y el surgimiento del chavismo’, in S.Ellner and D.Hellinger, *La política venezolana en la época de Chávez. Clases, polarización y conflicto* (Caracas, Nueva Sociedad, 2003), p.43.

²² Scott MacDonald and Georges Fauriol, *Fast Forward. Latin America on the edge of the 21st century* (New Brunswick, Transaction Publishers, 1997), p.181.

regime...and stimulated the programmatic convergence of the main political parties”.²³

Second, the economic model constructed around oil rents was threatened. Lombardi indicates how the political and economic elite based their notion of progress on the unsustainable assumption that “oil wealth on its own could transform an extractive economy into a modern diversified economy by recycling petro dollars in State-selected enterprises sustained by subsidies”.²⁴

Third, oil rents could no longer facilitate the consolidation of a democratic system where class divisions were dormant. Buxton points out, “Oil rents provided the State with a continuous flow of income for distribution in promoting national development and in satisfying social security obligations established in the 1961 Constitution.” With this acceptable rent distribution, Buxton continues, “Class divisions were dormant and free from politicisation despite efforts from the revolutionary left.”²⁵

Oil dependency meant multiple problems. The political system was vulnerable to declining rents in its capacity to sustain distributive politics, appease social tensions, and continue patron-client relationships. The economic model was dependent on its main motor and class conflict could no longer be avoided.

Oil booms worsened the negative impact of oil dependency

These negative outcomes were intensified by the destructive effect of the mismanagement of the booms in 1973-1975 and 1979-1980. There is little doubt that

²³ K.Roberts, ‘Polarización social y resurgimiento del populismo en Venezuela’, in S.Ellner and D.Hellinger, La política venezolana en la época de Chávez. Clases, polarización y conflicto (Caracas, Nueva Sociedad, 2003), p.77.

²⁴ J.Lombardi, ‘El permanente dilema de Venezuela: antecedentes de las transformaciones chavistas’, in S.Ellner and D.Hellinger, La política venezolana en la época de Chávez. Clases, polarización y conflicto (Caracas, Nueva Sociedad, 2003), p.14.

²⁵ J.Buxton, ‘Política económica y ascenso de Chávez al poder’, in S.Ellner and D.Hellinger, La política venezolana en la época de Chávez. Clases, polarización y conflicto (Caracas, Nueva Sociedad, 2003), p.147.

the boom years of the 1970s had intoxicated Venezuelans.²⁶ The country was living beyond its means. The Pérez administration's handling of the boom distorted the public sector in an unprecedented way.²⁷ Public industrial conglomerates created fiscal commitments that were unsustainable. Public debt was then increased significantly to compensate for declining rents. Venezuela ended up with a bloated public sector, a huge public debt to service and a weaker administrative capacity to deal with these problems. The State hugely expanded its jurisdiction, to use Karl's terms, but as she observed, "There was a striking lack of the juridical, complex, impersonal, and accountable bureaucracies necessary for managing its growing tasks."²⁸ The oil booms had served to exacerbate the negative consequences of fiscal dependency on oil rents.

Oil distorts macroeconomic performance

Macroeconomic scholars had also pointed to the negative macro effects of oil on the economy. This impact, felt through macroeconomic mechanisms such as the well known 'Dutch disease'²⁹ has been included in many accounts of Venezuelan troubles.³⁰ Oil has condemned the Venezuelan economy to almost total dependency on the oil industry, preventing its diversification.

²⁶ Jorge Olavarria, *ibid*; Aníbal Romero, La Miseria del populismo. Mitos y realidades de la democracia en Venezuela (Caracas, Centauro, 1986).

²⁷ Terry Karl, *ibid*; R. Hausmann 'Dealing with Negative Oil Shocks: The Venezuelan Experience in the Eighties' in P. Collier and Jan Willem (eds.), Trade Shocks in Developing Countries (Oxford, UK, Oxford University Press, 1999); For a detailed account of Pérez's economic expansion policy in the 1970s see Gumersindo Rodríguez, Era la gran Venezuela posible (Caracas, Ateneo de Caracas, 1986); For a defence of Pérez's neo-liberal policies, and implicit acknowledgment of the policy mistakes of the 1970s, see also Américo Martín, El Gran Viraje. Auge y caída (Capatara, Buchivacoa, 1995).

²⁸ Terry Karl, *ibid*, p.91.

²⁹ Dutch disease is understood as an economic concept that refers to that an increase in revenues from natural resources will deindustrialise a nation's economy by raising the exchange rate, which makes the manufacturing sector less competitive.

³⁰ Terry Karl, *ibid*, p.81 and 234; J.C. Boue, Venezuela: The political economy of oil (Oxford, Oxford University Press, 1993) p.179; Moises Naim, Paper Tigers and Minotaurs: the politics of Venezuela's economic reforms (Washington, Carnegie Endowment, 1993), p.36; See also Asdrúbal Baptista, 'Tiempos de Mengua', in Pedro Grases (ed.), Venezuela contemporánea: 1974-1989 (Caracas, Fundación Mendoza, 1989) for a discussion on the related mechanisms of currency over-valuation.

Similarly, internationally extracted oil rents distorted typical capital accumulation, with negative implications for the development of the political system.³¹

Additionally, Baptista has also pointed out the low level of private capital accumulation over recent decades.³² Hausmann reinforced this idea when he gave an explanation for the collapse in private investment.³³ What follows from this is that private capital has ceased to be an important stakeholder in the political system, and consequently has no ‘vested interest’ in its stability. In turn, this stability is more dependent on the fortunes of the public sector of the economy, which is in turn dominated by oil performance.

Oil promotes rent-seeking behaviour

Similarly, the ‘rentier’³⁴ behaviour has often been stressed in political economy accounts of Venezuela. Karl’s insights on the nature of ‘petro-states’ have often been used to emphasise ‘rent-seeking’ mechanisms in policy making. This emphasis, among some American scholars, stems from the ‘pluralist’ view of policy making as a battleground of private interests competing to extract rents, generally produced by state regulation.³⁵

The Venezuelan case presents some differences because oil rents are more akin to the classic ‘ground rent’ extracted by landlords.³⁶ While accepting that mechanisms for

³¹ Asdrúbal Baptista, *Teoría económica del capitalismo rentístico. Economía petróleo y renta* (Caracas, IESA, 1997).

³² Asdrúbal Baptista suggested this explanation in a conference in Cambridge University about the new Venezuelan constitution in December 1999.

³³ Ricardo Hausmann, ‘Venezuela’s growth implosion: a neo-classical story?’, in Dani Rodrik, *In Search of Prosperity: Analytic Narratives on Economic Growth* (Princeton, Princeton University Press, 2003).

³⁴ As ‘rentier’ is understood a person who derives a subsistence level or greater level of income from economic rent.

³⁵ For a paradigmatic analysis on rent-seeking see Anne Krueger, ‘The political economy of the Rent-seeking Society’, *The American Economic Review* 64:3, 1974; see also G. Tullock, *Rent Seeking* (Aldershot, Edward Elgar, 1993).

³⁶ See Bernard Mommer, *Global oil and the nation state* (Oxford, Oxford University Press, 2002); Asdrúbal Baptista and Bernard Mommer, ‘Renta petrolera y distribución factorial del ingreso’ in Hans-Peter Nissen, *¿Adiós a la Bonanza? Crisis de la distribución del ingreso en Venezuela* (Caracas, Ildis-Cendes, 1989); Bernard Mommer, *La cuestión petrolera* (Caracas, Tropykos, 1988), p.19.

capturing a share of the oil rents by organised interest groups have operated in Venezuela, as they commonly operate in any society with or without oil wealth, it appears that the main effect oil has exerted, in terms of 'rent-seeking' types of behaviour, is through generating cultural values based on the perception that Venezuela is enormously rich.

Various analysts and scholars have, in fact, examined the 'oil variable' in terms of its cultural influence. Pérez-Alfonzo, one of the founders of Opec, highlighted in the mid-1970s the negative effect of abundant oil income.³⁷ He infamously coined the expression "devil's excrement"³⁸ to describe oil. The concept of incredible wealth penetrated the social consciousness to such an extent that it reduced or removed the incentives for ensuring sustainable growth based on the productive efforts of society. In the same vein, other scholars, such as Coronil, support the "notion of oil as an independent force, as the dissolvent of morality in Venezuela".³⁹

These cultural values, formed over the years in which Venezuela was a prime world oil producer, were reinforced by the boom years' public display of overspending both at the collective and individual levels. The years of the so-called 'Saudi Venezuela' reinforced the 'myth of Venezuela's unlimited riches'.⁴⁰ Consumerism triggered by having a large amount of easily obtained oil money installed as the prevailing social behaviour.⁴¹

Yet once it became evident that the level of public spending was no longer sustainable, another cultural belief took hold: that the political system was corrupt. The reasoning being, as detected in public opinion surveys, that if Venezuela was

³⁷ Juan Pablo Perez Alfonzo and Domingo A. Rangel, El desastre (Valencia, Vadell Hermanos, 1976); R. Briceño-León, Los efectos perversos del petróleo (Caracas, Acta Científica Venezolana, 1990).

³⁸ Perez Alfonzo was a strident critic of public spending in the mid 1970s, he gave numerous interviews referring to oil as 'the devil's excrement'. He is frequently quoted as one of the first who alerted on the perils that the oil bonanza represented to the country.

³⁹ Fernando Coronil, The magical state. Nature, money and modernity in Venezuela (Chicago, University of Chicago Press, 1997), p.354.

⁴⁰ Aníbal Romero 'Rearranging the deck chairs on the Titanic. The agony of democracy in Venezuela', Latin American Research Review 32:1, 1997, p.10.

⁴¹ Luis Oropeza, Tutelary pluralism. A critical approach to Venezuelan democracy (Cambridge, MA, Center for International Affairs, Harvard University, 1983), p.14.

immensely rich, as was commonly believed, the absence of the once available abundant resources could have only one explanation: theft.⁴²

In fact, the efficiency of the public sector has been, and continues to be, very poor.⁴³ Waste of public resources went relatively unnoticed during the boom years, but when oil money dried up, inefficient and fraudulent use of public revenues became evident. The legitimacy of the system eroded progressively as corruption became the focus of intense media and public scrutiny, emphasised by the fact that corruption was never convincingly addressed by the State.⁴⁴

The extensive literature on the harm oil inflicts on the Venezuelan economic and political system has left some questions unanswered. It is yet to be explained why the political system has not addressed the distortions created by oil wealth in order to minimise them, or when it has done so why it has failed to counteract the negative effects alerted by micro and macroeconomic laws.

The complex relationship between oil wealth and the Venezuelan State has been extensively analysed and documented. In fact, many of the contributors to this body of knowledge have themselves occupied high positions in successive governments.⁴⁵ This thesis will analyse the institutional arrangements intended to counteract the negative collateral effects of oil wealth and will expose the factors that have rendered those attempts ineffective.

⁴² See J.A. Gil-Yepes, 'Public opinion, political socialization, and regime stabilization' in J.McCoy and D.Myers, The unraveling of representative democracy in Venezuela (Baltimore, The Johns Hopkins University Press, 2004). See M.Naim, 'The real history behind Venezuela's woes', Journal of Democracy 12 February 2001 for a similar reflection.

⁴³ R.A.González, Diagnóstico institucional del sistema de servicio civil en Venezuela, Inter-American Development Bank, 2002.

(<http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=626920>), p.60; Inter-American Development Bank, Venezuela Country Paper, Washington, 2006.

(<http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=424295>); M.Naim, *ibid.*; R.Perez-Perdomo, 'Corruption and political crisis' in L.Goodman et al (eds.), Lessons of the Venezuelan experience (Baltimore, The John Hopkins University Press, 1995).

⁴⁴ For a compilation of corruption scandals see Ruth Capriles, Diccionario de la Corrupción (Caracas, Capriles, 1989).

⁴⁵ Such is the case for Juan Perez-Alfonzo, Luis Oropeza, Jorge Olavarria, Gumersindo Rodríguez, Moises Naim, Ricardo Hausmann, Asdrubal Baptista, Bernard Mommer among others.

3) Although oil nationalisation in 1975 crystallised a consensual policy goal, it left unresolved issues of control of PDVSA and participation of private capital in the oil industry.

Some analysts have viewed the ‘oil variable’ from a slightly different angle. Oil is not blamed as such for Venezuelan problems. Instead, they have raised the issue of ownership and control of PDVSA to explain them. The ideological debate on the ‘oil variable’ continued after nationalisation. Hellinger points out that the Venezuelan political system was envisioned by a generation of political leaders who since 1936 had defended electoral democracy as the key to obtaining sovereign control over oil wealth.⁴⁶ Nationalisation of oil in 1975 crowned a long era of consensual nationalistic goals. Decisions made at the time of nationalisation, however, did not settle the debate about the oil issue.

Later on, for ‘oil nationalists’, dismal oil rents, and the consequential economic and political travails, were explained by the fact that the management of the nationalised industry inherited pre-nationalisation attitudes toward the oil industry. Venezuela’s interests, according to this line of thought, were not served by Venezuelan oil managers. Oil income had suffered from attempts to pursue policies that obstruct Opec’s price defence strategies, from doubtful management of oil operations intended to curtail state control of the industry and even using the oil company for political means.⁴⁷

This view, however, failed to account for the waste of the resources that the State has received, albeit limited according to this line of thought, from an industry administered by technocrats with anti-national attitudes. This thesis will demonstrate how oil money has been squandered despite successive attempts by the State to regulate it in the best public interests.

⁴⁶ Daniel Hellinger, *ibid.*

⁴⁷ J.C. Boue, La internacionalización de PDVSA: una costosa ilusión (Caracas, Ministerio de Energía y Minas, 2004); J.C. Boue, ‘El programa de internacionalización de PDVSA: ¿Triunfo estratégico o desastre fiscal?’ in L.E. Lander, Poder y Petróleo en Venezuela (Caracas, Faces-UCV, 2003); C. Mendoza-Pottella, Crítica petrolera contemporánea (Caracas, Faces-UCV, 2000); F. Mieres, PDVSA y el golpe (Caracas, Fuentes, 2003); B. Mommer, ‘Petróleo subversivo’ in L.E. Lander, Poder y Petróleo en Venezuela (Caracas, Faces-UCV, 2003).

Conversely, other analysts have suggested that the problem rests on precisely the state-owned character of the oil industry. Although these analysts do not accuse the management of the nationalised oil company of underperformance, they point to the adherence to Opec guidelines, the lack of investment due to the State's hunger for fiscal revenues and political interference as the reasons which explain why the oil industry has not brought the benefits to Venezuelans that it should have done. They suggested the idea of privatising oil rents through financial mechanisms that would made distribution of this rents available to all Venezuelan citizens. With these mechanisms they offered an alternative to the mechanisms governments have implemented to distribute oil rents.⁴⁸

In a mirror image from 'oil nationalists', these analysts failed to acknowledge, that, as this thesis will show, oil rent contributions to the Treasury have decreased in part owing to the augmented costs of operating the oil industry at the time the industry was considered to be acting more independently from the State's grip.

4) Focus on the collapse of 'Punto Fijo rules of the game' and on the replacing rules has missed elements of continuity underlying institutional 'volatility'.

Faltering Venezuelan institutions have added an additional dimension to the analysis of the problem, beyond an oil-centred perspective. As Hillman acknowledges, "Without ignoring the impact of oil, alternative explanations for the crises can be found in social and political developments caused by ideological and cultural forces that have been continuous throughout boom and bust economic fluctuations."⁴⁹

Levine has suggested that economic decline might not be the only explanation for the

⁴⁸ J.L.Cordeiro, El Gran Tabú Venezolano La desestatización y democratización del petróleo (Caracas, Cedice, 1997); L.Giusti, Conference talk entitled 'La economía venezolana y el petróleo: una tesis de armonización en términos de desarrollo nacional', Fifth Venezuelan Oil Congress, November 1994; L.Montiel-Ortega, Venezuela: una economía petrolera (Caracas, Arte, 1996); A.Quiros-Corradi, Petro-Estado: el costo de la abundancia', 54th Annual Conference proceedings (Caracas, Fedecamaras, 1994), p.55; A. Sosa-Pietri, Quo vadis Venezuela (Caracas, Andrés Sosa, 2000).

⁴⁹ R.Hillman, Democracy for the privileged : crisis and transition in Venezuela (Boulder, L.Rienner Publishers, 1994), p.17.

crisis in the political system. Factors such as political organisation, democratisation and failure to reform are deemed to underpin contemporary Venezuelan crises.⁵⁰

The decline and ultimately the breakdown of the Punto Fijo system brought a broader issue of institutional failure to the forefront of Venezuelan analysis. Not only did the ‘rules of the game’ embodied in the infamous Pact of Punto Fijo disintegrate but various other attempted institutional arrangements have either collapsed or have failed to fulfil their purposes.

The Pact of Punto Fijo in 1958 created the foundation ‘rules of the game’ largely credited with having been instrumental for establishing democratic politics after dictatorship. The democratic system crafted by the Punto Fijo elite, however, has been equally questioned for having turned to a particular type of democracy deemed as partial, somehow artificial and restrictive.⁵¹

The Punto Fijo institutional design, contained mainly in the Constitution of 1961, became some sort of a meta-institutional arrangement that departed from the intended ‘democracy building’ order. This discrepancy has received critical scholarly attention. Punto Fijo rules ended up producing a “*limited pluralist*” democracy according to Gil-Yepes; a “*conciliatory populist system*” for Juan Carlos Rey; a “*pactocracy*” for Cockcroft; a “*tarnished or pacted democracy*” according to Hellinger; a “*democracy for the privileged*” for Hillman; and a “*partyarchy or partidocracia*” for Coppedge.⁵²

⁵⁰ D.Levine, ‘Beyond the exhaustion of the model: Survival and transformation of democracy in Venezuela’ in E.Diniz (ed.), Os desafios da Democracia na America Latina (Rio de Janeiro, IUPERJ, 1996); See also M.Kornblith and D.Levine, ‘Venezuela. The life and times of the Party System’ in S.Mainwaring and T.Scully, Building democratic institutions. Party systems in Latin America (Stanford, Stanford University Press, 1995); D.Levine and B.Crisp, ‘Legitimacy, governability, and reform in Venezuela’ in L.Goodman et al (eds.), Lessons of the Venezuelan experience (Baltimore, The John Hopkins University Press, 1995).

⁵¹ J.Buxton, The failure of political reform in Venezuela (Aldershot, Ashgate, 2001).

⁵² James Cockcroft, Latin America. History, Politics and U.S policy (Chicago, Nelson-Hall publishers, 1996); M.Coppedge, ‘Partidocracia and reform in comparative perspective’ in J.McCoy et al. (eds.), Venezuelan democracy under stress (New Brunswick, Transaction Publishers, 1994); J.A.Gil-Yepes, The challenge of Venezuelan democracy (New Brunswick, Transaction Books, 1981); D.Hellinger, Venezuela: tarnished democracy (Boulder, Westview Press, 1991); R.Hillman, *ibid*; J.C.Rey, ‘El futuro de la democracia en Venezuela’ in J.A.Silva-Michelena (ed.) Venezuela hacia el 2000: desafios y opciones (Caracas, Nueva Sociedad, 1987).

In fact, Punto Fijo rules allowed, first, a system in which democracy rested on managed electoral competition biased toward the AD and Copei incumbency.⁵³

Second, the Constitution of 1961 provided for a theoretical checks and balances institutional design that never worked adequately, save some instances when an opposition-controlled Congress curtailed some Executive initiatives or the infamous impeachment of President Pérez in 1993, when the system was already in evident decay.

Third, the system promoted a cosy settlement with capital and labour. Almost every policy mechanism was designed to allow for a ‘corporatist’ arrangement with the participation of business (notably, the main umbrella business association – Fedecamaras) and the unions (notably, the Confederation of Venezuelan Workers, the CTV). The arrangement was mirrored in the economic arena by a conception of the role of the State as the predominant economic actor combined with a model that, based on ISI rules, gave the private sector a protected environment in which to develop itself.

By the mid-1980s, some parts of the Venezuelan elite pushed for reforms. This call for ‘new rules’ came from a sector of society which had benefited from the distribution of oil by becoming better educated, by having access to better living standards and by benefiting from the trickle down effect of expansionary, albeit unsustainable, economic policies. The prevailing argument behind the reforms was that the old rules were not fit for purpose under the new economic, social and political conditions.

Fresh rules intended to revitalise the system were, therefore, introduced in the late 1980s and early 1990s. First, political reforms, driven by the claims of the so-called civil society, and granted by the embattled Punto Fijo elite, were expected to restore legitimacy to the political system.⁵⁴ The ‘decentralisation’ of the State and the

⁵³ J.Buxton, *ibid.*

⁵⁴ These reforms were mainly crafted by the Presidential Commission for State Reform, known for its acronym ‘COPRE’, set during the administration of President Lusinchi (1984-1989).

opening of new political spaces, such as the election of State governors for the first time, initially brought a breath of fresh air to the political arena. This initial success encouraged a sense of optimism among some Venezuelan observers.⁵⁵ Early success, however, was rapidly curtailed. President Caldera's administration halted the decentralisation process. The surviving regulations promoting decentralisation of the State have not produced the intended results.⁵⁶

Similarly, some economic reforms were introduced with the short-lived, but highly influential neo-liberal inspired package in 1989-1993. In the same vein as the political reforms, some components of the neo-liberal package succeeded such as the dismantling of ISI policies and, similarly, some early success was achieved in limiting the State's share of the economy by privatising some important state-owned assets.⁵⁷ The new rules in the economy, however, were resisted by old beneficiaries of Punto Fijo, mainly the traditional political parties, and to any practical effect, were sidelined.

These failures to implement reform aggravated the weakness of the Punto Fijo system, resulting in a de-legitimisation of the whole political system. Analysts and scholars were left with no alternative other than to acknowledge that the Punto Fijo regime was severely, and perhaps fatally, damaged.⁵⁸ A consensus about the underlying causes of Venezuela's malaise returned, with explanatory emphasis again accorded to oil: economic deterioration mainly due to the failure to escape from oil dependency and the neglect of building an effective State capacity to deliver public

⁵⁵ Merilee Grindle, Audacious reforms: Institutional invention and democracy in Latin America (Baltimore, The Johns Hopkins University Press, 2000); There was much analysis of the emergence of new actors (or the so-called 'Civil Society'). See, for instance, J.C.Navarro, 'Venezuela's new Political actors' in L.Goodman et al (eds.), Lessons of the Venezuelan experience (Baltimore, The John Hopkins; University Press, 1995); D.Levine, *ibid.*

⁵⁶ M.García-Guadilla, 'Democracy, decentralization and clientelism. New relationships and old practices', Latin American Perspectives, 29 May 2002.

⁵⁷ The most important was the privatisation of the national telecommunication company.

⁵⁸ See two volumes that compile a thorough reflection by both Venezuelan and American scholars on the strained Punto Fijo regime: L.Goodman et al (eds.), Lessons of the Venezuelan experience (Baltimore, The John Hopkins; University Press, 1995) and J.McCoy et al. (eds.), Venezuelan democracy under stress (New Brunswick, Transaction Publishers, 1994). For an early warning of the collapse of the Punto Fijo regime see J.C.Rey, *ibid.* For an analysis of the collapse of the neo-liberal package see: M.Naim, Paper Tigers and Minotaurs: the politics of Venezuela's economic reforms (Washington, Carnegie Endowment, 1993); J.Corrales, Presidents without parties: the politics of economic reform in Argentina and Venezuela in the 1990s (University Park, The Pennsylvania State University Press, 2002). See also Scott MacDonald and George A.Fauriol, *ibid* ; Aníbal Romero, *ibid.*

goods. The consensual view also identified that defiance by ‘civil society’ of the centralising, clientilistic and power monopolising AD and Copei practices combined with large disaffected sectors of society to erode the legitimacy of the system.

Another broken rule that arose from the decaying process of Punto Fijo received less scholarly attention, relative to its crucial significance. The Chávez-led aborted coup in February 1992 broke the rule of military subordination to civilian power. Even if the military, despite further attempts in the form of an aborted coup or near-missed rebellions, never took power as such, subordination was no longer guaranteed and military-civilian tensions remained a political factor of the utmost importance.⁵⁹

The final blow to Punto Fijo materialised in the unforeseen sweeping electoral triumph of Hugo Chávez, which paradoxically questioned the ‘informal’ and, ultimately, trademark rule of the Punto Fijo regime: the bias in the electoral system in favour of AD-Copei.⁶⁰ But it was not the election result in 1998 that buried Punto Fijo. It was the swift and decisive use of his electoral mandate that led Chávez to convene a constitutional convention to redraft the Constitution of 1961, the fundamental product of the Punto Fijo arrangement. Chávez seized the opportunity to rewrite the ‘rules of the game’ that the embattled Punto Fijo elite had failed to achieve despite numerous calls to do so in previous years.⁶¹ A new Constitution was approved in December 1999 abolishing the longest-standing Constitution in Venezuelan history. In fact, the Constitution of 1999, the 23rd in the history of the country, replaced the

⁵⁹ F. Agüero, ‘Crisis and decay of democracy in Venezuela: the civil-military dimension’ in J.McCoy et al. (eds.), *ibid*; F. Agüero, ‘Debilitating democracy: political elites and military rebels’ in L.Goodman et al (eds.), *ibid*; W.Burggraaff, ‘More than failed coups: the crisis in Venezuelan civil-military relations’ in L.Goodman et al (eds.), *ibid*; G.Philip, ‘The strange death of the Venezuelan party system’, delivered at Latin American Studies Association meeting, Sept 2000; H.Trinkunas, ‘The Military. From marginalization to center stage’ in J.McCoy and D.Myers, The unraveling of representative democracy in Venezuela (Baltimore, The Johns Hopkins University Press, 2004).

⁶⁰ J.Buxton, *ibid*.

⁶¹ For analysis on aborted constitutional reforms see Rafael Caldera, Los causahabientes de Carabobo a Puntofijo (Caracas, Panapo de Venezuela, 1999), p.157; M.Kornblith, ‘The politics of constitution-making: Constitutions and democracy in Venezuela’, Journal of Latin American Studies 23:1, 1991; M.Kornblith, ‘Political crisis and constitutional reform’ in L.Goodman et al (eds.), Lessons of the Venezuelan experience (Baltimore, The John Hopkins University Press, 1995); M.Kornblith, Venezuela en los noventa. Las crisis de la democracia (Caracas, IESA, 1997).

Constitution of 1961 which had lasted for 38 years, a remarkable fact considering the tradition of short-lived constitutional texts.⁶²

This thesis will look at ‘rules of the game’ regarding the oil sector. In a similar fashion to the Punto Fijo and post-Punto Fijo sets of rules, successive institutional designs have failed to regulate the actual behaviour of both the oil company and the government. Findings regarding the performance of oil institutions will support the argument that ‘rules of the game’ per se do not seem to explain a continuous volatility in the institutional blueprint of the Venezuelan society coupled with continuous failure to organise political and economic arenas.

The results of the rewriting of the Punto Fijo rules can be ascertained only with time. Some initial developments, however, are instructive. This thesis will examine various cases, regarding the oil sector, that show how the constitutional rules have performed in their initial implementation. These early indications seem to support the observation by some scholars that the system has retained many of the features of its predecessor.⁶³

Crucially, it is important to note that Venezuela has continuously produced rules to organise its polity and its economy but at the same time, has witnessed how these very same rules are either blatantly ignored, easily abandoned, rewritten in the hope of ‘getting things right’ or simply accommodated to particular and circumstantial interests.

This constant proclivity for rewriting the rules of the game has confused some analysts. When analysts have addressed the decline of Punto Fijo by correctly

⁶² Previously to 1961, only two Constitutions endured more than a decade (the first Constitution of 1930 and that of 1881, which lasted 27 and 10 years respectively). Constitutions lasted six years 86 days on average before 1961. See J.Olavarria, ‘De Crespo a Caldera 1894-1994’ in R.J.Velásquez (ed.), Balance del Siglo XX Venezolano (Caracas, Fundación Herrera Luque, 1996).

⁶³ J.Buxton, ‘Venezuela’s contemporary political crisis in historical context’, Bulletin of Latin American Research 24:3, 2005; R.Briceño-León, ‘Petroleum and democracy in Venezuela’, Social Forces 84:1, 2005 p.,21; L.R.Davila, ‘The rise and fall and rise of populism in Venezuela’, Bulletin of Latin American Research 19:2, 2000; Jennifer McCoy, ‘From representative to participatory democracy? Regime transformation in Venezuela’, in J.McCoy and D.Myers (eds.), *ibid*; G.Philip, Democracy in Latin America: surviving conflict and crisis?, (Cambridge, UK, Polity Press, 2003).

describing many of its failures, they could not, however, have anticipated that the new 'rules of the game' would retain Punto Fijo features, including those that were specifically identified as dysfunctional.

5) Analysis of the 'Chavista' regime has tended to favour a polarised vision of its early features, obscuring signs of continuity with old Punto Fijo practices.

That the collapse of the system was not followed by a significantly different new order has suggested a more subtle development of Venezuelan scholarly work. This has been all the more challenging because the analysis of current events, i.e. of the *Chavista* regime, is tainted by an acute sense of polarisation that in part has arisen from the common characterisation of '*Chavismo*' as a 'revolution'. This extreme view has emerged mainly as a consequence of a reiterative rhetoric emanating, to a great extent, from President Chávez himself, who consistently stresses the 'revolutionary' character of his government. This radical and limited vision of the changes occurring in Venezuela since Chávez has been in power, this thesis argues, has been reinforced by the parallel characterisation of the *Chavista* regime as a comprehensive departure from the past by the very same supplanted Punto Fijo elites and the analysts sympathetic to their vision.

In analysing institutional failure in Venezuela, the *Chavista* regime has added a crucial new dimension. The emergence of a new political class in 1998 as the replacement of the Punto Fijo elite has been viewed, among commentators and some early scholarly work, with markedly contrasting prospects. The analysis of the significance of *Chavismo* in recent Venezuelan history ranges from interpretations that see it as an authoritarian regime, and President Hugo Chávez as an 'aspiring dictator', to an 'alternative to neo-liberalism', to a sort of 'saviour of democracy'.⁶⁴

⁶⁴ J.Corrales 'Hugo Boss', *Foreign Policy*, January to February 2006, p.32-40; F.Domínguez, *Chávez: La revolución pacífica y democrática* (Caracas, Freddy Dominguez, 1999); T.Gibbs, 'Business as unusual: what the Chavez era tells us about democracy under globalisation', *Third World Quarterly* 27 February 2006, p.265; D.Parker, 'Chavez and the search for an alternative to neoliberalism', *Latin American Perspectives* 32:2, 2005, p.39; John Pilger, *The Guardian*, 13 May 2006, p.30.

Much of the analysis of Chávez's presidency suggests it is personality-driven, given his extraordinary charisma and popular appeal, or focused on issues of leadership, given the ample 'personalistic' nature of the *Chavista* regime.⁶⁵ This analysis has been supplemented with thorough accounts of the central events that have marked *Chavismo*, such as the Chávez-led aborted coup in February 1992, the run up to the elections in 1998 and the election itself, the enacting of a new Constitution in 1999, the anti-Chávez aborted coup in April 2002 and the major oil stoppage in 2002-2003.⁶⁶

Both the tendency to hold a polarised vision of the Chavista regime and the concentration on him and on the main events that have shaped the Chavista era have left an analytical space for a deeper analysis of what the Chávez administration has done in concrete areas of public policy, including in the crucial oil sector.

Developments in the oil market since President Chávez took office in February 1999 have been of paramount importance. After his inauguration, one of Chávez's first priorities, perhaps the main policy initiative outside his strictly political agenda was to revive the prospects of the sluggish Opec. The organisation's heads of state met for the first time in decades under the auspices of President Chávez in Caracas in 2000. This triggered a recovery in oil prices, added to by the events in Iraq in 2003 and, more structurally, by the increased demand for energy in the fast growing economies of the world, notably China and India.

⁶⁵ A. Blanco-Muñoz, Habla el comandante (Caracas, Fundación Pío Tamayo, 1999); C. Blanco, Revolución y desilusión: La Venezuela de Hugo Chávez (Madrid, Los Libros de la Catarata, 2002); A. Garrido, La historia secreta de la revolución bolivariana (Mérida, Editorial Venezolana, 2000); R. Gott, In the shadow of the liberator : Hugo Chávez and the transformation of Venezuela (London, Verso, 2000); C. Marcano and A. Barrera-Tyszka, Hugo Chávez sin uniforme. Una historia personal (Caracas, Melvin, 2005); L. Vivas, Chávez: la última revolución del siglo (Caracas, Planeta, 1999); A. Zago, La rebelión de los ángeles (Caracas, Warp, 1998).

⁶⁶ A. Frances and C. Machado-Allison (eds.), Venezuela : la crisis de abril (Caracas, IESA, 2002); E. Golinger, The Chavez code: cracking U.S intervention in Venezuela (La Habana, Jose Marti, 2005); J. Kelly, 'Thoughts on the Constitution: Realignment of ideas about the economy and changes in the political system in Venezuela, delivered at Latin American Studies Association meeting, March 2000; M. McCaughan, The battle of Venezuela (London, Latin American Bureau, 2004); T. Petkoff, La Venezuela de Chávez. Una segunda opinión, (Caracas, Grijalbo, 2000); T. Petkoff, Dos izquierdas (Caracas, Alfadil, 2005), R. Santodomingo, La conspiración del 98: un pacto secreto para llevar a Hugo Chávez al poder (Caracas, Alfadil, 1999); P. Márquez y R. Piñango (eds.), En esta Venezuela (Caracas, IESA, 2003).

High oil prices have produced an extraordinary windfall of oil revenues for the Chávez administration. This external factor has marked the Chavista regime as significantly as the events in the political arena. As has been the case throughout the history of Venezuela during the last eight decades, the oil variable is intertwined with other economic and political factors in explaining the country's performance. President Chávez, similarly to some of his predecessors, has been put to the test in an area crucial to Venezuela's performance: the task of handling an 'oil boom'.

Although social, economic and political conditions prevailing at the time of Chávez's boom differ from those of the booms under the first Pérez's administration (1974) and of the Herrera's administration (1980), the capacity of the State to handle the additional revenues, this thesis will demonstrate, has shown important continuities with the 1970s and even the 1980s.

This observation is critical to understanding the 'oil variable' in Venezuelan economy, politics and society. It provides a new dimension through which to analyse the causal relationship between the oil sector and developments in the wider economy, the political system and in Venezuelan society in general.

Venezuela has managed its oil wealth, this thesis argues, in response to factors beyond oil-determined dynamics and, widely accepted, oil-determined effects. Causation does not run exclusively from the 'oil variable' to the rest of the determinant factors of Venezuelan political economy. This research demonstrates an alternative relationship. An examination, offered through the novel empirical evidence researched and analysed in this thesis, of the institutional arrangement adopted to deal with the 'oil variable' provides a complementary vision of the complex relationship between the Venezuelan State and its oil wealth.

1.3 Organisation of the thesis

The thesis analyses two concrete aspects of the relationship between the Venezuelan State and oil, and revises the accepted interpretations of them. It scrutinises oil policy

in Venezuela over the three decades following the nationalisation of the oil industry in 1975. The research focuses on the institutional arrangements (i.e. the ‘rules of the game’) concerning, first, the spending of the revenue which the Venezuelan State obtains from oil exports through royalties, taxation and dividends from the state-owned oil company Petróleos de Venezuela’s (PDVSA) – i.e. oil revenues; and second, the exercise of political authority and the use of institutional resources to control PDVSA and define its policy guidelines – i.e. governance.

First, the use of the revenues obtained from oil exports is addressed through investigating three funds that were directly fed with oil money: the Investment Fund (1970s-1980s), the Stabilisation Fund (1990s) and the Development Funds (2000s). These funds were chosen because they are the only three institutional arrangements that directly regulated oil revenues. The rest of the revenues collected from taxing the oil industry are channelled through normal budget mechanisms.

Second, governance of PDVSA is analysed through examining three periods: the ‘post-nationalisation’ period (1975-1988), the ‘neo-liberal inspired’ period (1989-1998) and the ‘*Chavista*’ period (1999-2005).

The thesis is organised chronologically. First, the thesis examines the oil boom of 1974 and the immediate post-nationalisation period. Chapter 2 examines the post-nationalisation institutional arrangements adopted to control PDVSA. It seeks to validate the observation that politicians responded to the long awaited step of nationalising the oil industry by, complacently, abandoning the previous regulatory capacity contained in the old Ministry of Mines and Hydrocarbons. Similarly, the chapter will reveal the breaching of rules agreed with the company as a consequence of self interested political entrepreneurship and circumstantial imperatives. These factors, it will be argued, initiated a chain of dysfunctional actions by both the government and PDVSA that hindered governance in the future.

Chapter 3 will examine the Investment Fund set afresh in 1974 to channel the extra resources obtained from the unexpected surge in oil prices. It will be demonstrated that specific and well defined rules and a carefully constructed bureaucratic capacity were not enough to counteract lack of political will to get claims over oil resources in

check. The Investment Fund, as conceived and initially implemented, was able to prevent misdirection of oil money. It was, however, bypassed and rendered ineffective by the rest of the State.

The thesis then addresses the so-called 'neo-liberal' interlude. This period, from 1989 to 1999 covers the second administration of both Presidents Pérez and Caldera.

Chapter 4 examines the governance of PDVSA under two administrations that were, through different means, attempting to implement neo-liberal inspired policies. The chapter will demonstrate how the company emerged from that period in a superior position vis-à-vis its political master. The findings of the chapter will show that this supremacy of PDVSA resulted from two contradictory dynamics. First, during the technocratic Pérez cabinet, the government tried to curtail PDVSA's influence. The company, however, could resist these initiatives because the government became critically weakened due to the political crisis of 1992-1993. The chapter will argue that it was during the administration of Caldera, who ran for the Presidency on a furious rejection of neo-liberalism, that PDVSA outmanoeuvred its regulators and pursued a privatisation policy. The resulting feature at the end of that period was that the relationship between PDVSA and the State was dysfunctional and likely to be rebalanced whoever followed those administrations.

Chapter 5 analyses the Stabilisation Fund enacted in 1998 but conceived as part of the orthodox thinking prevailing in the early 1990s. The chapter will show how, in similar fashion to the case of the Investment Fund, a straight forward mechanism targeted at correcting the macroeconomic distortions discussed earlier in this chapter, failed as a result, again, of lack of enforcement by other components of the State. Even the fact of having elevated the Fund to a constitutional status, in the Constitution of 1999, proved ineffective in guaranteeing its proper functioning.

Finally, the thesis examines the period of the *Chavista* regime (1999-2005). Chapter 6 addresses the Chávez administration's actions regarding the governance of PDVSA. The chapter will show how, contrary to Chávez's ex-post rhetorical representations of the facts, the administration's initial response was influenced by a cautious stance toward the company, even as Chávez had made perfectly clear in the presidential campaign in 1998 his opposition to PDVSA's privatisation drive. It was, the chapter

will argue, the infiltration of a broader political dispute into the company by its technocrats that prompted the Chávez administration to overhaul the company in an extraordinary fashion. The new rebalancing of power, however, did not resolve agency issues and new problems are likely to preserve the dysfunctional character of the PDVSA-government relationship.

Chapter 7 scrutinises the Chávez administration's response to the surge in oil revenues in the early 2000s. By establishing a series of spending mechanisms that finally took the form of a Development Fund, the Chávez government, this chapter will argue, followed similar institutional mechanisms to its predecessors. The implementation of the Fund, in the form adopted by Chávez's administration, required bending previous rules, accommodating new rules for short term imperatives and even overcoming constitutional mandates. Other parts of the State failed to counteract the administration's use of the oil windfall in its preferred way. The spending of oil revenues continued to depend on the Presidency of the Republic.

Chapter 8 consolidates the findings of the empirical chapters, drawing important conclusions about the post-nationalisation management of oil in Venezuela.

Chapter 2

Governance of PDVSA: the post-nationalisation years (1975-1989)

This chapter examines the institutional arrangements adopted in 1975 to regulate the relationship between the State and the new oil holding, PDVSA. Nationalisation, the zenith of Venezuelan oil policy's achievements, marked a significant change in the institutional arrangements that evolved since oil began to be exploited in the mid-1920s. Put briefly, this arrangement regulated the distribution of oil rents between foreign oil companies and the State. This arrangement was implemented through a regulatory body, the Oil Ministry, amply considered an efficient watchdog.⁶⁷

The chapter examines the institutional arrangements that emerged from nationalisation, in conjunction with the circumstances in which the nationalisation process took place. Despite the great importance assigned to the long awaited move to nationalisation, the institutional set-up adopted did not serve the aims of, on the one hand, managing the oil company as an independent, commercial concern and on the other, maintaining the oil company's accountability to its political masters. The main argument supported by this chapter is that politicians and policy makers alike became complacent following the nationalisation process, which they regarded as a significant achievement. In addition, prevailing conditions at the time of nationalisation imposed constraints that, combined with such complacency, produced an unbalanced and frail institutional arrangement. Notably, the efficient regulator that the Oil Ministry once was had become a weakened body.

Later, when economic conditions worsened, policy makers tinkered with the oil business as a quick fix, or in an attempt to attenuate economic strains. In addition, key

⁶⁷ The Oil Ministry originated from a section within the Ministry of Industry. It evolved, and changed its denomination several times, to a full Ministry by the time of nationalisation.

policy makers meddled with oil policy decisions as a means to advance their own careers. Similarly, politicians used contentious oil issues as tools for inter-party competition during elections. This chapter argues that these factors combined distorted the post-nationalisation arrangements, sowed the seeds for subsequent tensions between the oil conglomerate and the Venezuelan State and began a pattern of politicisation that prevailed over subsequent years.

The chapter is organised into five sections. The first section discusses the background of the nationalisation process and the prevailing constraints when the new institutional arrangements were designed. Section two examines the exact form of the institutional arrangements, adopted in the aftermath of nationalisation. Section three discusses how these arrangements were challenged and subsequently distorted during the years that followed. Section four underlines the decline of the Ministry of Energy as the most significant development of the pre-nationalisation arrangement. The final section draws conclusions from the analysis.

2.1 Defining post-nationalisation rules of the game

President Pérez signed the nationalisation law on the 29 August 1975. The occasion signified the culmination of continuous, incremental steps that the Venezuelan State had taken over five decades, to raise its claims over oil revenues. Regulation of the oil business evolved from bluntly favouring the operators (foreign companies) to the detriment of the owner (the State), to a more favourable arrangement for the Venezuelan State. Nationalisation represented the ultimate vindication for Venezuelans regarding oil governance.

When commercial oil exploitation began in the 1920s the terms in which Venezuela participated in the business were extremely weak. The State regulatory body was immediately captured by the industry. When independent minded Minister Gumersindo Torres first drafted a law regulating the business in 1922, the foreign oil companies protested directly to President General Gomez. They argued that the reason they were interested in Venezuelan oil was that Mexico had raised taxes and if Venezuela were to do the same they would leave. Gomez replied by saying that he

was a cattle rancher and knew nothing about oil. He asked the companies to write the legal code they deemed fit, promising that this would be State policy. In 1922 a new law was enacted, with the consent of foreign companies.⁶⁸ Not surprisingly, when the nationalisation law was passed in 1975 a feeling of vindication was widely shared among policy makers and politicians.

In fact, nationalisation was widely supported across the political spectrum. The main political parties AD and Copei threw their support behind the measure. Although nationalisation of the oil business generated heated debate and abundant commentary and analysis, main policy makers, politicians from different ideological stances and oil commentators celebrated the milestone amidst a highly emotional shared sense of national achievement.

Table 2.1 summarises the main steps taken, from the 1920s to 1975, by Venezuela regarding the governance of oil wealth. Table 2.2 shows how Venezuela's share of oil rents evolved throughout this period. This contribution of oil to total fiscal revenues (hereafter, oil fiscal participation) had grown to an average of 61.83% of gross oil income in the six years previous to 1975.⁶⁹ The step of nationalisation was considered the zenith of the long struggle over the oil rents.

The celebratory mood, however, overshadowed the need for important policy decisions. Such policy decisions needed to take into consideration several constraints: the conditions of the oil infrastructure; the need to assimilate oil technocrats and high management of the oil conglomerate to the new status as public sector managers and officials; the need for exploration of new oil reserves; and the necessity of access to technology and commercialisation channels in international oil markets.

On the other hand, old oil policy pillars such as the tax regime, the oil conservation guiding principle and the role of the Ministry of Energy also needed to be reconsidered in the light of the new situation.

⁶⁸ Information from Tomas Carrillo-Batalla, interview by author, Caracas, 21 August 2003. See also F.Tugwell, The politics of oil in Venezuela (Stanford, Stanford University Press, 1975).

⁶⁹ Author's estimate based on data compiled by Bernard Mommer.

Table 2.1 Highlights of Venezuelan oil policy (1920s-1970s)

Date	Policy instrument	Implications
Pre-commercial exploitation	Colonial Laws of Mines (1584,1784) and first Republican laws (1829, 1832, 1854, 1881 and 1893)	Gave the Venezuelan State (first, the Colony and later the independent Republic) the right to claim ownership over resources underneath the soil. Oil as such is first mentioned in the Mining Code of 1893.
Early 1920s	First concessions	Concessions are granted to explore oil reservoirs by General Gomez (dictatorship).
1922	Law of Mines	First regulations of concessions system and royalties.
End of 1930s	Consolidation of concessions	After concessions were scattered and granted to General Gomez's cronies, the industry is consolidated around three big foreign companies (50% Standard Oil, 35% Shell and 14% Gulf Oil) that bought those rights.
1943	Hydrocarbons law	Substantial rises in taxes on oil companies and regularisation of the concessions system for the next 40 years.
1945-48	Tax reforms	Oil companies were taxed beyond previous agreements. Fiscal participation in oil revenues rose.
1956-1957	New concessions	General Pérez Jimenez (dictatorship) granted new concessions.
1958	Tax reforms	Interim President Sanabria increased tax burden to oil companies (Decree 476 of 19 December 1958).
1959	'No more concessions' policy	Minister of Mines Pérez Alfonzo stated policy of not granting more concessions on conservation grounds. President Betancourt strongly supported Pérez Alfonzo.
Early 1960s	Foundation of Opec	Venezuela promoted the creation of the Organisation of Petroleum Exporting Countries.
1971	Reversion Law ⁷⁰ and Decree 832 ⁷¹	Congress passed a law to regulate how oil assets will revert to public ownership once concession expired. Decree 832 tightened operational control by the Ministry.
1975	Nationalisation law	Concessions prematurely expired as the whole industry is transferred to public ownership.

Source: R. Betancourt, *Venezuela, Oil and Politics* (Boston: Houghton Mifflin, 1979); Giacopini 'Aspectos históricos' in J.C.Arreaza (ed), *Diez años de la industria petrolera nacional (1976-1985)*. (Caracas,PDVSA,1986); B.Mommer, *Global Oil and the Nation State* (Oxford: Oxford Institute for Energy Studies, 2002).

⁷⁰ Official Gazette 29,577, 6 August 1971.

⁷¹ Official Gazette 29,689, 18 December 1971.

Table 2.2 Fiscal participation (as % of value of a barrel of oil)

Period	Oil fiscal participation per barrel (US\$)	Price per barrel (US\$)	Oil fiscal participation per barrel (%)
1917-1935	0.08	0.92	9
1936-1944	0.19	0.97	20
1945-1949	0.62	1.72	36
1950-1958	0.82	2.39	34
1959-1963	0.88	2.21	40
1964-1968	0.92	1.91	48

Source: Pérez Alfonzo, Juan, Petróleo y Dependencia (Caracas, Sintesis Dos Mil, 1971)

Policy makers had to take account of several factors when they designed the new institutional arrangements. Concomitantly, they were very cautious about disrupting the functioning of the industry. In the words of the former Minister of Energy and member of PDVSA's board Alirio Parra, "There was a significant fear of failure in the great challenge of nationalisation, which had been decided by President Pérez from the very beginning."⁷²

Oil industry infrastructure had deteriorated significantly and was in need of prompt updating. The foreign companies had reduced investment to the minimum enforced by the Ministry of Energy, since nationalisation was clearly on the horizon several years prior to 1975. Fresh investment was imperative in several areas such as oil wells and secondary gas recovery, just to maintain the production capacity of matured fields. Another area needing urgent attention was refining, as the country's few refineries were technologically dated. Similarly, the petrochemical business was in disarray. The state-owned petrochemical company was not profitable and was in need of extensive restructuring.⁷³ There was, in short, a clear programme of technical imperatives requiring immediate attention.

Almost no new discoveries of oil had been made in the previous years. Exploration for new commercial reservoirs was essential. A great majority of the fields exploited by the concessionaries were of light and medium crude oil. Moreover, these fields

⁷² Alirio Parra, interview by author, London, 16 September 2003.

⁷³ The 'Instituto Venezolano de Petroquímica', the petrochemical company, had been established in 1956.

were mature and declining in production. The geophysical information available at that time suggested that the bulk of the Venezuelan reserves were of heavy and extra-heavy crude oil. The Ministry needed to explore the oil province known as the Orinoco Belt, where a majority of those reservoirs were thought to be located. But not only was the Orinoco area to be explored. There were other areas such as offshore platforms. All these combined demanded a significant exploration effort, crucial to ensuring that Venezuela could augment its oil reserves.

More than 15 companies operated the oil industry prior to 1975.⁷⁴ Each company operated under its own systems of personnel, finance, procurement and commercialisation. The first priority was to integrate those systems into the new organisation to be created for administering the conglomerate. Additionally, the new entity had to assure access to technology and commercialisation channels as these two areas were most commonly managed by the foreign companies from abroad. Policy makers were aware of the great responsibility that running a complex industry implied and the risk associated with assuming that responsibility. The consensus was that decisions regarding administrative, organisational and technological issues were to be taken in a way that minimised possible disturbances to the current operations.

Both the senior management and the technocratic layer of all foreign operators needed to be assimilated to the new status of public sector employees. Both the employees and public officials feared changes in the status quo, although for opposite reasons. Former oil companies' employees were concerned with the possible interference of politicians in the running of the industry. Guillermo Rodríguez -Eraso pointed out, "There was a general expectation about the conduct, functioning and results of the industry under the control of the State and of the effect that possible changes in the administration and running of the new companies might have. These expectations were particularly acute among the personnel of the operating companies that were prepared to carry on with their daily duties with the same dedication but were fearful that nationalisation might introduce politics into the sector, therefore significantly

⁷⁴ Production was concentrated in four companies: Exxon, Shell, Mobil and Gulf.

varying work conditions and the traditional merit based management of the industry.”⁷⁵

On the other hand, policy makers and politicians were deeply suspicious of the loyalty of former foreign companies’ employees. Having been trained under the organisational culture of foreign companies and having operated in a sort of ‘enclave’, those former employees contrasted with the typical public sector official. Ramón Espinasa, former Chief Economist of PDVSA, commented, “The oil companies were considered a foreign enclave requiring a Venezuelanisation.”⁷⁶ Leopoldo Díaz-Bruzual, former President of the Central Bank, said, “PDVSA people did not act in the best interest of the country. They were a bunch of inefficient and arrogant managers that believed they knew better. They were still in the transnational mindset.”⁷⁷ Francisco Mieres wrote, “The companies that succeeded the transnational affiliates have local managers within that act as Trojan horses. They were subordinates to their old bosses’ schemes and are still loyal to their old headquarters and become anti-national enclaves.”⁷⁸

During the concessionary regime the institutional arrangements were based on the tax regime, technical regulations, pricing regulations and the policy guidelines such as what were known as the ‘conservationist’ and the ‘no more concessions’ policies.

Formulated by Juan Pablo Pérez-Alfonzo, the most influential oil policy maker throughout the concessionary regime, the ‘conservationist’ policy was based on three principles. First, the rate of exploitation should not exceed the rate of discoveries of new reserves. Second, even if reserves were added at a faster rate than exploitation, oil production should not exceed a volume needed to finance indispensable public spending for social and economic development. Third, Venezuelan oil production

⁷⁵ Rodríguez-Eraso, Guillermo, ‘Aspectos operacionales y administrativos’ in Diez Años de la industria petrolera (Caracas, PDVSA, 1986), p.72.

⁷⁶ Ramon Espinasa, interview by author, Washington, 15 August 2003.

⁷⁷ Leopoldo Díaz-Bruzual, interview by author, Caracas, 31 March 2003.

⁷⁸ Mieres, Francisco ‘La paradoja del petróleo’ in PDVSA y el Golpe (Caracas, Editorial Fuentes, 2003). p.22.

should not contribute to overflow the international market (i.e. supply exceed demand for oil).⁷⁹

The ‘no more concession’ policy was originally postulated by Pérez-Alfonzo in 1946. He considered that the concessions already granted to international oil companies had given them excessive power over Venezuelan oil.⁸⁰ This policy principle was ratified when Pérez-Alfonzo served as Minister of Energy (1959-1964). He continued defending this policy arguing, for instance in 1965, that the unpublished reserves of all concessionaries doubled the officially reported figures.⁸¹ The nationalisation of the oil industry, in 1975, was the logical successor of this policy.

These factors shaped the initial institutional arrangements adopted by policy makers, notably the Executive and Congress, in 1975.

2.2 Post-nationalisation rules of the game

Policy makers undertook a broad consultation process for defining a new institutional arrangement to implement nationalisation. The three main centres of policy making were: the Executive; a special Commission specifically created for defining nationalisation guidelines; and Congress. The process began in 1974 when President Pérez got a strong mandate in the 1973 elections (48.70% of votes). By that time conditions for nationalisation were ripe. Days after being inaugurated in office, President Pérez created the so-called ‘Presidential Commission for Reversion’ entrusted with defining nationalisation policy.⁸² Table 2.3 shows the ample political and technical spectrum of the members of the commission.

⁷⁹ Juan Pablo, Pérez-Alfonzo, ‘Venezuela y su petróleo. Lineamientos de una política’, Imprenta Nacional, 1960. p.38.

⁸⁰ Juan Pablo, Pérez-Alfonzo, ‘La dinámica del petróleo en el progreso de Venezuela’, Universidad Central de Venezuela, 1965. p.25.

⁸¹ Pérez-Alfonzo, *ibid.*, p.93.

⁸² Official Gazette 30,358, 22 March 1974.

Table 2.3 Members of the Presidential Commission for Reversion

Member	Affiliation
Valentin Hernández	Minister of Mines and Hydrocarbons
Hector Hurtado	Minister of Finance
Carmelo Lauria	Minister of Industry and Commerce
Gumersindo Rodríguez	Minister of Planning
Carlos Carnevali	Corporation of Venezuelan Petroleum
Godofredo Gonzalez	Senator from Copei party (Right wing)
Arturo Hernández	Deputy from AD
Valentin Montana	Armed Forces
Radames Larrazabal	Communist Party
Freddy Munoz	Socialist Party
Leonardo Montiel Ortega	URD party (Center left)
Celestino Armas	Deputy from AD party
Luís E. Oberto	Copei party
Armando Azpurua	CCN party (Right wing)
Alvaro Silva-Calderón	MEP party (Left wing)
Rafael Tudela	FDP party (Center right)
Augusto Malave	Unions (CTV)
Luís Tovar	Unions (CTV)
Carlos Pinerua	Unions (Fedepetrol)
Alfredo Paul	Business (Fedecamaras)
Reinaldo Cervini	Business (Pro-Venezuela)
Felix Miralles	Business (Banking)
Enrique Tejera	Universities
Alejandro Zahlout	Universities
Pedro Gomez	Universities
Gastón Parra	Universities
Domingo Maza Zavala	Universities
Hugo Pérez La Salvia	Professional associations (Engineers)
Julio C. Arreaza	Professional associations (Lawyers)
Haydee Castillo	Professional associations (Economists)
Miguel Layrisse	Professional associations (Scientific)
Anibal Martínez	President representative
Alirio Parra	President representative
Ezequiel Monsalve	President representative
Humberto Penaloza	President representative
Carlos Rafael Silva	President representative
Humberto Calderón-Berti	Liaison staff of Ministry of Mines and Hydrocarbons
Guillermo Altuve	Liaison staff of Ministry of Mines and Hydrocarbons
Ruben Gilson	Secretary

Source: Official Gazette, various issues; Julio Cesar Arreaza, 'Aspectos Históricos y Jurídicos' in Diez Años de la industria petrolera (Caracas,PDVSA, 1986)

On the other hand, Congress was controlled by AD party. Table 2.4 shows the composition of Congress elected in 1973. Both the Commission and Congress worked

in a relatively consensual fashion in producing a draft of the nationalisation bill, except for the very contentious issue of future participation of private capital. Despite disagreements on this later issue, which are discussed later in the chapter, AD's control of both the Executive and the legislature guaranteed the passing of the law.

Table 2.4 Composition of Congress (1973-1978)

Party	Senators	Deputies
AD	28 (59%)	102 (51%)
Copei	13 (28%)	64 (32%)
Others	6 (13%)	34 (17%) (9 Right wing, 25 Left wing)
Total	47	200

Source: Consejo Nacional Electoral (CNE)

President Pérez signed the law on the 29 August 1975.⁸³ A day later, according to Article 6 of the law, the holding company 'Petróleos de Venezuela, S.A.' (PDVSA) was created by presidential decree.⁸⁴ These two legal acts officially initiated the new institutional arrangements regulating the oil industry and its new absolute owner, the Venezuelan State. This institutional arrangement is described in the next section.

PDVSA was conceived as a holding responsible for "planning, coordinating, supervising and controlling the functioning of the affiliates".⁸⁵ At the same time, the subsidiaries were thought to mimic the former conglomerate of foreign owned operators. Gustavo Coronel, a member of PDVSA's first board, pointed out, "During this very early stage in the life of the nationalised oil industry the relationships between the holding company and the operating companies was that of a loose federation with a rather weak central government providing industry with a general sense of direction and acting as a welcome cushion between industry and the political world."⁸⁶

⁸³ Official Gazette 1,769 Extraordinary, 29 August 1975.

⁸⁴ Official Gazette 1,770 Extraordinary, 30 August 1975.

⁸⁵ Statutes of PDVSA, see Official Gazette 1,770 Extraordinary, 30 August 1975.

⁸⁶ Gustavo Coronel, The nationalization of the Venezuelan Oil Industry, (Lexington, Lexington Books, 1983), p.80.

The adopted model addressed two concerns. First, by replicating the former organisational web of operating companies, minimum disturbances were guaranteed in administrative and operational factors. The companies could continue functioning as before, only substituting the foreign holding companies for a common holding, PDVSA.

Second, it was aimed at isolating the operating companies from direct contact with the political world. The holding company was granted total independence in controlling its subsidiaries including naming the board of those companies. The tacit agreement was that the affiliates would carry on as they had been operating for decades. Pablo Reimpell, who served on the Board of PDVSA for 15 years, commented, “PDVSA had contact with the political world. The implicit promise was not to bother the operating companies.”⁸⁷ Creating an intermediate level between the political world (i.e. the Executive, Congress, and other constitutional bodies) and the operating companies was one of the assurances President Pérez and prominent political leaders wanted to transmit to the oil technocrats.⁸⁸

The situation resulting from the urgent need to update the oil infrastructure, the necessity of discovering new reserves and rationalising the scattered organisational structure provided policy makers with a clear guideline of what to demand from the newly created holding. Political legitimacy was provided by blaming the old foreign companies for the lack of investment during the years leading up to nationalisation. As politicians had grown with the ‘nationalist’ sentiment, opposed to the foreign companies, the need to compensate for their failings fit perfectly with their inclinations.

Additionally, a definitive and undisputable course of action such as this facilitated a good understanding between technocrats and policy makers. These conditions allowed the government and the senior oil industry management to agree on some ground rules. The most significant of these was economic independence. Consequently, the

⁸⁷ Pablo Reimpell, interview by author, Caracas, 9 August 2003.

⁸⁸ See speech given by President Carlos A. Perez on the opportunity of signing into law the nationalisation bill on the 29 August 1975. See also, Gustavo Coronel, *ibid.*, p.91.

holding company was granted financial autonomy. This prerogative was a high priority in the minds of technocrats. As, Gustavo Coronel put it, the company “could not risk going through the political system to obtain the capital required for investment because in a strongly politicised environment, such as the Venezuelan one, this would probably mean long delays, distortion of original objectives or, even worse, opening the doors to large scale corruption”.⁸⁹

This financial independence was written in the nationalisation law. Article 6, Part Five ordered that: “To provide the company to be created with enough resources to develop the national oil industry, the operating companies to be constituted will supply an amount of money equivalent to ten per cent (10%) of the net income produced by the oil exported by each of them in the previous month. This amount will be exempted from paying taxes or other national fees and will be deductible from the corporate income tax.”⁹⁰ Table 2.5 summarises the consensual agenda:

Table 2.5 Main issues of the post-nationalisation agenda

Area	Objectives
Exploration	Increase the proven reserves throughout the country.
Refining	Modernisation of refining facilities, adaptation to new environmental regulations and new needs from Venezuelan oil mix.
Petrochemicals	Rescue the ailing ‘Petrochemical Institute’ and restore profitability.
Orinoco Belt Reservoir	Evaluation of the vast oil province known as the ‘Orinoco Belt’ in the south east part of the country.
Trade	Improve international trading and transport capabilities.
Technology	Guarantee the technical assistance initially required and improve that capacity internally.
Organisation	Rationalisation of former network of multiple operating companies.
Infrastructure updating	Plant and equipment renovation.

Source: Rodríguez -Eraso, Guillermo, “Aspectos Operacionales y Administrativos” in Diez años de la Industria Petrolera Nacional (Caracas,PDVSA, 1986); Coronel, Gustavo ,The Nationalization of the Venezuelan Industry (Lexington, Mass,Lexington Books, 1983)

To complement the tacit agreement on the need to carry on with this agenda, PDVSA’s statutes stated that approval of the investment plans of the industry were a

⁸⁹ Gustavo Coronel, *ibid.*, p.92.

⁹⁰ Official Gazette 1,769 Extraordinary, 29 August 1975.

responsibility of PDVSA's board. Clause 27 Section 4 stated that the Board of PDVSA could "examine, approve and coordinate investments and operating budgets of the subsidiaries".⁹¹ Similarly, procurement across the oil conglomerate was internally regulated.

The initial institutional arrangements regarding personnel were aimed at implementing the assurances that the political world thought it was necessary to grant to former oil industry employees, who were concerned about their new status as members of the public administration. Pablo Reimpell said, "The nationalisation law gave the former employees the same prerogatives they enjoyed before. The law contained much detail about this, which was unprecedented in such a type of law."⁹² For instance, Article 8 of the nationalisation law specified: "The directors, administrators, employees and field workers of the companies to be created, including those of the Venezuelan Corporation of Petroleum once converted to a commercial firm, are not going to be considered as public administration officials or employees."⁹³

Similarly, the first statute of PDVSA included several assurances to the senior management regarding its stability and promotions to the top levels. The regulation of the structure, duration and composition of the board was intended to transmit stability and respect from the old technocracy. Article 18 of the statutes stipulated that the board was to be in operation for four years and, more specifically, that it was in the future to be formed, preferably, from former board members.⁹⁴

The first board, however, was filled mostly with outsiders from the oil industry. Coronel explained, "Up to that moment ...the oil executives had been working for multinational corporations, and public opinion tended to perceive them as closely associated with those interests. Although the patriotism and honesty of those men were never in doubt, there seemed to be good strategic considerations for keeping them at the operating company level, at least for the moment. The tacit agreement

⁹¹ Statutes of PDVSA. See Official Gazette 1,770 Extraordinary, 30 August 1975.

⁹² Pablo Reimpell, interview by author, Caracas, 9 August 2003.

⁹³ Official Gazette 1,769 Extraordinary, 29 August 1975.

⁹⁴ Official Gazette 1,770 Extraordinary, 30 August 1975.

among all concerned, though, was that by the time the nationalised oil industry settled down to routine, these men would be the logical choice for Petróleos de Venezuela's highest positions."⁹⁵

Policy makers promised to respect merit based and autonomous management of the operating companies' personnel. Alirio Parra, member of the first board of PDVSA, confirmed, "Meritocracy was to be 100% respected in the PDVSA's affiliates. That was the very clear consensus among all concerned."⁹⁶

On the other hand, PDVSA as such, needed to be filled, at least partially, with the proven nationalists from the former pool of regulators. It was, however, not clear what to do with the Ministry of Energy. As the former source of proven nationalist technocrats, the Ministry risked being weakened if it were to be emptied. Bernardo Alvarez, former Deputy Minister of Energy, recalled, "When nationalisation was discussed there was more than one view on what to do regarding the Ministry and the new holding company. Some suggested that the Hydrocarbons division within the Ministry should be transformed as the head of PDVSA."⁹⁷ The compromise 'rule of the game' in this matter was to fill PDVSA with both former Ministry officials and individuals from the former old foreign companies. The exodus of senior Ministry officials to PDVSA is discussed later in this chapter.

The most immediate consequence of the nationalisation law was the termination of the old concessionary system. Article 1 of the law stated, "The concessions granted by the Executive are to be extinguished and that extinction will be effective on the 31 December 1975."⁹⁸ This direct action was the ultimate manifestation of the 'no more concessions' policy established in 1959 the AD party had returned to power and was able to implement a policy that had been advocated in the 1940s. The rules concerning future participation of private capital, albeit partially, in the oil industry were the natural successor of that policy.

⁹⁵ Gustavo Coronel, *ibid.*, p.79.

⁹⁶ Alirio Parra, interview by author, London, 16 September, 2003. See also Gustavo Coronel, *ibid.*, p.92.

⁹⁷ Bernardo Alvarez, interview by author, Washington 12 August 2003.

⁹⁸ Official Gazette 1,769, 29 August 1975.

In fact, these rules, contained in what became the infamous Article 5, were the most controversial issue in an otherwise largely consensual discussion of the nationalisation law. At the end, the Executive, with the support of the AD hierarchy, imposed its position. The AD's stance can be summarised in the words of its founder Rómulo Betancourt. He said, "I strongly support associations allowed in Article 5....it is similar to the security valves in the 1961 Constitution and in the Hydrocarbon Law of 1967, in order not to tie the State's hands."⁹⁹ Similarly, AD leader Gonzalo Barrios advocated flexibility in the rule. He said, "You do not embark into deep waters without a lifejacket."¹⁰⁰ This precaution was manifested in the controversial wording of Article 5. This provision was approved by the AD and other minor parties against the opposition of the right wing party Copei and left wing parties MEP, MAS and PCV.¹⁰¹ The approved rule allowed associations with private interest in 'special cases' under the following conditions: 1) limited duration; 2) the State should retain control of the associations; and 3) Congress must approve it.¹⁰² Notoriously, former President and leader of Copei, Rafael Caldera fiercely opposed Article 5. In the debate in Congress he said, "All of us who have fought the transnationals know that if we open a little window they manage to transform it in an open door."¹⁰³

Policy makers favoured continuity in most of the regulations that were in place during the concessionary system. They wanted to minimise disturbances during the transition to the new arrangements and to guarantee an uninterrupted fiscal contribution from the oil business. The tax regime was the most important institutional arrangement that was maintained. Table 2.6 summarises the most significant features of the tax regime.

⁹⁹ Romulo Betancourt cited in Julio Cesar Arreaza, 'Aspectos Históricos y Jurídicos' in Diez Años de la industria petrolera (Caracas, PDVSA, 1986), p.216.

¹⁰⁰ Gonzalo Barrios cited in Julio Cesar Arreaza, *ibid.*, p.215.

¹⁰¹ There is extensive discussion and documentation of the debate in Congress about Article 5. See Julio Cesar Arreaza, *ibid.*

¹⁰² Official Gazette 1,769, 29 August 1975.

¹⁰³ Rafael Caldera cited in Julio Cesar Arreaza, *ibid.*, p.213.

Table 2.6 Principal features of the oil tax regime in 1976

Date of regulation	Regulated area	Legal instrument
January 1976	Liquidation of taxes (terms, instalments)	Presidential Decree 1404
March 1976	Export Fiscal Values	Ministries of Energy and Finance joint decree ¹⁰⁴
June 1976	Freightage (complement of Export Fiscal Values)	Ministries of Energy and Finance joint decree ¹⁰⁵
June 1976	Conversion to local currency of exports ¹⁰⁶	Central Bank and Ministry of Finance agreement ¹⁰⁷
July 1976	Tax rate for oil activities	Presidential decree ¹⁰⁸

Source: Jose Moreno Leon, Profundización de la nacionalización petrolera venezolana (Caracas, Ediciones Centauro, 1981)

The central feature of the inherited tax regime was the Export Fiscal Values. This was a taxation mechanism used during the concessionary system to prevent foreign companies manipulating prices between the local subsidiaries and their holding companies. The government retained the right to fix prices for oil exports as mandatory for taxation purposes. As the government had the legal right to fix those values, this tool was used for both fiscal purposes and to implement Opec agreements.

In the new context of a nationalised industry this discretion was retained. In fact, it was one of the most important tools for controlling PDVSA. Pablo Reimpell remembered, regarding the initial years of PDVSA, “Although the government obtained the fiscal income it sought, the export fiscal values were always fixed after lengthy negotiations between the government and PDVSA.”¹⁰⁹ It is noteworthy that during the initial years of PDVSA two factors facilitated these negotiations. First, international oil prices were at a peak and second, the consensus regarding the post-nationalisation agenda discussed earlier in this chapter guaranteed that PDVSA investment plans were well received by government officials.

¹⁰⁴ Official Gazette 30,934, 4 March 1976.

¹⁰⁵ Official Gazette 31,009, 23 June 1976.

¹⁰⁶ Ten per cent of the net value of oil exports was retained by PDVSA for financing oil industry projects.

¹⁰⁷ Official Gazette 31,011, 28 June 1976.

¹⁰⁸ Official Gazette 1,895 Extraordinary, 20 August 1976.

¹⁰⁹ Pablo Reimpell, *ibid.*

Other pillars of the pre-nationalisation arrangements were not challenged. As production had dropped 11.6% and 21.2% in 1974 and 1975 respectively, Pérez Alfonzo's conservationist position, often in line with Opec policy, was not threatened. In fact, production declined in all ten years after nationalisation except for 1979.¹¹⁰ A decade later, in 1985, daily average production was two-thirds of that inherited from the concessionary arrangement. Similarly, proven reserves were 18,400 million barrels in 1975.¹¹¹ The discovery and certification of new reserves brought significant results in 1985 when proven reserves almost tripled to reach 54,454 million barrels.¹¹² As proven reserves improved while production declined, the 'conservationism' principle was, in practice, well preserved for the immediate post-nationalisation years.

2.3 The post-nationalisation Ministry of Energy

The Ministry of Energy, created in 1950¹¹³ as a unit separate from the Ministry of Industry and Commerce, had become the main regulator of the oil industry. In addition to monitoring technical regulations and selling prices, the Ministry extended its control over managerial aspects as a consequence of the provisions established in the Reversion Law in July 1971 and further regulated in Decree 832 in December 1971. These rules aimed to prevent opportunistic behaviour from the oil companies in the final years before the validity of the concessions expired.¹¹⁴ In addition, as the natural gas business was nationalised that year, it was widely accepted that nationalisation of oil was a just a matter of time.¹¹⁵ Table 2.7 shows the main controls introduced by Decree 832.

¹¹⁰ OPEC Annual Statistical Bulletin 1999.

¹¹¹ Guillermo Rodríguez-Eraso, 'Aspectos Operacionales y Administrativos' in Diez años de la Industria Petrolera Nacional (Caracas, PDVSA, 1986), p.73.

¹¹² OPEC Annual Statistical Bulletin 2002.

¹¹³ Official Gazette 23,418, 30 December 1950.

¹¹⁴ The 'landmark' Hydrocarbons law of 1943 established that all concessions expired in 1983.

¹¹⁵ See discussion of 1971's measures in Gustavo Coronel, *ibid.*, p.37-43.

Table 2.7 Main features of Decree 832 of December 1971

Area	Control
Exploitation	The Ministry had to approve production levels, exploitation plans and monitor compliance with conservationist regulations.
Exploration	The Ministry could set a minimum level of exploration activity.
Sales	The Ministry could veto clients and challenge prices.
Reporting	Number a frequency of reports regarding plans and programs in many areas were increased.
Refining	Ministry could modify refining levels.
Financial data	Companies had to inform the Ministry all financial data including sales, investments.

Source: Gustavo Coronel, *The nationalization of the Venezuelan Oil Industry* (Lexington, Mass, Lexington Books, 1983), p.41; Julio Cesar Arreaza, "Aspectos Históricos y Jurídicos" in *Diez Años de la industria petrolera* (Caracas, PDVSA, 1986), p.242

Gustavo Coronel, a top manager in one of the foreign companies at that time, considered that Decree 832 significantly changed the role of the Ministry. Coronel pointed out, "For all practical purposes the Venezuelan Oil industry was in the hands of the State in 1972. The Ministry staff which, up to then, had been mostly auditors of the industry now became co-managers. There was nothing that the industry could do without the previous approval of the Ministry."¹¹⁶

When PDVSA commenced operating on the 1 January 1976 all these regulations were in place. Nothing in the Nationalisation Law or in the Statutes of PDVSA conflicted with the rules as they had applied to the foreign companies. The Ministry's officials continued to enforce the old regulatory framework. The only difference now was that the Ministry's counterparts also responded, albeit in theory, to the same political masters.

At the highest level, however, this 'business as usual' approach rapidly gave rise to tension. Friction between the Board of PDVSA and the Ministry promptly emerged. Hostility between PDVSA's President, General Alfonzo-Ravard and Minister of Energy Valentin Hernández was notorious.¹¹⁷ Alfonzo-Ravard presided over a board composed mainly of outsiders to the oil industry. Alirio Parra, a former Minister of

¹¹⁶ Gustavo Coronel, *ibid.*

¹¹⁷ Oscar Murillo, interview by author, Caracas, 19 August 2003.

Energy, said, “Alfonzo-Ravard was a technocrat without a political agenda.”¹¹⁸ One initial, albeit informal, rule was that the President of PDVSA held regular meetings with the President, effectively bypassing the Minister. This way of working was maintained in subsequent administrations, making it very difficult for Ministers of Energy to exert their authority vis-à-vis the President of PDVSA.

The Ministry, in 1976, had the pre-nationalisation senior staff still in their positions. As tensions grew during the first year, the board of PDVSA asked President Carlos Andrés Pérez, in December 1976, for a clarification of the roles of both PDVSA and the Ministry.¹¹⁹ Julio Cesar Arreaza, who was acting as interim President of PDVSA at the time, alluded to the outcome of that meeting, “Pérez said that the functions already granted to PDVSA by law were intact, that the relations between the Executive and the oil industry were to be channelled through PDVSA and the Decree 832 had lost its validity with the nationalisation law.”¹²⁰

President Pérez promised a presidential directive clarifying the PDVSA-Ministry roles. He produced such a directive in the form of a memorandum three months later. This form of directive, inferior in the legal administrative hierarchy to a Decree, still hinted at a sort of ‘informality’ in this institutional arrangement, not commensurate with its vital importance.

Nonetheless, the presidential directive established:

The Ministry of Energy was responsible for:

- 1) Establishing oil policy guidelines.
- 2) Establishing goals for the development of the oil and petrochemical industries.
- 3) Delineating geographic areas for operating companies to explore and exploit.
- 4) Supervision of the oil and petrochemical companies in regard to technical regulations.

¹¹⁸ Alirio Parra, *ibid.*

¹¹⁹ Julio Cesar Arreaza, *ibid.*, p.245.

¹²⁰ Julio Cesar Arreaza, *ibid.*, p.246.

- 5) Controlling, in conjunction with the Ministry of Finance, all matters regarding PDVSA's tax contributions. Notably, both ministries were responsible for setting export fiscal values.
- 6) Supervision, in conjunction with the Ministry of Environment, of all matters regarding environmental regulations.
- 7) Relations with Opec and enforcement of its resolutions.
- 8) Setting internal market prices for oil derivatives and other prices (such as transport freightage).
- 9) Research and analysis of the oil and petrochemical economy.
- 10) Statistics on the hydrocarbons industry.
- 11) Representing the shareholder (i.e. the State) in PDVSA shareholders meetings.

For its part, PDVSA, was responsible for:

- 1) Executing directives of the Ministry of Energy.
- 2) Approving operating companies' budgets (operational and investment) and to inform the Ministry of Energy about them.
- 3) Fixing oil and derivatives prices according to Ministry of Energy guidelines.
- 4) Being an intermediate between the executive branch and the operating companies (subsidiaries).

It was critical for PDVSA to ensure its control of the operating companies. Pablo Reimpell indicated, "The most important characteristic of the relations between PDVSA and the government was the independence of PDVSA in dealing with the operating companies, the core of the industry."¹²¹

The presidential directive helped to complete the initial institutional arrangements regarding the control of PDVSA. The roles of shareholder (the State) and administrator (PDVSA), however, were never clear cut. In practice, oil policy making and implementation of important decisions were defined through constant power struggles between the Ministry and PDVSA. Alberto Quiros-Corradi, President of the second largest subsidiary at that time, recalled that both PDVSA's president and the Minister of Energy "carried a copy of the memorandum in their pocket in order to

¹²¹ Pablo Reimpell, *ibid.*

show to each other when defending decisions that they considered to be under their sphere of influence”.¹²² This institutional arrangements performed only partially well in subsequent years.

Changing roles of the Ministry

The steps taken in 1971, leading to nationalisation in 1975 had substantially increased the power of the Ministry of Energy. The Reversion law and Decree 832, both of 1971, demanded an expansion in the Ministry in order to attend to the new regulatory demands. Decree 832 strengthened the regulatory power of the Hydrocarbons Division (known as the Technical Office of Hydrocarbons). This division was the main regulatory arm within the Ministry. The Reversion law also commanded the creation of a new division, the Reversion Division. This unit was responsible for monitoring oil companies’ assets that would transfer to the State once the concessions expired.

Completing the regulatory bodies within the Ministry there were two permanent committees, the Marketing and Conservation Committee, responsible for administering the export fiscal values, and the Local Market Committee, in charge of regulating the hydrocarbons internal market. Additionally, the Ministry participated in a joint committee with the Ministry of Finance, responsible for monitoring the foreign company finances and their tax payments.

At the moment of nationalisation in 1975 the Ministry had a well structured and technically minded bureaucracy.¹²³ The Ministry’s personnel shared a sense of ‘nationalism’ developed during decades of dealing with foreign companies. Not surprisingly, the Ministry was very antagonistic to foreign companies. This independent stance was explained by the great political consensus in oil policy built across several decades. Since the early 1940s, all the main parties, including AD,

¹²² Alberto Quiros-Corradi, ‘Tres pasos al frente’, *El Nacional*, 17 November 1996.

¹²³ This is a consensual view ratified across numerous interviews with ex-officials in both government and foreign companies such as Pablo Reimpell, Alirio Parra, Ramon Espinasa, Alvaro Silva-Calderon.

Copei and the left wing parties, had converged on a nationalistic oil policy based on vindicating the Venezuela position vis-à-vis the foreign company. Bureaucrats in the Ministry understood that advancement in their careers depended on the strength shown in dealing with the foreign companies.¹²⁴

Although Venezuelan bureaucracy is habitually associated with patron-client practices, cronyism and partisan politics, the Ministry of Energy had departed remarkably from such practices. Technical personnel were very stable. Alirio Parra, who joined the Ministry in 1957, said, “When the new democratic system replaced the Pérez Jimenez’s dictatorship in 1958 the new government respected the positions of the technical personnel in the Ministry. This stability continued for decades until nationalisation.”¹²⁵

The model adopted for nationalisation treated the companies as a ‘going concern’.¹²⁶ This position had several implications for policy making regarding the Ministry. The political consensus of policy makers was to continue, as much as possible, conducting business as they had before nationalisation. As a consequence of this ‘business as usual’ stance, the habitual position within the Ministry was to treat PDVSA the same way they had treated foreign companies.¹²⁷

On the other hand, there was a dilemma for politicians. Long held distrust of foreign company technocracy dictated that PDVSA had to be filled with proven ‘nationalist’ officials. Nationalist oil experts were mainly based in the Ministry of Energy. Transferring those officials, however, could risk depriving the Ministry of its best trained technocrats. The dilemma was partially resolved by transferring some of the Ministry’s officials to PDVSA. Alirio Parra, ex-Ministry official and member of the PDVSA’s first board, said, “The belief that PDVSA and the Ministry were the same thing was, at that time, in the mind of politicians and in all those concerned with oil

¹²⁴ Arévalo Guzmán-Reyes, interview by author, Caracas, 5 March 2004.

¹²⁵ Alirio Parra, *ibid.*

¹²⁶ ‘Going concern’ usually refers to the ability of a company to continue functioning as a business entity without an imminent risk of being liquidated or ceasing to operate.

¹²⁷ Gustavo Coronel, *ibid.*, p.106.

issues.”¹²⁸ He added, “We simply did not foresee the need for a clear separation of the two.”¹²⁹

Table 2.8 shows some selected former Ministry of Energy staff who went on to occupy prominent positions in PDVSA.

Table 2.8 Selected senior officials transferred from the Ministry to PDVSA

Official	Relevant public position	Position in PDVSA
Julio Cesar Arreaza	State-owned CVP/ Legal officer in Ministry	Vice President
Alirio Parra	Ministry’s official until 1969	Member of the board
Jose Martorano	Ministry’s official at Hydrocarbons division	Member of the board
Luís Plaz Bruzual	Ministry’s official at Hydrocarbons division	Member of the board
Enrique Daboin	Ministry’s official	Member of the board
Humberto Calderón-Berti	Reversion Director in Ministry	Director of Research & Development Institute
Arevalo Guzmán-Reyes	Hydrocarbons Director in Ministry	Member of the board

Source: Rafael Quiróz Serrano, *Meritocracia petrolera ¿Mito o realidad?* (Caracas, Editorial Panapo, 2003), p.104-113

In the middle ranks of the Ministry another development arose. Ministry officials, especially those located in the oil fields, were trained to keep their counterparts in the foreign companies in check. When nationalisation took place on the 1 January 1976 the former ‘opponent’ remained the same but with the difference that both were now public officials. Coronel commented, “For many of them [Ministry officials] the continued presence at the helm of the nationalised oil companies of the managerial group that had worked under the multinationals seemed to be enough reason for distrust. A high level officer at the Ministry once confessed this feeling to me.”¹³⁰ Coronel, who was a foreign company official, cited a top level manager at the Ministry: “We do not know everything that is going on in the industry and I have the

¹²⁸ Alirio Parra, *ibid.*

¹²⁹ Alirio Parra, *ibid.*

¹³⁰ Gustavo Coronel, *ibid.*, p.107.

suspicion that it is in the areas we know least about that you are deceiving us.”¹³¹ Coronel added, “This deeply ingrained distrust was probably the product of many years in which the State sector had been left very much in the dark by more experienced oil industry staff.”¹³²

Arévalo Guzmán-Reyes, whose career in the Ministry of Energy spanned from oil field inspector to Deputy Minister, observed, “In the oil fields we had to be very aware of, and strict about, all manoeuvres of the foreign managers. I had numerous problems with them when I had to enforce regulations. Once, a top manager in one of the foreign companies tried to undermine my authority. He bypassed me and went to complain to my superiors in the Ministry. Fortunately, my position was maintained in the end.”¹³³ Ministry officials, in 1976, wanted to continue enforcing the enhanced regulatory scope granted by Decree 832 in 1971.¹³⁴ As long as PDVSA has asserted its position vis-à-vis the Ministry, officials from the latter were frustrated and demoralised.¹³⁵

The languishing Ministry of Energy

President Pérez’s solution for the diminished Ministry was to merge it, in December 1976, with a division, formerly within the Ministry of Trade and Industry, responsible for regulating the electric sector.¹³⁶ This administrative manoeuvre was intended, in the words of PDVSA’s vice president at the time, not as “a simple change of denomination, but it was intended to restrict the action of the office in the petroleum sector”.¹³⁷ Figures 2.1, 2.2 and 2.3 show how the divisions formerly regulating the oil industry were reduced.

¹³¹ Gustavo Coronel, *ibid.*, p.107.

¹³² Gustavo Coronel, *ibid.*, p.107.

¹³³ Arevalo Guzmán-Reyes, *ibid.*

¹³⁴ Gustavo Coronel, *ibid.*, p.106.

¹³⁵ For example, President Perez, intervening in the dispute between Minister Valentin Hernandez and PDVSA’s president Alfonso Ravard, annulled Decree 832 in December 1976.

¹³⁶ Official Gazette 1,932 Extraordinary, 28 December 1976; 31,145, 4 January 1977 and 1,999 Extraordinary 22 March 1977.

¹³⁷ Julio Cesar Arreaza, *ibid.*, p.245.

Figure 2.1 MEM's organisational chart in 1975

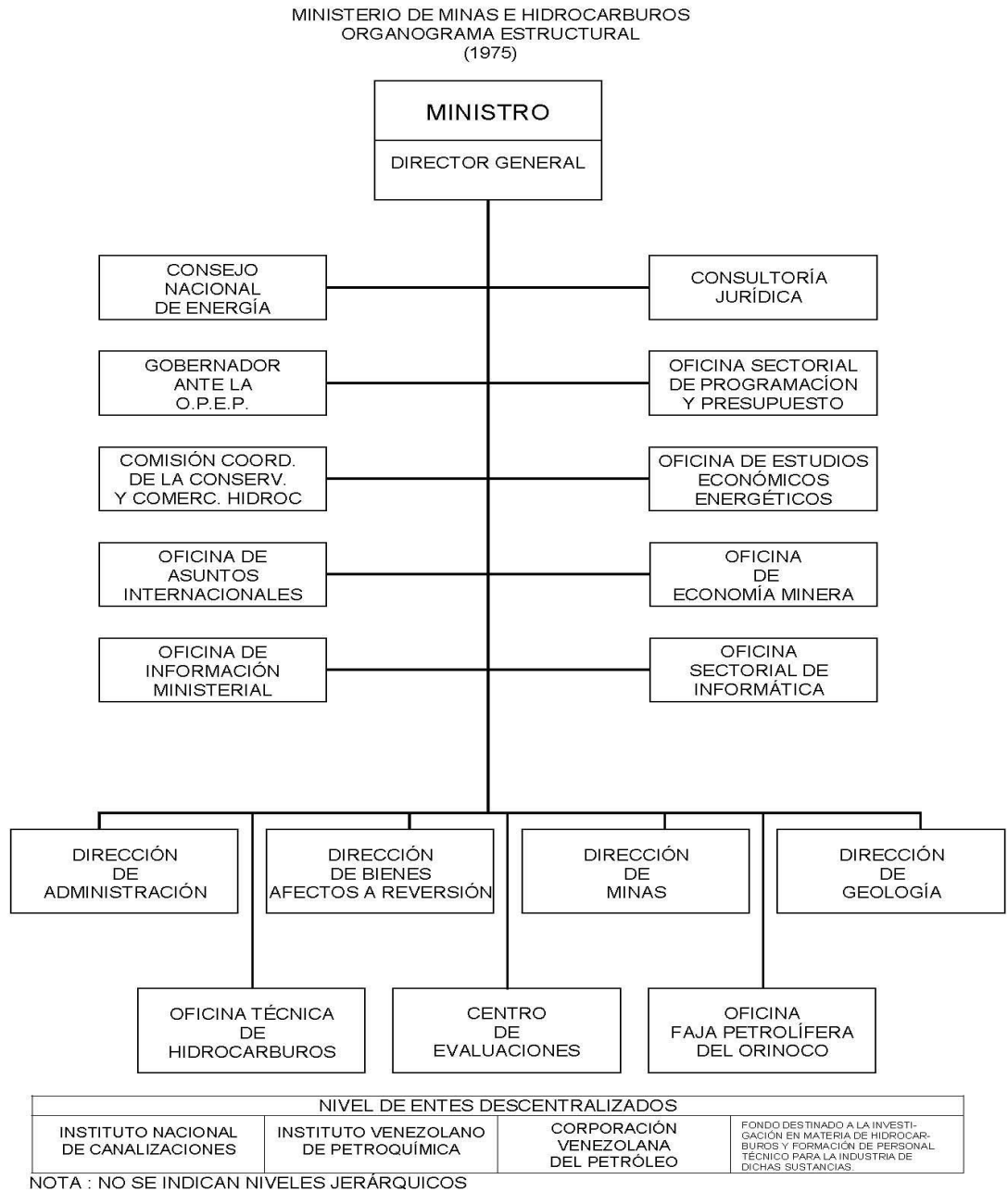


Figure 2.2 MEM's organisational chart in 1976

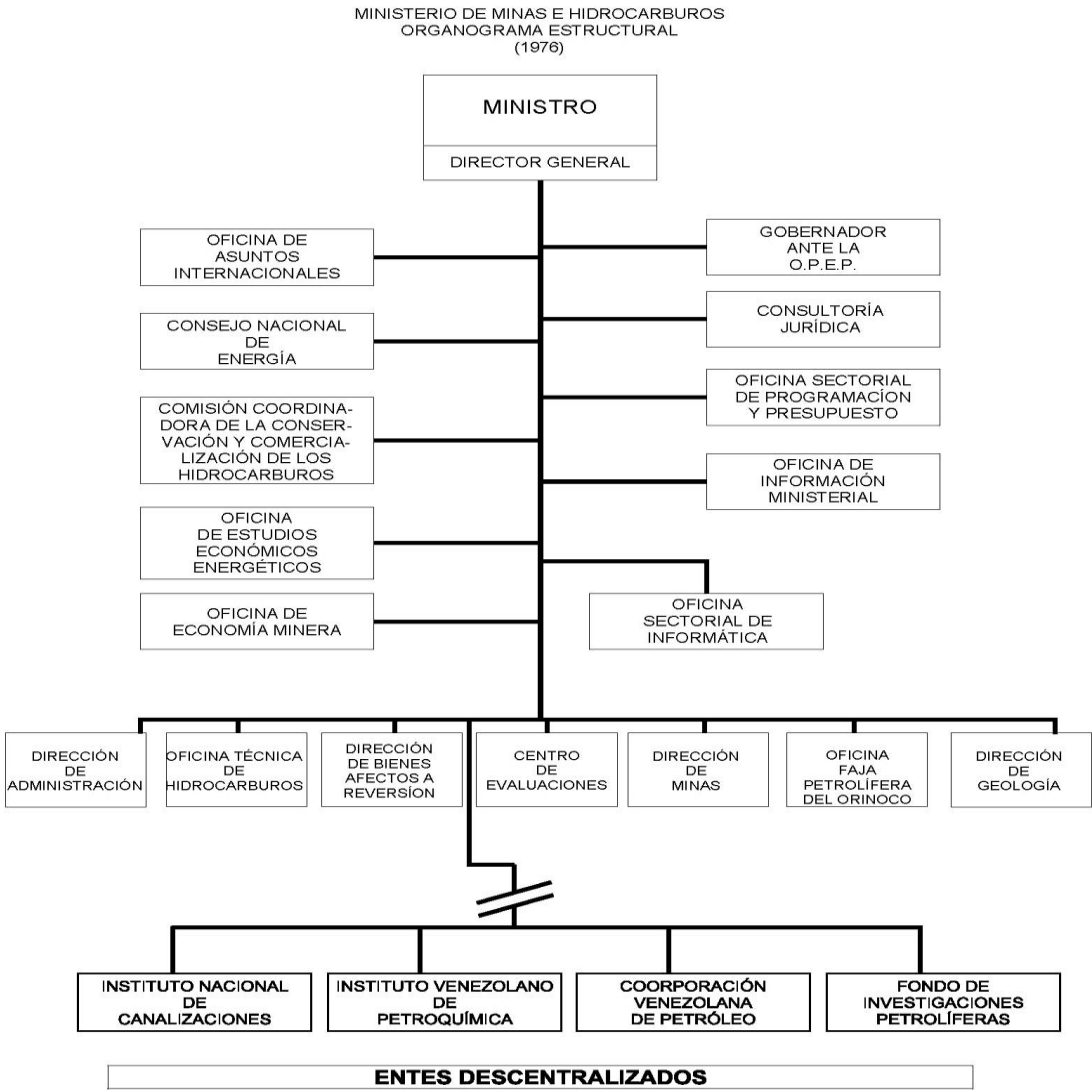
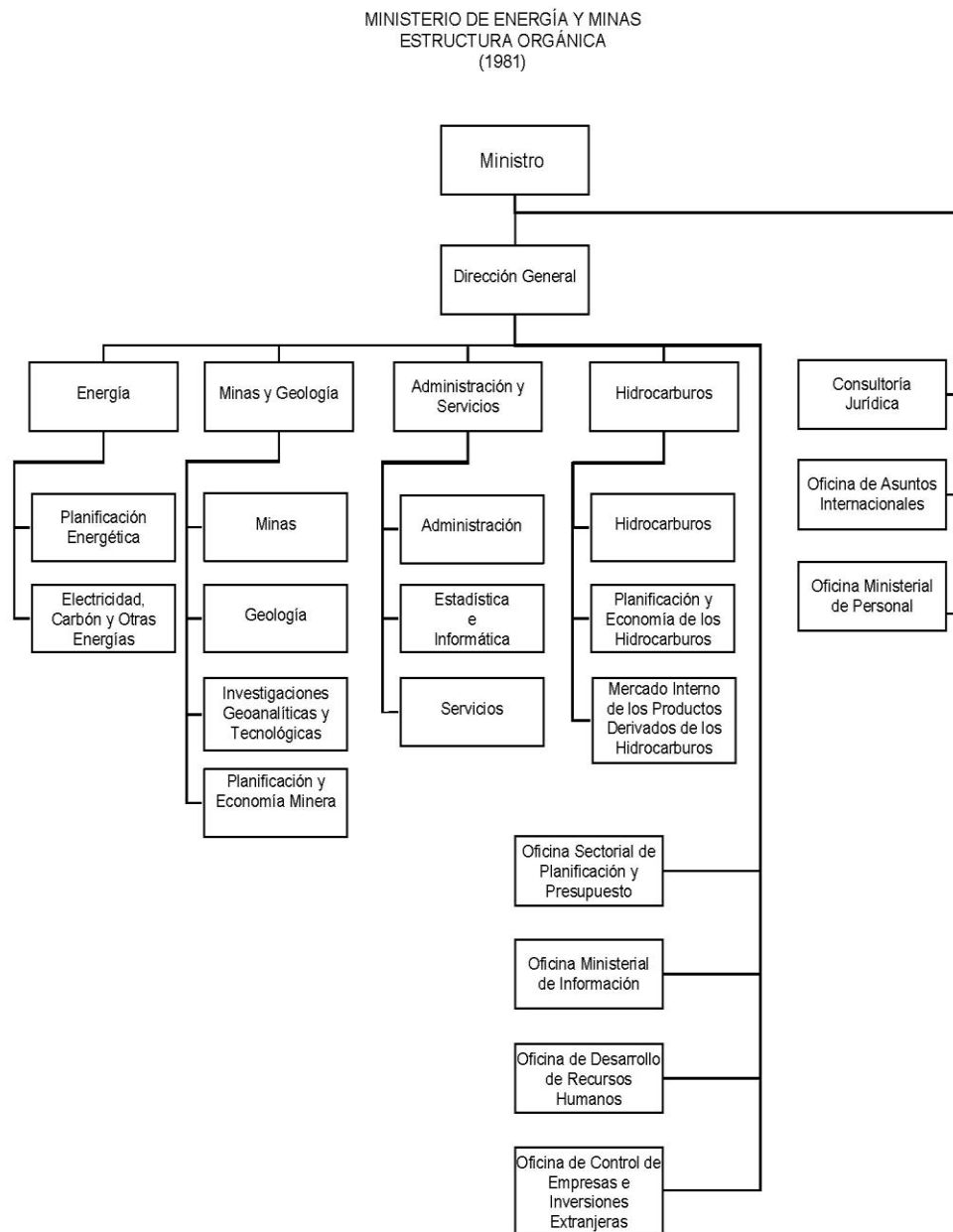


Figure 2.3 MEM's organisational chart in 1981



Notably, the former division in charge of developing the vast reservoirs of Orinoco Belt was dismantled in the new Ministry.¹³⁸ This removal from the Ministry followed an earlier dispute between Minister Valentin Hernández and PDVSA's board. Although Minister Hernández favoured transferring the Orinoco belt administration to PDVSA, the Ministry's technocrats wanted to retain control over it. President Pérez resolved the dispute in PDVSA's favour.¹³⁹ The Orinoco belt development division was then taken away from the Ministry.

The new Ministry, combining hydrocarbons, mines and the recently added electric sector began activities in 1977. Despite the expansion of the office to include an additional sector, the Ministry steadily continued its decay. Ministerial budget figures demonstrate this weakening. Table 2.9 shows the Ministry's budget from 1976 to 1989.

The Ministry budget shrank significantly over the fifteen years following nationalisation. The 1989 budget was only 19.33% of the equivalent budget in 1976 in US dollar terms and only 18.85% in Bolívar terms. The Ministry of Energy's budget also dropped in relation to the national budget. In 1975, the Ministry of Energy obtained 0.73% of all resources allocated in the national budget. This figure collapsed to only 0.26% in 1989, a decline in financial significance of almost two-thirds.

Furthermore, the divisions within the Ministry directly responsible for monitoring the oil industry also lost their former significance. Table 2.10 shows the decline in importance of the activities branded as "planning, supervision and technical and fiscal control of the nationalised industry".¹⁴⁰

The divisions responsible for monitoring the oil industry halved their internal weight within the Ministry. Similarly, the budget of these divisions relative to the value of the fiscal revenues obtained from oil activities being monitored, demonstrates the significance of the collapse. The allocated resources of these divisions were, in 1989, 73% less than in 1976 vis-à-vis the total revenues obtained from the oil industry.

¹³⁸ The Orinoco belt is an area north of the Orinoco River in the south-east part of Venezuela.

¹³⁹ Gustavo Coronel, *ibid.*, p.113.

¹⁴⁰ According to the annual budget law passed by Congress.

Table 2.9 Ministry of Energy's annual budgets (1976-1989)

Year	US\$ million (Current)	Bolívar million (of 1984)	As % of national budget
1976	56.57	599.28	0.73
1977	130.64	1,280.99	1.57
1978	43.58	398.54	0.42
1979	44.18	335.62	0.41
1980	43.60	276.61	0.33
1981	56.77	326.10	0.32
1982	48.04	255.92	0.24
1983	22.20	192.69	0.22
1984	21.69	162.70	0.21
1985	13.51	178.87	0.19
1986	9.96	178.62	0.18
1987	9.38	163.91	0.18
1988	8.71	143.84	0.18
1989	10.94	113.02	0.26

Source: Budget Office (Onapre), BCV. Estimates by author.

Table 2.10 Significance of oil industry direct monitoring within the Ministry of Energy.

Year	Budget of oil industry direct monitoring divisions as % of the Ministry of Energy's total budget	Budget of oil industry direct monitoring divisions as % of oil revenues
1976	26.09	0.26
1977	9.05	0.20
1978	23.98	0.16
1979	21.70	0.18
1980	22.86	0.12
1981	17.60	0.08
1982	16.99	0.06
1983	20.84	0.09
1984	19.91	0.08
1985	18.24	0.06
1986	15.84	0.05
1987	14.14	0.09
1988	15.43	0.05
1989	12.36	0.07

Source: Ministry of Energy, Budget Office (Onapre). Estimates by author.

Manuel Da-Silva, a staff member in one of those divisions commented that the Ministry was simply being deprived of resources to carry on with its normal activities, although it formally continued with its activities. There were no substantial changes except that it was now PDVSA which produced the information and the Ministry accepted it as accurate. They did not have the means to corroborate the accuracy of PDVSA's reporting.¹⁴¹

PDVSA's aid to the Ministry

PDVSA recognised the Ministry of Energy's decline. Pablo Reimpell, a member of the PDVSA Board from 1977 to 1992, commented, "We observed the deterioration not only of the Ministry of Energy but of the whole public bureaucracy. The Ministry started to lack the former highly professional staff for which they were once renowned. Although this was happening in many other public offices, whilst PDVSA was growing stronger the Ministry was weakening. We were conscious that this disequilibrium was not going to help the relations between the two organisations. We even paid for a study by renowned consultants McKinsey into the possible reorganisation of the Ministry but that was never carried out."¹⁴²

Ramón Espinasa, former chief economist of PDVSA, asserted, "The Ministry, which was formerly the pride of all ministries, deteriorated as did the other public offices. But the difference here was the existence of PDVSA, which created a marked contrast. The creation of PDVSA represented the Venezuelanisation of an Anglo-Saxon enclave with a different culture. PDVSA wanted the rest of the country to be like them. There is no point in denying that PDVSA was assuming the role of the Ministry. PDVSA, however, thought about creating a sort of spin off that would become the industry regulator."¹⁴³

None of the reorganisations of the Ministry that had been considered were ever implemented. The Ministry kept functioning in an inertial way. The Ministry's size, in

¹⁴¹ Manuel da Silva, interview by author, Caracas, 8 March 2004.

¹⁴² Ricardo Corrie, interview by author, 9 June 2006.

¹⁴³ Ramon Espinasa, *ibid.*

terms of number of employees, stagnated. Between 1981 and 1990 total personnel dropped by 4.5% whilst the total of the so called 'Public National Administration' (i.e. all government ministries) increased by 51.3%.¹⁴⁴ PDVSA instituted, both formally and informally, diverse forms of 'aid' to the Ministry.

First, PDVSA complemented the salary of the Ministry's staff. Initially, PDVSA paid for a supplement of the salaries of the Hydrocarbons and Reversion divisions of the Ministry.¹⁴⁵ Later, this policy was extended to all employees in the Ministry.¹⁴⁶ This supplement represented 60% of the remuneration of the Ministry's personnel.¹⁴⁷ In dollar terms, the Ministry of Energy's employees were paid, on average, US\$ 208/month in 1986, 35% above the average for all ministries.¹⁴⁸ The employees of the Ministry of Energy were, with this 'aid', among the best paid of all ministries (for instance, in 1991, only employees of the Ministry of Foreign Affairs were better paid and that included salaries in US\$ for diplomats posted abroad).¹⁴⁹ Public bureaucracy salaries were, however, well below those in PDVSA.¹⁵⁰

Anecdotal evidence also illustrates the subordinate status of the Ministry of Energy in comparison to their counterparts in the oil industry. PDVSA often subsidised the Ministry by paying business expenses such as transportation and accommodation when they travelled together. PDVSA donated different type of office equipment, sometimes used, to the Ministry. Top officials in the Ministry had access to holiday homes that PDVSA maintained within its locations across the country.¹⁵¹

¹⁴⁴ Oficina Central de Personal, 'Distribucion de cargos y costos de la Administracion Publica Nacional Periodo 1981-1990'. Economist Asdrubal Baptista has estimated that the size of Venezuelan public bureaucracy has historically exceeded the correspondent dimension according to its degree of development measured as GDP per capita. He estimated that, for instance in 1985, the public bureaucracy exceeded its correspondent value by 64.5%. See Asdrubal Baptista, El relevo del capitalismo rentistico. Hacia un nuevo balance de poder (Caracas, Fundacion Polar, 2004), p.286-289.

¹⁴⁵ Official Gazettes 30,346, 7 March 1974 and 30,919, 12 February 1976.

¹⁴⁶ Official Gazette 37,296, 3 October 2001.

¹⁴⁷ Heliodoro Quintero, interview by author, London, 9 May 2006.

¹⁴⁸ Oficina Central de Personal, 'Distribucion de cargos y costos de la Administracion Publica Nacional', 1986.

¹⁴⁹ Oficina Central de Personal, 'Distribucion de cargos y costos de la Administracion Publica Nacional', 1991.

¹⁵⁰ Exact figures of PDVSA salaries could not be obtained. Anecdotal evidence, however, corroborated this assertion.

¹⁵¹ Various interviews by author in Caracas: Victor Ramos, 2 May 2002; Mercedes Navarro, 2 May 2002; Oscar Veracoechea, 1 August 2003; Rafael Garrido, 7 August 2003; Raiza Pradet,

By the end of the 1980s the Ministry of Energy was effectively incapable of matching the necessary technical and administrative resources of PDVSA. Its regulatory duties had been weakened although many regulations from the time of the concessionary system survived. The enforcement of those regulations was impaired by this lack of resources. For any practical purpose, the Ministry of Energy ceased to play the institutional role that it had done before nationalisation.

2.4 Breaching the post-nationalisation rules of the game

The so called ‘honeymoon’ post-nationalisation period lasted four years. During those years the institutional arrangements described in the previous section held mostly unchallenged. This stability, however, was first disrupted in 1979. President Herrera modified PDVSA’s statutes just days before the term of the first board was to expire. This reform of the statutes marked the beginning of several challenges to the agreed post-nationalisation rules. This section discusses the main alterations of those rules.

Reform of PDVSA statutes of 1979

President Herrera named Humberto Calderón-Berti as Minister of Energy in March 1979. He had previously held senior positions in both the Ministry (Director of the Reversion division) and in the oil conglomerate (Director of the Research and Development arm of the holding). Calderón-Berti had been associated to President Herrera’s party Copei and was one of the closest friends of Herrera.¹⁵² In August 1979 the first board of PDVSA was about to finish its statutory term. On 23 August, President Herrera reformed the statutes altering two significant rules.¹⁵³

First, financial and operational independence was dented. Investment plans, not only of the holding company but those of the operating subsidiaries, were required to be

7 March 2004.

¹⁵² Gustavo Coronel, *ibid.*, p.176.

¹⁵³ Official Gazette 31,810, 30 August 1979.

approved by the Assembly, which was also compelled to convene twice yearly. Additionally, Minister Calderón-Berti changed the previous practice of granting the holding autonomy in appointing operating companies' senior officials.¹⁵⁴

Second, the regulations regarding the board of PDVSA were equally altered. The board's term was reduced from four to two years. Additionally, the clause that guaranteed preferential rights to the members of the board to occupy the most senior positions on the Board was eliminated. This departure was also perceived as a rupture of the tacit agreement of respect for a merit based executive career within the industry, leaving more space for political manipulation of senior appointments.¹⁵⁵

These reforms gave the Ministry a tighter grip on the management of the oil industry. Senior managers' initial reaction was, in the words of Coronel, to give Minister Calderón-Berti "the benefit of the doubt."¹⁵⁶ Later events, however, confirmed that fears about politicisation of the board were well deserved. Coronel pointed out, "The selection of some of the new directors did not seem to follow proper evaluation procedures but seemed to have been made on the basis of Calderón-Berti's personal preferences."¹⁵⁷ Later in 1983, President Herrera appointed acting Minister of Energy Calderón-Berti as new President of PDVSA. Pablo Reimpell commented, "This appointment was simply a mistake; things were never the same after that event."¹⁵⁸ The 1979 reforms hinted that the 'non-intervention' stance adopted by policy makers regarding PDVSA in the aftermath of nationalisation was broken.

Foreign reserves crisis of 1982

Although oil prices peaked in 1981 and 1982 reaching an average of US\$ 32.51 and 32.38 per barrel respectively,¹⁵⁹ oil market prospects were grim. Locally, the Venezuelan economy had entered into a period of post-boom blues. Notably, foreign

¹⁵⁴ Andrés Sosa-Pietri, interview by author, Caracas, 4 August 2003.

¹⁵⁵ Julio Cesar Arreaza, *ibid.*, p.266.

¹⁵⁶ Gustavo Coronel, *ibid.*, p.180.

¹⁵⁷ Gustavo Coronel, *ibid.*, p.182.

¹⁵⁸ Pablo Reimpell, *ibid.*

¹⁵⁹ Opec Annual Statistical Bulletin, 1999.

reserves had been depleted thanks to a capital flight that had threatened the erstwhile strong Bolívar.¹⁶⁰ International reserves held by the Central Bank had dropped by 36% in recent months. In August 1982 they plunged to US\$ 6,152 million (they had peaked in May 1981 at US\$ 9,620 million).¹⁶¹

The response of President Herrera's administration to fend off the capital flight crisis was to rely on PDVSA's own foreign reserves, with the aim of restoring financial health to the Central Bank. On 27 September 1982 the Board of PDVSA was summoned to the Ministry of Energy's office to be informed that President Herrera had decreed that PDVSA's foreign reserves were to be transferred to the Central Bank. PDVSA would have the equivalent amount frozen in Bolívars in a Central Bank account.¹⁶² The Central Bank was entitled to allow PDVSA to maintain some liquid assets in foreign currency for only specific uses and after rigorous consideration. The Central Bank, in any case, would be in charge of administering those assets.

This hasty governmental directive further undermined the rule of financial independence agreed in the nationalisation law in 1975. PDVSA board's immediate reaction was a bitter one, not only because of the lack of consultation during the drafting of the measure but because of the curtailment of its highly valued financial and administrative autonomy. PDVSA feared that it had now to depend on exogenous bureaucratic considerations to carry on with its own administrative affairs. PDVSA asked for compensation if the measure was to be ratified, such as for the income lost in interest on its liquid assets. Similarly, it suggested a reduction in the Export Fiscal Values. It also asked for several modifications to the original resolution in order to make access to foreign currency more flexible both for PDVSA and for the operating companies.¹⁶³

Senior government officials, led by the President of the Central Bank Leopoldo Díaz-Bruzual, refused to modify the resolution. President Herrera, however, established a

¹⁶⁰ Venezuela's local currency is called 'Bolívar', after the country's founding father.

¹⁶¹ Statistics published by Banco Central de Venezuela.

¹⁶² 'Frozen' meant that those resources could not be transferred to other financial institutions.

¹⁶³ Julio Cesar Arreaza, *ibid.*, p.295-303.

joint PDVSA-government commission to discuss the company's concerns. Díaz-Bruzual was a sworn enemy of PDVSA. He commented, "The Board of PDVSA were a bunch of inept managers. I would long before have sent all members of the board to prison because of their lousy management of a purchase of pipes that was outrageously detrimental to Venezuela."¹⁶⁴

Díaz-Bruzual was adamant in maintaining the government position. The government introduced a measure, intended as compensation to PDVSA, in December 1982. The Ministry of Energy ordered the creation of a trust fund in the Central Bank in which some of the retained PDVSA reserves would be invested in 'secured assets'. The accruing interests from this trust would compensate PDVSA for the loss caused by not having the controversial foreign reserves at its disposal. The draft was almost approved, but was in the end opposed by the President of the Central Bank.

Congress intervened in the dispute. The governing party did not have a majority either in the Senate or in the Lower chamber (see Table 2.11). The AD party led the defence of the PDVSA position. They introduced two reforms in Congress, on the 21 October 1982, first to the Central Bank law and second, to the nationalisation law. Both reforms were intended to reverse President Herrera's resolution. In the case of the Central Bank law reform, foreign currency generated by PDVSA exports was not counted as being part of the Bank's reserves. As for the Nationalisation Law, the reform made explicit that PDVSA's reserves held in the Central Bank could not be considered net profit subject distribution to the Treasury. The reform asserted PDVSA's right to keep these resources for future investment or other needs related to the management of the conglomerate.¹⁶⁵

¹⁶⁴ Leopoldo Díaz-Bruzual, interview by author, Caracas, 31 March 2003.

¹⁶⁵ Julio Cesar Arreaza, *ibid.*, p.306-309.

Table 2.11 Composition of Congress (1978-1983)

Party	Senators	Deputies
AD	21 (48%)	88 (44%)
Copei	21 (48%)	84 (42%)
Others	2 (4%)	27 (14%) (2 Right wing, 25 Left wing)
Total	44	199

Source: Consejo Nacional Electoral (CNE)

Eleven months later, Congress approved only the Central Bank Law reform. With the votes of AD and some left wing parties, Congress passed a modification of the law ensuring PDVSA access to foreign currency in an amount set in the PDVSA annual budget, approved by the Assembly.¹⁶⁶ This amendment to the law settled the PDVSA-government dispute. PDVSA was, for the first time, seriously affected by a decision the company overtly opposed. PDVSA's board almost resigned.¹⁶⁷ Although the final outcome was a watered down version of the President Herrera's initial resolution, this episode soured relations between the government and PDVSA. The top management of the industry became more suspicious of government intentions to extract ever larger resources from PDVSA for its own fiscal purposes. According to Bernard Mommer, they promised not to be taken by surprise again. He commented, "The PDVSA leadership took the fateful decision never to hold cash again and to spend the money before the government could levy taxes on it."¹⁶⁸

The foreign reserves crisis of 1982 made public the enormous distrust that existed between PDVSA and the government. In a year-long dispute, the arguments, both in the congressional hearings and in meetings between government officials, PDVSA's technocrats and politicians, revealed that PDVSA plainly feared that the government would utilise PDVSA's funds for shoring up public finances.¹⁶⁹ On the other hand, the President of the Central Bank Díaz-Bruzual accused PDVSA in a congressional hearing on the 25 November 1982 that the company "had plenty of resources while

¹⁶⁶ Official Gazette 3,252 Extraordinary, 12 September 1983.

¹⁶⁷ Alirio Parra, *ibid.*

¹⁶⁸ Bernard Mommer, Global oil and the nation state (Oxford, Oxford University Press, 2002), p.208.

¹⁶⁹ Letter (Reference PV-PE-82/040) sent by the PDVSA's board to the Ministry of Finance on the 7 December 1982 cited in Julio Cesar Arreaza, *ibid.*, p.317.

the rest of the public sector was dried up”, and also questioned the judgement of PDVSA in its investment of those resources abroad.¹⁷⁰ This dispute brought to an end the convivial arrangement that characterised the post-nationalisation years.

The internationalisation crisis of 1983

After the foreign reserves crisis in 1982, the next institutional feature to be tested was the association with privately owned companies. The controversial Article 5 of the nationalisation law regulated potential associations with private capital. The implementation of that provision, however, was not tested until December 2002. PDVSA’s board approved an association with the partly state-owned German company Veba Oil.

The origin of the association with Veba was a cooperation agreement signed between the governments of Venezuela and Germany during the previous administration of President Pérez. PDVSA’s officials seized the opportunity and asked the government for permission to explore the possibilities for the energy area of the agreement (a task that normally would have been assigned to the Ministry of Energy). PDVSA led the exploratory contacts with Veba’s officials. Representatives of the Ministry of Energy participated in those negotiations. PDVSA thought that the public ownership (albeit partial) of Veba would represent a less contentious issue with the political world. In fact, PDVSA had previously explored, to no avail, an association with France’s state company Elf-Aquitaine.¹⁷¹

The arrangement with Veba entailed a joint venture to operate a refining complex (known as Ruhr Oel) in Germany, intended to process Venezuelan heavy crude oil. PDVSA’s rationale was based on two arguments. First, access to international markets and second, the need to make the vast reserves of heavy oil marketable. The Minister of Energy Calderón-Berti backed the association. The remaining hurdle was to determine if Article 5 of the Nationalisation Law applied or not. Minister Calderón-Berti defended the idea of signing without legislative approval. Solicitor General

¹⁷⁰ Leopoldo Díaz-Bruzual cited in Julio Cesar Arreaza, *ibid.*, p.312.

¹⁷¹ Pablo Reimpell, *ibid.*

Carlos Leañez¹⁷² ruled that there were no impediments for PDVSA in going ahead with the Veba deal as long as it was approved by PDVSA's assembly.¹⁷³

PDVSA signed the Veba association in April 1983. The signing in Düsseldorf was attended by Minister Calderón-Berti and PDVSA's officials. PDVSA's president Alfonzo-Ravard was notably absent. He was unhappy with the Minister Calderón-Berti's high profile role in what he considered a technical and commercial matter. He feared that the Minister's direct involvement would render the event too political.¹⁷⁴

In fact, the Veba association was soon questioned in the political arena. President Herrera's administration was under great stress. Only months later, an acute economic crisis was triggered by the first devaluation of the local currency in decades. In addition, the governing Copei party was in a minority in Congress and elections for both Congress and President were scheduled for December that year. The potential conflict of the Veba association with the requirements of Article 5 of the nationalisation law brought a political dimension to the deal. The Copei party, which opposed Article 5 when nationalisation was sanctioned, defended the association and claimed it did not require the legislature's approval. Conversely, the AD party, the main proponent of Article 5, insisted this association was unlawful.

AD's opposition to the Veba deal was led by Celestino Armas, a member of AD's National Executive Committee¹⁷⁵ and an expert in oil policy issues. He denounced the illegality of the Veba contract.¹⁷⁶ AD with the backing of several left wing parties (Movimiento Electoral del Pueblo, Communist Party, among others) initiated a congressional inquiry on the Veba deal.

The special congressional committee appointed to investigate the deal undertook hearings and discussions for months. PDVSA's officials and the Minister were grilled thoroughly. Pablo Reimpell recalled, "Those were turbulent times in which senior

¹⁷² The Solicitor General is appointed by the President of the Republic.

¹⁷³ Cesar Baena, The policy process in a Petro-State (Ashgate, Aldershot, England, 1999), p.81

¹⁷⁴ Pablo Reimpell, *ibid.*

¹⁷⁵ National Executive Committee, known by its Spanish initials, 'CEN', was AD's regular decision making body.

¹⁷⁶ Celestino Armas cited in Cesar Baena, *ibid.*, p.120.

PDVSA officials were accused of all sorts of wrongdoings. Frequently, the attacks reached personal levels. Congressional hearings were very tense. There were several inconvenient observations about PDVSA although they treated us with respect. They especially resented the fact that the negotiations were conducted mainly inside PDVSA.”¹⁷⁷ Similarly, Minister Calderón-Berti complained that he was summoned to Congress thirty one times.¹⁷⁸

Opponents to the Veba deal in Congress extended their reservations beyond the original claim of non-compliance with Article 5.¹⁷⁹ They objected to the inconvenience of a large investment abroad under another country’s sovereignty; to the cost of the operation; and to technological dependence on foreign companies. They also expressed conservationist concerns on the ground that the contract guaranteed the supply of a fixed amount of oil. They were also worried about neglecting local refining projects and the impact of the deal on commercialisation autonomy, including Opec binding agreements. Similarly, old concerns were revived by nationalist minded politicians. They saw this move by the PDVSA’s as a back-door entry for foreign capital to have a say on Venezuelan oil again. Nonetheless, the debate was prolonged enough to reach the electoral contest in December 1983. By that time it was clear that a new administration and a new Congress would be responsible for resolving the dispute.

The AD presidential nominee, Jaime Lusinchi, achieved a landslide victory in December 1983 (57% of the votes). The AD party obtained a handsome majority in Congress as well (see Table 2.12).

¹⁷⁷ Pablo Reimpell, *ibid.*

¹⁷⁸ Humberto Calderon-Berti, cited in Cesar E Baena, *ibid.*, p.126.

¹⁷⁹ For a detailed critical assessment of the VEBA OEL deal see, Rafael Guevara, Petroleo y Ruina. La verdad sobre el contrato firmado entre PDVSA y la VEBA OEL AG (Caracas, Ediciones de Instante, 1983).

Table 2.12 Composition of Congress (1983-1988)

Party	Senators	Deputies
AD	28 (64%)	113 (57%)
Copei	14 (32%)	60 (30%)
Others	2 (4%)	27 (13%) (4 Right wing, 23 Left wing)
Total	44	200

Source: Consejo Nacional Electoral (CNE)

President Lusinchi appointed former member of the congressional permanent committee of Energy Arturo Hernández-Grisanti as Minister of Energy. At the same time, President Lusinchi dismissed PDVSA's board. He sacked Calderón-Berti, who had assumed the presidency of PDVSA only five months earlier, and restructured the board by appointing nine new members and ratifying five. Notably, Vice President Petzall, who played an important role in the Veba deal, was dismissed. Among the new comers was Juan Chacín, an oil industry man believed to be a blood relative of President Lusinchi.

AD's U-turn

Back in power, AD's oil policy makers, notably Hernández-Grisanti, changed their opinion about the internationalisation strategy. Pablo Reimpell recalled, "Hernández-Grisanti told me that although he opposed it before he had realised that internationalisation was necessary."¹⁸⁰ After a period of caution, President Lusinchi gave his full support to the internationalisation strategy initiated by the Veba deal. Lusinchi and the AD party managed to achieve an 'elegant' conclusion to the congressional dispute. Another committee dominated by AD supporters was set up in Congress to give a final word to the debate. The committee produced a report condemning the way the deal had been carried out without congressional approval and considered that the Solicitor General's opinion was not sufficient to comply with legal requirements. The case was remitted to the Supreme Court. It was, however, never pursued and was effectively forgotten.

¹⁸⁰ Pablo Reimpell, *ibid.*

A popular President with a strong mandate and full legislative support in his 'honeymoon' period was able to settle a controversial issue. On the other hand, PDVSA embarked, this time, in a lobbying effort to create the political conditions to pursue the internalisation agenda further.¹⁸¹ AD's U-turn on the Veba deal and its backing of the internationalisation strategy revealed that the strong opposition of the party that had led to PDVSA's policy during the election year of 1983 was not grounded in a significant disagreement with PDVSA. It seemed rather an opportunistic move to attack a vulnerable administration in an election year.¹⁸² The Veba association broke with another tacit rule of the post-nationalisation arrangements. PDVSA issues, which had been largely of an administrative and corporate nature, could now be used for partisan convenience.

Conclusions

Venezuelan policy makers obtained the long awaited goal of nationalising the oil industry in 1975. The 'euphoria' brought about by this step and the initial 'cautious' stance regarding the oil company, however, did not produce a stable institutional arrangement for the post-nationalisation era. Policy makers became complacent at the beginning of this period. A consensual agenda on the urgent tasks required to assure a smooth transition from the concessionary system to the new state-owned arrangement contributed, on the one hand, to grant legitimacy and to set clear rules on how to proceed in the immediate years following nationalisation in 1975. Yet on the other hand, this understanding between the oil conglomerate and the government was not translated into a more stable institutional arrangement.

The resulting institutional arrangement was frail. First, the government left the Ministry of Energy to vegetate. The need to fill PDVSA with 'proven nationalists' deprived the Ministry of some veteran technocrats. Additionally, as the Ministry was

¹⁸¹ Pablo Reimpell cited in Cesar E. Baena, *ibid.*, p.161.

¹⁸² For a lengthier discussion of the internalisation strategy pursued by PDVSA in the 1980s see Cesar E. Baena, *ibid.* and Juan Carlos Boue, La internacionalización de PDVSA: una costosa ilusión (Caracas, Fondo Editorial 'Darío Ramírez'/Ministry of Energy, 2004).

neglected, no replacement was developed for the future. Second, policy makers and politicians distorted rules agreed in 1975 to serve other purposes. In 1979, the then Minister of Energy presided over a reform of PDVSA's statutes that enabled himself to be appointed President of PDVSA years later. In 1982, a stressed administration facing an acute economic crisis, including a significant capital flight, abandoned the rule of financial independence of PDVSA to weather the economic storm of the moment. In 1983, an election year, the main opposition party and largest party in Congress opposed a deal led by PDVSA, only to give its approval some months later when they returned to power. Factors such as personal career advancement, economic urgency and inter-party competition during elections began to influence the governance of PDVSA after a honeymoon period following nationalisation.

The weakening of the Ministry of Energy was matched with a strengthening of the PDVSA position vis-à-vis the regulator. PDVSA not only operated without the same scrutiny that the former foreign company had had but also assumed some roles such as the administration of reservoirs, as the case of the Orinoco Belt illustrates. Similarly, PDVSA's technocracy reacted to the meddling of policy makers and politicians with the agreed rules. PDVSA factored those interventions into its corporate strategy. They minimised exposure to the risks associated with interventions, such as financial independence, which had been curtailed with the seizing of PDVSA's foreign reserves. PDVSA also began to lobby politicians to minimise, as well, their interference as perceived by top technocrats.

The resulting institutional arrangement was unstable. Although the government retained its authority over PDVSA, it began to be outmanoeuvred by a far better prepared technocracy. The weakening of the Ministry of Energy meant that the governance of PDVSA came to rely less on former regulatory mechanisms. This imbalance between the capacity of political masters to hold PDVSA to account and the need to guarantee to the PDVSA technocracy a stable institutional arrangement in which they could base their decision making on commercial and technical grounds, sowed the seeds for future governance problems, which are discussed in subsequent chapters. Moreover, left-leaning politicians confirmed their suspicions about PDVSA's lack of response to the national interest. In all major Punto Fijo political groupings, anti- and pro-PDVSA positions began to coexist. Such tensions emerged

later, both in the neo-liberal years (1990s) and when President Chávez took power. This is discussed in Chapters 4 and 6.

Chapter 3

The Investment Fund (1974-1989)

This chapter examines the Venezuelan Investment Fund created in 1974. The creation of the Fund coincided with the process of nationalisation analysed in Chapter 2. Venezuelan policy makers were faced with a unique opportunity regarding long standing oil policy goals. Nationalisation meant state control of business decisions in the oil industry. Redirecting oil wealth to productive investment had been a long standing aspiration symbolised by Arturo Usler-Pietri's infamous phrase published in 1936: *Sowing the oil*.¹⁸³ The phrase became a constant reference for politicians and intellectuals but it was never tested in practice. In 1974, for the first time, oil revenues were earmarked for a special fund aimed at 'sowing the oil'. The Investment Fund represented an opportunity to make the old slogan a reality.

The 'clean slate' that both nationalisation and the unprecedented oil boom meant for Venezuelan oil policy helped policy makers to commit to a new set of 'rules of the game' regarding oil wealth. The Investment Fund was intended as an institutional mechanism for the use of a significant share of oil revenues. Similarly to the rules designed to implement nationalisation, the regulation of the Fund was conceived in order to avoid politicisation and improvisation in the use of the vast resources that were entering into the economy. The chapter shows how this objective failed to materialise.

This chapter reviews how the Fund was conceived and implemented and what results were obtained from it. The main findings of the chapter indicate that institutionalisation of the spending of extra oil revenues was not achieved despite a careful institutional design and professional implementation. Politicisation of the decision making mechanisms, unchecked supremacy of the President regarding the disposing of oil money and the absence of mechanisms of checks and balances meant

¹⁸³ Arturo Usler-Pietri, 'Sembrar el Petroleo', *Diario Ahora*, Caracas 14 July 1936.

that distortions in the Fund's purpose were not corrected. Consequently, resources in the fund were squandered to a large extent.

The chapter is organised as follows: first, it discusses the background that led to the creation of the Fund in 1974. Second, it describes the initial structure of the Fund. Third, the chapter shows how the Fund operated in practice. Fourth, it demonstrates how the Fund rules were either distorted or ignored, producing the opposite results to those originally intended. Lastly, the chapter examines the final conversion of the Fund to a privatisation mechanism.

3.1 Towards the creation of an investment fund

For 50 years, following the beginning of oil exploitation, Venezuela had managed its oil revenues through regular budgetary mechanisms. Those mechanisms were basically a central collection of taxes and allocation of spending through the national budget. The budget was prepared by the executive branch and required legislative approval. In practice, Congress exerted little or no influence over the budget. Oil revenues were appropriated in the form of taxes collected by the central government.

In 1973 the oil price more than tripled, rising from an average of US\$ 3.05 in 1973 to US\$ 10.73 per barrel in 1974.¹⁸⁴ Venezuelans suddenly faced the need to administer this 'bonanza'. The newly elected president, Carlos Andrés Pérez, promised prudence in his inaugural speech (see introduction to the thesis).¹⁸⁵

Standard macroeconomic thought suggested that the injection of vast fiscal resources into the Venezuelan internal economic mainstream would cause serious imbalances, such as a sharp surge in the inflation rate. Within this context, the new administration's economic team, lead by Gumersindo Rodríguez, Minister of Planning, and by Hector Hurtado, Minister of Finance, agreed the new government should hold part of the oil income aside from established, day to day spending mechanisms. Two months after being inaugurated the Pérez administration asked

¹⁸⁴ OPEC Annual Statistical Bulletin 2001.

¹⁸⁵ President Carlos A. Perez inaugural speech, 12 March 1974.

Congress to concede to the Presidency special powers to dictate laws by decree in economic and financial matters. Among those matters was the establishment of the Venezuelan Investment Fund (FIV).

When the FIV was established in the mid-1970s the idea of grand centralised plans for ‘national development’ was in full swing. Gumersindo Rodríguez, indisputably leader of the economic team, thought himself “not a strong believer in planned economies, nor a blind supporter of the market logic, more an eclectic social democrat”.¹⁸⁶ He envisioned his role as one of managing the economy not as a socialist economy but one that combined ‘state capitalism’ with a ‘socialist bias’, according to his own words.¹⁸⁷ With the boom, the Pérez administration foresaw an immense opportunity to “accelerate the country’s economic development”.¹⁸⁸ Venezuela, however, did not have any large scale projects underway at that time. Rodríguez lamented, “The largest project we inherited from the Caldera administration was an urban development in downtown Caracas called Central Park.”¹⁸⁹ There were some iron, steel and petrochemicals projects, but clearly nothing of the scale of the economic and financial potential that ministers then believed to be possible given the hike in oil prices and the country’s increased wealth.

As a consequence Rodríguez’s cabinet level portfolio, the Office for Planning (known as Cordiplan) promptly began preparing an ambitious plan, called the Fifth National Plan. This plan was encapsulated by President Pérez’s slogan ‘The Great Venezuela’. In addition to the grand ambitions of the Plan, Rodríguez joined with Hurtado and another influential Minister, Carmelo Lauria, regarding the need to introduce what they considered a key political strategy: the ‘irreversibility’ of the infrastructure projects to be undertaken. Rodríguez reaffirmed, “We needed to tie in those projects and to force their future financing. We feared that the ‘patron-client’ practices of Acción Democrática,¹⁹⁰ which I knew very well, would rapidly eat all the resources.”¹⁹¹ Another political dimension of this ‘irreversibility’ strategy had to do

¹⁸⁶ Gumersindo Rodríguez, interview by author, Caracas, 20 March 2003.

¹⁸⁷ Gumersindo Rodríguez, *ibid.*

¹⁸⁸ Official Gazette 30,412, 31 May 1974.

¹⁸⁹ Gumersindo Rodríguez, *ibid.*

¹⁹⁰ Acción Democrática hereafter will be referred as AD.

¹⁹¹ Gumersindo Rodríguez, *ibid.*

with a tension with Juan Pablo Pérez-Alfonzo's policy of restraining oil production.¹⁹² A commitment to a large scale national development programme certainly affected future oil policy, because the money required to finance the scheme whetted the appetite for oil revenues. Pérez-Alfonzo's conservationist ideas were hindered because of the scale of the projects later chosen. The rationale was as follows: once an order is placed with a manufacturer to build a turbine for a ten megawatt hydroelectric power plant over five to eight years, reneging on that commitment would be very costly.

It became clear to policy makers in 1974 that the opportunity to embark on an industrial expansion programme, fuelled by the rise in oil revenues, was finally at hand. This expansion, however, needed time to mature. As Constantino Quero-Morales, former cabinet member and later FIV's president, reflected, "It was critical to have a reserve available to implement an ambitious programme fostering productive structures at the heart of development plans."¹⁹³

Venezuela already had two structures for promoting and implementing industrial expansion: a national 'industry fostering' corporation (Corporación Venezolana de Fomento, CVF) and the regionally orientated Venezuelan Corporation for Guayana (Corporación Venezolana de Guayana, CVG). Quero-Morales, however, acknowledged, "The CVF had lost its prestige and was in a vegetative state unable to evolve to manage the oil money. Its policy of diversification had distracted from the focus on industrialisation. They had abandoned seed capital policy and were involved in many other projects."¹⁹⁴ In short, in Quero-Morales's view, these two bodies were not capable of handling the enormous investments to come. The Guayana Corporation was linked to only one region. Although that region received much investment from the future Fund, its regional horizon was not suitable for the new challenges. Additionally, Venezuela had another structure for industrial financing, a bank targeted to the industrial sector (Banco Industrial de Venezuela, BIV) but, in Quero-Morales

¹⁹² Pérez-Alfonzo was an influential AD party veteran and co-founder, with AD's founding father Romulo Betancourt, of AD oil policy. He defended the idea of 'conservationism' in oil production that basically advocated low levels of production.

¹⁹³ Constantino Quero-Morales, interview by author, Caracas, 20 March 2003.

¹⁹⁴ Constantino Quero-Morales, *ibid.*

own words, “It was mired in corruption scandals and was in disarray.”¹⁹⁵ These poor performing and ill equipped existing governmental agencies required a new entity to be created.

Gumersindo Rodríguez commented on the situation, “I knew very well how the AD party worked. I knew something had to be done to protect some of the vast resources now available from the traditional practices within the party and its main constituencies. If we had not sheltered some of those resources there would have been a queue of local governors asking for infrastructure projects, the teachers unions asking for salary hikes, and so on.”¹⁹⁶ Rodríguez and Minister Hurtado formed an alliance within the Pérez administration to give form to the new entity.

Rodríguez acknowledged Hurtado’s crucial role. Hector Hurtado was a respected figure in the AD party with vast experience of Venezuelan public administration. Hurtado was a disciple of a former influential figure in AD, Manuel Pérez-Guerrero, an economic guru close to the AD’s founding father, Rómulo Betancourt. Hurtado, who had trained as a lawyer and had been a magistrate of the Supreme Court, had a comprehensive knowledge of Venezuelan public finances. He had been Deputy to Pérez-Guerrero and Minister of Planning in former AD administrations. Carlos Rafael Silva, former cabinet member and President of the Central Bank, said of Hurtado’s ability, “Hurtado was a very pragmatic figure. He knew exactly how to do things to please the President of the Republic even if it was not in the best overall national interest.”¹⁹⁷

Gumersindo Rodríguez explained how the ‘team’ worked: “Hurtado had an incredibly meticulous knowledge of the legalities of Venezuelan public administration. This knowledge and his skills, together with his being a trained lawyer, prepared him very well to shape the legislation the way it best suited the aims of the Fund as we intended. But Hurtado knew all the tricks of the public administration as well.”¹⁹⁸ Both Hurtado and Rodríguez realised that the opportunity was ripe to ask Congress

¹⁹⁵ Constantino Quero-Morales, *ibid.*

¹⁹⁶ Gumersindo Rodríguez, *ibid.*

¹⁹⁷ Carlos Rafael Silva, interview by author, Caracas, 3 April 2003.

¹⁹⁸ Gumersindo Rodríguez, *ibid.*

for an Enabling Law.¹⁹⁹ They intended, in Rodríguez's own words, "To squeeze every possible bit from an Enabling Law to allow the President to legislate on a myriad of economic issues without the interference of Congress."²⁰⁰ Rodríguez believed, at that time, that Congress, controlled by AD, would easily pass the law because: "During the honeymoon period at the beginning of each administration, Venezuelan congressmen typically expect all kind of favours from the Executive, and they are therefore willing to approve anything the government submits to them."²⁰¹ Rodríguez bluntly concluded, "You know how things work in Venezuela... they are expecting perks of all sorts from the government, they are hoping for business 'opportunities' for their friends."²⁰²

Article 1, Section 3 of the Enabling Law, passed by Congress on 31 May 1974, authorised the President to: "Create the Venezuelan Investment Fund as an independent entity with legal authority whose purpose will be the administration and investment of its own assets in order to complement the funding of the expansion and diversification of the national economic structure, to invest resources in profitable options abroad and to promote international cooperation programmes. All of this is in order to contribute to the economic and financial stability of the country."²⁰³

The creation of the Fund required a change in the legislation regulating the national Treasury. The concept of 'unity of the Treasury' was reformed to allow for the creation of a separate fiscal entity. President Pérez, with the authority of the new Enabling Law of May 1974, changed the 'Organic Law of Public Finance' to pave the way for the establishment of the FIV. Decree 150, Article 1, dictated, "50% of the fiscal revenues coming from the tax on oil and gas exploitation and from income tax affecting those activities will be exempted from becoming part of the national Treasury and therefore the source for public spending."²⁰⁴ It also established that, "At the end of each fiscal year, this percentage can be increased or decreased as the result of an adjustment mechanism related to the variation of the mentioned revenues in

¹⁹⁹ This practice meant that Congress would pass its legislative prerogative to the President.

²⁰⁰ Gumersindo Rodríguez, *ibid.*

²⁰¹ Gumersindo Rodríguez, *ibid.*

²⁰² Gumersindo Rodríguez, *ibid.*

²⁰³ Official Gazette 30,412, 31 May 1974.

²⁰⁴ Official Gazette 1,660 Extraordinary, 21 June 1974.

relation to those of 1974.”²⁰⁵ A mechanism for controlling what proportion of oil income had to be devoted to the national annual budget and what had to be deposited in the Fund was deferred to the law regulating the Fund. This modification of a long lasting fiscal tradition allowed policy makers, for the first time, to separate some part of oil revenues from the traditional budgetary process. As the ‘unity of the Treasury’ had been broken, Pérez’s administration was entitled to allocate funds outside the budgetary loop.

President Pérez and his team promptly began to work on the basis of that modification. First, they created two funds specially targeted to the industrial and agricultural sectors.²⁰⁶ Both the Industrial Credit Fund (Fondo de Crédito Industrial, Foncrei) and the Agriculture Credit Fund (Fondo de Crédito Agropecuario, FCA) were provided with an initial endowment of about US\$ 500 million. Later in 1975, an identical fund with the same endowment was created for urban development (Fondo Nacional de Desarrollo Urbano, Fondur).²⁰⁷ These funds, however, did not have provisions for further replenishment from oil revenues. In a different approach, the Venezuelan Investment Fund (FIV) was created, with a unique organisational structure and with provisions for redirecting oil revenues in the future.

3.2 The Venezuelan Investment Fund (FIV)

On 11 June 1974, enabled by Congress to legislate by decree, President Pérez created the FIV through the Statute of the Venezuelan Investment Fund.²⁰⁸ This instrument gave legal and organisational form to the Fund.

The Fund reported to the Presidency of the Republic. The law regulating the structure of the executive branch, the ‘Organic Law of the Central Administration’, did not give the Fund the stature of a Ministry. The President, however, used a prerogative of creating ‘Ministries of State’ in charge of specific tasks (Article 3 of the Central

²⁰⁵ Official Gazette, *ibid*.

²⁰⁶ Official Gazette 30,420, 10 June 1974.

²⁰⁷ Official Gazette 30,790, 9 September 1975.

²⁰⁸ Official Gazette 30,430, 21 June 1974.

Administration Law) to give the FIV ministerial status.²⁰⁹ From the beginning, therefore, the Fund was fully considered a new Ministry. Its head formally known as ‘President of the Executive Board of the Fund’ was immediately appointed to the cabinet.

FIV’s funding

The autonomous resources of the Fund were established as follows:

- a) An initial endowment of US\$ 3,023 million (Bolívar 13,000 million) applicable to 1974’s fiscal year.
- b) 50% of revenues from taxes on oil and gas exploitation and from income tax on those economic activities. Those funds were to be deposited in the fund as long as they were collected.
- c) Contributions from the Executive originated in the direct or indirect State participation in the oil business.
- d) Benefits from the fund’s own operations and from the sale of its own assets.
- e) Any other extraordinary contribution in goods or in cash that the Executive might decide in favour of the Fund.

Although it was established that 50% of oil revenues were to be deposited into the FIV, the Statute had a provision that allowed for adjustments on the annual contribution to the Fund. The last section of Article 3 stated: “In the case that the tax collection previously referred to in this article varies in relation to that of 1974, the percentage dedicated to the Fund will be adjusted as a function of those variations in accordance with: 1) In case of a rise in revenues: the percentage will be increased proportionally to half the proportion of that increment up to a maximum limit of 75%; 2) In case of a fall in revenues: it will be decreased proportionally to double the proportion of that diminution. In any case the obligation to replenish the Fund cannot

²⁰⁹ Official Gazette 1,932 Extraordinary, 28 December 1976.

interfere with the resources dedicated to the national budget in a proportion equalled to the previous year plus the average increase of the previous three years.”²¹⁰

FIV's governance

The Fund's supreme authority was the General Assembly which was composed as depicted in Table 3.1.

Table 3.1 Members of the FIV's assembly

Member	Appointed by
Minister of Finance (President)	President of the Republic
Minister of Industry and Trade	President of the Republic
Minister of Agriculture	President of the Republic
Minister of Mines and Hydrocarbons (later denominated Minister of Energy)	President of the Republic
Ministry of Planning	President of the Republic
Three other Ministers	President of the Republic
Two representatives of Legislature	Congress of the Republic
President of the FIV's board	President of the Republic
President of the Central Bank	Nominated by the President of the Republic and ratified by Congress.
President of the National Banking Council	Public-Private sector partnership. The President of the Council was chosen by the Minister of Finance, usually, from the most prominent Bankers in the country.
President of the Conference of Venezuelan Workers	Unions
President of Private Business association (Fedecamaras)	Private sector

Source: Law of the Venezuelan Investment Fund

Only four out of fifteen members were not direct appointees of the President of the Republic. The CTV (unions) and Fedecamaras (business association) members of the Assembly reflected the traditional 'Punto Fijo' practice of incorporating labour and business representatives into the boards of public bodies.²¹¹ Having two

²¹⁰ Official Gazette 1,660 Extraordinary, 21 June 1974.

²¹¹ It was a custom by AD and Copei parties, which achieved a qualified majority in Congress

representatives from Congress was also common in this type of public body. A quorum of twelve members was established and a minimum of nine votes were required to make valid decisions. This requirement strengthened the control of the Assembly by the executive branch.

The General Assembly was responsible for overall policies of the Fund, especially those regulating the financial aspects such as the proportion of liquid assets it had to maintain. It was also responsible for the appointments of the internal comptroller of the Fund and external auditors. Additionally, it had to approve the Board's annual report and to examine both the external auditor's and the comptroller's reports.

The Fund's top administrative body was the Executive Board. The Board was formed by a President, a Vice President and three other members, all of them in a full time capacity and all appointed by the President of the Republic. Nothing regulated the appointment or dismissal of a Board member. The Statute, however, established some requisites such as being a Venezuelan citizen, having sound knowledge and expertise in financial, banking and foreign exchange matters and being a solvent person, all common nominal requirements for most public posts in Venezuela. In practice, officials are usually nominated more on loyalty grounds than according to 'sound knowledge' or any other technical requirements.

The Board also had three substitute members. Presidential absences were filled by the vice president, those of the vice president by any of the directors and finally, absent directors with substitute members of the Board. The quorum required for Board meetings consisted of the President and two directors. Decisions were made by simple majority. In case of a tie the President had a decisive vote. When the Board was convened under minimum quorum decisions required unanimity.

The Board's function included:

- 1) Authorising contracts with third parties.
- 2) Financial programming including annual budget, although the General Assembly's approval was required.

most of the time, and by Presidents to appoint labour and business representatives in public agencies, consultative commissions and state-owned company boards.

- 3) Setting administrative norms, appointing officials to the fund, advisers, consultants, special agents and representatives of the Fund to third parties, both nationally and internationally.
- 4) Preparing quarterly reports to Congress and the biannual report to the General Assembly.
- 5) Dealing with, in general, all those matters that were not the exclusive responsibility of the General Assembly.

Another important role reserved for the Executive Board, which proved subsequently to be very controversial, was the appointment of representatives of the Fund in those companies in which it had participation. This was later a source of conflict with other organisations of the central and decentralised administration.

FIV's functions

The Fund was originally conceived for two purposes. First, investing in productive projects in prioritised industrial areas within the country, and second, to invest abroad in order to avoid the conversion of the all accumulated foreign reserves into Bolívar denominated funds. The Fund, however, was initially authorised only to finance the external component of those projects in a limited number of industrial areas, including hydrocarbons, energy, petrochemicals, steel and metals, mines, naval industry and international transport. The external component referred to imported services, equipment and materials.

A window, however, was opened for other areas. Article 21, Section B of the Statute contained a feature common in Venezuelan legal frameworks. This window allowed the Fund to accommodate particular situations even if they did not comply with FIV's original objectives. The section stated that the Fund could “complement, *when necessary*, the financing of *great* projects in agriculture and manufacturing areas inside the country and for exports through global credit facilities channelled through existing public financial institutions”.²¹² A cap, though, was established for this type

²¹² Official Gazette 30,420, 10 June 1974.

of financing. It could not exceed half the budget already set for these financial institutions.

The Fund was authorised to buy shares or other financial instruments, with no restriction on the type of company, but only “when the State was required to participate in certain enterprises”.²¹³ This permitted activity anticipated the future policy of nationalisation that characterised the rest of 1970s.

The list of permissible operations abroad was more extensive. The Fund could finance, directly or indirectly, projects abroad in which the Venezuelan private or public sectors participated. It could invest in high rated and liquid foreign securities and hold capital in foreign companies (there were no restrictions about the type of company). In addition, the Fund was allowed to establish trusts in high rated institutions abroad and to participate with them in international project financing. In terms of liabilities, the Fund was allowed to issue debt or other short term credit instruments denominated in local or foreign currencies. These credit operations were not included in the sovereign debt regulated by the law of public credit.

FIV's accountability

The Fund had to report its financial situation twice a year. These reports needed to be approved by the General Assembly and published in the official report (Official Gazette) and in at least one national newspaper. The operations of the Fund were subject to the control of the Comptroller General (the government's supreme accounting inspector). To facilitate this, the Comptroller General opened an office of inspection inside the Fund.²¹⁴ Additionally, the Fund had external auditors reporting directly to the General Assembly.

These provisions for the external control of the Fund were common among Venezuelan governmental agencies. The Comptroller General normally monitors

²¹³ Official Gazette, *ibid.*

²¹⁴ Official Gazettes 30,484, 27 August 1974; 1,735 Extraordinary, 30 April 1975; 31,236, 17 May 1977 and 33,065, 18 September 1984.

compliance with regulations regarding administrative procedures but does not assess the substantive quality of economic transactions. Similarly, the external auditing usually only reflects compliance with standard accounting practices. Neither the Comptroller General's supervision, nor external auditing, could provide a check on the economic feasibility of the Fund's decisions.

3.3 FIV's bureaucracy

The original rules and procedures, conceived to make the Fund a distinctive bureaucracy, failed to perform as anticipated. Although traditional features of the Venezuelan public sector, such as low level of specialisation, cronyism and patron-client politics were curtailed, decisions imposed in high levels of the Executive distorted the Fund's objectives.

The Fund started to function as a *de facto* ministry. Its first president was Carlos Guillermo Rangel, former president of the umbrella business association Fedecamaras. As a consequence of health problems he lasted only for a few months. He was succeeded by Constantino Quero-Morales, an economist also formerly linked to Fedecamaras in an advisory capacity. Quero-Morales was already serving in the cabinet as Minister of Industry and Trade.

Quero-Morales was in charge of developing initial internal policies and procedures in the Fund. He recalled: "The initial phase could not have been more propitious, the legal instrument was potent, the initial staff was of excellent quality, and the Fund had the institutional backing of the World Bank and the Inter-American Development Bank (IDB) in Washington, and of the Central Bank locally. In short, the Fund was a flagship organisation prepared to undertake the duties for which it was conceived, which was not usual for Venezuelan bureaucratic standards."²¹⁵ Hermann Luís Soriano, Director of the Fund since 1976 and later President also recalled, "The Fund was directly reporting to the President, was well financed and had a very minimalist bureaucracy. Additionally, the presidents of the Funds were close allies of the

²¹⁵ Constantino Quero-Morales, *ibid.*

President of the Republic.”²¹⁶ The Fund was in an unprecedented position in comparison with other bureaucratic bodies.

This privileged position attracted to the Fund competition and resentment from other governmental agencies. The Ministry of Finance felt that the Fund should have been under its control. The Ministry of Energy and Mines resented the fact that the main electricity generation projects were controlled by the Fund. Furthermore, as the Guayana region industrial conglomerate was under its direct influence, the Guayana Corporation (CVG), also at cabinet level, usually joined forces with regional constituents to put pressure on the Fund for getting financing to varied projects in the region. When the Fund rejected some of these projects, frictions between Guayana’s interest groups and the Fund usually created an acrimonious environment. Put simply, the Fund was an unusual body in Venezuela’s public administration. The Fund disturbed traditional structures, which felt threatened by a new organisation and were fearful that it was taking their roles.

The Fund received, in 1974, a primary endowment of US\$ 3 billion plus a subsequent injection of US\$ 1.8 billion. These initial resources represented an equivalent of 32.2% and 53.48% of the 1974 and 1975 consolidated central government budgets respectively (see Table 3.2). At the outset, the use of these funds was unclear. What was to become the gigantic and ambitious national development plan, the ‘Fifth National Plan 1976-1980’, was in its earliest stage of development by the Ministry of Planning. Additionally, many of the projects in the Guayana region were at planning stage. As other projects were not mature for investment either, the Fund’s initial strategy was to invest the money abroad.

In order to invest money abroad, the Fund built a network of financial relations with the multilateral organisations such as the World Bank, the Inter-American Development Bank (IDB), the Caribbean Development Bank and the Central-America Bank for Economic Integration.

²¹⁶ Hermann L. Soriano, interview by author, Caracas, 7 April 2003.

Table 3.2 FIV assets vs. consolidated central government budget

Year	FIV's total assets as % of consolidated central government budget	FIV's total assets as % of Central Bank international reserves
1974	32.20	48.74
1975	53.48	59.00
1976	53.59	66.38
1977	54.53	82.42
1978	57.25	113.11
1979	67.57	102.44
1980	59.86	137.11
1981	55.99	153.67
1982	67.18	150.48
1983	84.86	103.85
1984	90.03	87.68
1985	87.09	45.19
1986	102.73	54.35
1987	74.90	45.62
1988	59.34	53.84
1990	85.15	46.83
1992	93.46	46.09
1993	74.38	32.84
1994	54.33	32.14
1995	87.55	33.26

Source: FIV annual reports (various years); IMF Government Finance Statistics yearbook (various years); BCV

The Fund opened a trust in the IDB and bought a considerable amount of World Bank bonds. But, more significantly, apart from the financial tie, the Fund established technical cooperation agreements with the multilateral organisations. The government invited Robert McNamara, President of the World Bank, to visit Venezuela.

Gumersindo Rodríguez, who hosted the visit, recalled, “The World Bank was very keen on assisting a rich country, such as Venezuela was at that time. They were expecting further increases in oil prices and saw an enormous potential to embark on big industrial and infrastructure projects.”²¹⁷

These international organisations served as the main technical advisors to the Fund. This cooperation brought technical expertise into the area of project valuation. Moreover, these imported techniques were transmitted to other public bureaucracies

²¹⁷ Gumersindo Rodríguez, *ibid.*

such as the Ministry of Planning. Additionally, experts from these international organisations, hired especially for that purpose, assessed many of the projects presented to the Fund.

The FIV's staff was trained by World Bank and IDB technical experts. Most of the technical procedures for analysing the industrial projects were copied from prevailing practices in the multilateral organisations. Quero-Morales corroborated the high quality of the relationships, in terms of cooperation, between the FIV and these organisations.²¹⁸ The President of the IDB, Antonio Mena, brought Quero-Morales to the Bank in Washington, DC after he left the Pérez administration in 1979. He spent the next ten years in several different roles, but always as Mena's advisor. In addition to the cooperation with multilaterals, Fund staff was also trained by leading private sector financial organisations such as First Boston, Merrill Lynch, Morgan Guaranty Trust, Salomon Brothers, Citicorp, Deutsche Bank and Swiss Bank Corporation.

Within Venezuela, the Fund had assistance from the Central Bank, both logistically and technically. FIV occupied some Central Bank offices for more than twenty years. The Fund also used the information technology facilities of the Central Bank. Many of its initial staff had previously been trained in the Central Bank bureaucracy, reputed for being technically minded and, by Venezuelan standards, non-politicised. The Central Bank also supported the Fund in its international financial operations, both as financial agent and in an advisory capacity. In short, as Julian Villalba, President of the Fund in 1993-1994, commented, "The Fund was created under the shadow of the Central Bank."²¹⁹

These circumstances and bureaucratic influences inherited from those organisations ensured the Fund was a professional, efficient, and technically minded agency. The Fund, which was managing an amount equalling to almost 70%, on average, of Venezuela's consolidated central government budget (see Table 3.2), and almost 75% of the foreign reserves controlled by the Central Bank, never had more than 200 employees. Ten years after being created, the performance of the Fund's internal bureaucracy was considered effective. In the words of the Fund's own report, "All

²¹⁸ Constantino Quero-Morales, *ibid.*

²¹⁹ Julian Villalba, *ibid.*

achievements of the Fund have been reached as a product of a reasonable administrative continuity and the selection of capable personnel that have enjoyed enough stability and have worked with dedication and optimism.”²²⁰

Stability is a rare attribute of Venezuelan public office. Hence, the Fund’s self congratulatory description of its administrative achievement. Furthermore, Aquiles Vilorio, who spent more than 20 years at the Fund and served as General Manager before retirement, corroborated the Fund’s atypical behaviour in terms of patron-client practices in the public bureaucracy usually controlled by the two main political parties. He said, “There was always certain autonomy in personnel selection. Merit-based considerations prevailed over political interferences most of the time.”²²¹ He further pointed out, “The staff enjoyed a great deal of technical power. They often used that power to counteract central government attempts at tinkering with the Fund’s functioning. Using technical and legally backed objections, the Fund officials managed to make it very difficult for such interferences to go through.”²²²

FIV’s internal operation was carefully established. Operating procedures were thoroughly laid out. The ‘operating policy’ manual stated a thorough list of procedures to inform Fund officials of what actions were allowed.²²³ These manuals were intended to protect the Fund from the appetite of all other public entities for seeking financing. In addition to the administrative units, a series of committees was set up to make decisions on the operations of the Fund. As a result of all these procedures, the Fund was formally able to filter, revise and modify the projects that were submitted for consideration.

The personnel of the Fund held a special status amongst public bureaucracies. President Pérez decreed a special statute for the Fund’s employees.²²⁴ This instrument gave the Fund employees special treatment in many areas, such as job security, promotion, selection, and many others. The instrument even included a provision

²²⁰ Fondo de Inversiones de Venezuela, Special Report 1974-84.

²²¹ Aquiles Vilorio, interview by author, Caracas, 2 April 2003.

²²² Aquiles Vilorio, *ibid.*

²²³ Fondo de Inversiones de Venezuela, Operating Policies Manual 1975.

²²⁴ Official Gazette 2,232 Extraordinary, 26 April 1978; 31,540, 1 August 1978 and 33,636, 13 January 1987.

(Article 52) that allowed the President of the Republic in the Council of Ministers to establish a special regulation for working day hours. Another Presidential Decree gave Fund employees benefits beyond those granted to other public employees in areas such as social protection. This special regulatory framework conferred on Fund employees a privileged status among public officials.

The Fund's bureaucracy was well placed to function as a highly specialised agency. It was relatively well protected from other governmental units and from interference by political parties. Several of FIV's former senior officials confirmed that the bureaucracy should not be blamed for the Fund's overall performance. Quero-Morales said, "The Fund rapidly acquired a mature, proficient group of technocrats capable of assessing the merits of each project that the Fund had to consider."²²⁵ Luís Hinestrosa, General Manager 1979-1984 confirmed, "The evaluation of the projects was made under strict professional criteria with international expertise."²²⁶ Hermann Luís Soriano, President of the Fund 1981-1984, characterised the Fund's bureaucracy as: "Small, well trained, and well resourced, as well as in direct contact with the President of the Republic through the President of the Fund, who was generally accessible to him."²²⁷ Julian Villalba, former President of the Fund, admitted, "When I entered the Fund, in its Privatisation era, we did not change its functioning, which was professional and generally adept and efficient, in terms of the number and expertise of its employees."²²⁸

All these factors taken together suggest that the FIV bureaucracy was well positioned to achieve the Fund's objectives. The Fund's internal functioning was relatively immune to the vices that have generally undermined other Venezuelan public bodies. The existence, however, of a relatively professional organisation was not a sufficient condition to avoid deviations from its original purpose. Middle levels of FIV bureaucracy, although proficient, were mostly unable to resist decisions taken at the highest level. In addition, some of those decisions were not implemented by the Fund. Once a loan was granted to a public enterprise or direct participation in a state-owned

²²⁵ Constantino Quero-Morales, *ibid.*

²²⁶ Luis Hinestrosa, interview by author, Caracas, 2 April 2003.

²²⁷ Hermann L. Soriano, *ibid.*

²²⁸ Julian Villalba, *ibid.*

company's capital was decided at the senior level, or rather externally imposed on the Fund, its middle ranks were constrained in making significant changes.

The defensive strategy adopted by the Fund's internal bureaucracy, as claimed by former FIV's general manager Vilorio, was powerless to avert deviations from the Fund's purpose. The Fund, as became clear with the passage of time, evolved from a saving fund devoted to highly productive investments into a hotchpotch of industrial holdings, a quasi-nationalisation instrument, a bail out agency for all sorts of ailing public ventures and a caretaker of dying enterprises. In other words, it became a kind of residual agency governed by politics.

3.4 FIV's decision making

Since the Fund was not legally a ministry, it did not report to Congress. It had to report, though, to the General Assembly, the highest internal FIV's authority. The legal requisite, however, for the General Assembly to approve the annual report was stated in the FIV's Statute (Article 31).²²⁹ The configuration of the General Assembly, though, assured it became a mere appendage of the cabinet and practically impossible to contravene the wishes of the President of the Republic.

The corporatist habit of having senior trade union members and top business representatives as members of this collective body was simply gesture politics. The same can be said of the inclusion of two appointees from Congress. The Assembly was not an effective monitor of, or counter balance to, the Executive but rather a formality.²³⁰ The design of the Fund had effectively blocked any counter balance from other branches of the State. Furthermore, limiting the role of Congress in exercising oversight reduced enormously political parties meddling with the Fund. The Fund was a direct bureaucratic instrument of the President of the Republic. Contrary to the national budget, which required congressional approval, the discretion the President had over the Fund was absolute.

²²⁹ Official Gazette 30,420, 10 June 1974.

²³⁰ Luis Hinestrosa, *ibid.*

This total Presidential autonomy over the Fund was exactly what President Pérez's economic team, lead by Gumersindo Rodríguez and Hector Hurtado, had conceived of. The economic team wanted to shield the extra oil money pouring in during the boom, from other parts of the State. The rationale was to protect the extra resources from the temptation of spending it irrationally and insensibly by pork barrel politics in the Congress and elsewhere.

This protection was thought to be achieved by restricting the areas in which the Fund could invest. Although the Statute of the Fund established a set of restrictions on the areas in which the Fund could operate it still granted a great deal of discretion to the President of the Republic. The protection of the funds relied on the judgement of the President. The FIV's design was intended to assure that while oil prices were high, a significant proportion of the subsequent extra oil revenues were handled through an autonomous Presidential mechanism.

The formal body for operational decisions was the Fund's Executive Board. Members of the Board were directly appointed by the President of the Republic. In its original version the Statute determined that the Board was composed of the Fund's President, a Vice President and three Directors. This arrangement was later changed to the President and four Directors.²³¹ Initially, President Pérez (from AD Party) asked Copei (the main opposition party) to nominate two members of the board (a 'Principal' and his Deputy). Constantino Quero-Morales, FIV's President at that time, recalled, "President Pérez told me that he regarded the Fund as a high priority for the State. With such a significant amount of resources to be administered he wanted to have a monitoring presence from the opposition. I went to talk to Rafael Caldera, founder of Copei, and communicated this to him. As a consequence they nominated Alejandro Suels and Hermann Luís Soriano for the Board."²³²

The Fund's board was, however, rarely the place where conflicting interests were resolved. The President of the Board enjoyed significant influence over decisions supposedly to be taken by that plural decision making mechanism. On many occasions the Board acted as a rubber stamp. In addition, the way the Board was

²³¹ Official Gazette 30,636, 11 February 1975.

²³² Constantino Quero-Morales, *ibid.*

configured guaranteed a sufficient majority of appointees of the President of the Republic. Table 3.3 shows how the FIV's Board compared to other boards of similar public entities. The configuration of other such boards usually responded to 'corporatist' practices. Non-presidential appointees often opted for cooperative strategies that accommodated their interests.

In practice, the President of the Republic's direct access to the FIV was through the Fund's President. The President of the Fund was elevated to the cabinet as Minister of State (see Table 3.4).

**Table 3.3 Configuration of Executive Boards
(Selected governmental organisations)**

Organisation	Total members	Direct presidential appointees	Indirect appointees
FIV	5	5	0
Foncrei	7	4	3 { 1 from Industrial Council (private), 1 from CTV(Unions) and 1 from Small and Midsize Enterprises Federation (private)}
FCA	7	4	Similar but from agriculture sector
Fondur	7	4	3 { 1 from National Banking Council (semi-private), 1 from Savings and Loan entities Federation (private), 1 from State workers.

Source: Official Gazette (various issues)

FIV's decisions were usually taken at the cabinet level. Presidents of the Republic were unconstrained in imposing important decisions on the FIV, usually presented at the cabinet meetings. Decisions on large industrial and infrastructure projects were imposed on the FIV. The Fund had to deal with the implementation and execution of those projects rather than acting as a strategic investor making business-like decisions. The power over the Fund's decisions was located outside the FIV. The Fund was a player among others in the game of getting approval by the President of the Republic.

Despite FIV's *de facto* ministerial autonomy, traditional ministries such as Energy or Finance, or entities such as the Guayana Corporation (CVG) all felt that they had to influence fund allocation. As new resources became available in the Fund, a complex 'game' of influences between different ministries and regional actors began. The FIV's initial stance was to act as a project financier and comptroller. The Fund wanted to provide 'seed capital' and to be a lender for local projects.²³³ The other initial aim was to serve as the arm for international cooperation, especially financing poor countries hit by the oil price hike.

Table 3.4 Presidents of the Fund (1974-1989)

Year	President F.I.V.	Background	President of the Republic
1974	Carlos Guillermo Rangel	Businessman, Ex President Fedecamaras (1971-1973)	C.A.Pérez
1975	Constantino Quero-Morales	Economist- Fedecamaras consultant	C.A.Pérez
1977	Hector Hurtado	Former held many post in Public Administration- Closely related to A.D.	C.A.Pérez
1979	Leopoldo Díaz-Bruzual	Economist and Lawyer. Central Bank experience. Former President of Institute for Foreign Trade- Related to Copei	L.Herrera
1981	Hermann Luís Soriano	Economist. Former Director of the Fund 1976-1979. Closely related to Copei. Member of the L.Herrera Campaign team.	L.Herrera
1984	Carlos Rafael Silva	Economist. Vice-President of Central Bank for 18 years. Former Minister of Education	J.Lusinchí
1986	Hector Hurtado	Former President of FIV (see above)	J.Lusinchí.
1988	Heberto Urdaneta	Former senior staff FIV	J.Lusinchí

Source: FIV, Special Report (Memoria Especial) (1974-1988)

These initial FIV investment priorities were, however, rapidly tested by the most varied requests for funding. Intense competition for the Fund's resources soon started. The Guayana regional development corporation (CVG) led the process. CVG had

²³³ Seed capital is understood as the initial investment required in big industrial projects. Subsequent financing commonly is obtained in financial markets and/or paid from the project's own cash flow.

been established in the 1960s. It was responsible for various industrial projects in the iron and aluminium sectors. CVG's good reputation for efficient management put it in the front line to receive FIV's resources. Both the iron (Sidor) and aluminium (Alcasa) ventures immediately asked for grand-scale expansion projects. Furthermore, CVG asked for funding for new enterprises in aluminium (Venalum), steel (Acelcar), bauxite (Interalumina and Bauxiven), among others.

Several ministries, directly or indirectly, emerged as bidders. The Ministry of Energy and Mines, responsible for the electric sector, pushed for hydroelectric (Edelca) and thermoelectric (Cadafe) projects. The Ministry of Defence, the *de facto* administrator of state-owned companies such as the maritime cargo company (Cavn), shipyards (Dianca and Astinave) and an aeronautical company (Venemaica), equally requested financing from the Fund. The Ministry of Agriculture asked for financing for its sector's development bank (Bandagro). Mining projects in salt, gold and carbon were also submitted for FIV funding. Four projects for cement plants were also proposed. Similarly, FIV was used to implement nationalisation policy in the electric distribution business. FIV bought 98.63% of Enelbar and 99.85% of Enelven, both regional electricity companies nationalised by President Pérez.

Political lobbying, from all quarters, was intense. First, regional pressure groups soon asked for their share in the FIV financing pie. Luís Hinestrosa, former FIV General Manager, remembered, "Each regional group pushed for their own projects. The State of Zulia wanted another steel mill, the State of Anzoátegui pressed for its mines, the city of Cumana wanted a shipyard and so on."²³⁴ Regional development corporations, state-level business and labour associations, universities, state legislatures' representatives joined forces to apply pressure on the Fund to invest in their local pet projects.

On the international front, the activity was no less intense. Since one of the Fund's permitted areas of investment was in programmes of international cooperation, officials from the Ministry of Foreign Affairs, Ministry of Energy and Mines (linked to Opec) and even the President of the Republic indirectly generated commitments

²³⁴ Luís Hinestrosa, *ibid.*

which the Fund had to honour or pay attention to.²³⁵ Some of the projects involved foreign private interests. Leopoldo Díaz-Bruzual, a former FIV President, remembered how even “the King of Spain showed interest in one of the shipyard projects under consideration in which Spanish investors were participating”.²³⁶ Luís Hinestrosa, Díaz-Bruzual’s Deputy, also recalled, “I received calls from the office of France’s Prime Minister lobbying for one of the projects.”²³⁷

With the passage of time, all of these efforts were creating an intricate web of hierarchical relations, indirect links and informal liaisons between the Fund, state-owned enterprises and many other governmental high offices (see Figure 3.1). The game of power over the Fund’s decisions was played with the President of the Republic as supreme arbitrator.

In turn, the President of the Fund and other senior officials competed to influence the President. Many decisions were taken in the cabinet or through informal ministerial meetings. Luís Hinestrosa recalled a meeting, in a private hotel, chaired by the Minister of the Interior, with fellow Ministers of Industry, Finance and the FIV where the Fund’s senior officials presented their case for a long debated and controversial steel mill project for the Zulia region. When the project was rejected, the Minister of Interior, who was the least you would have expected to lead a decision making process for a strictly economic issue, was very disappointed. Hinestrosa said, “The Minister of Interior pulled his hair out because he was the one who had called the meeting.”²³⁸

The real power over decisions shifted all the time around the President and whichever Minister had ascendancy over his/her peers and had a more influential relationship with the President of the Republic. There were no predictable patterns. Theoretically powerful ministries, such as Finance or Industry, were not necessarily as powerful as observers might expect. The President of the Guayana Corporation (CVG), who oversaw the great bulk of FIV financed projects, for instance, enjoyed a similar status

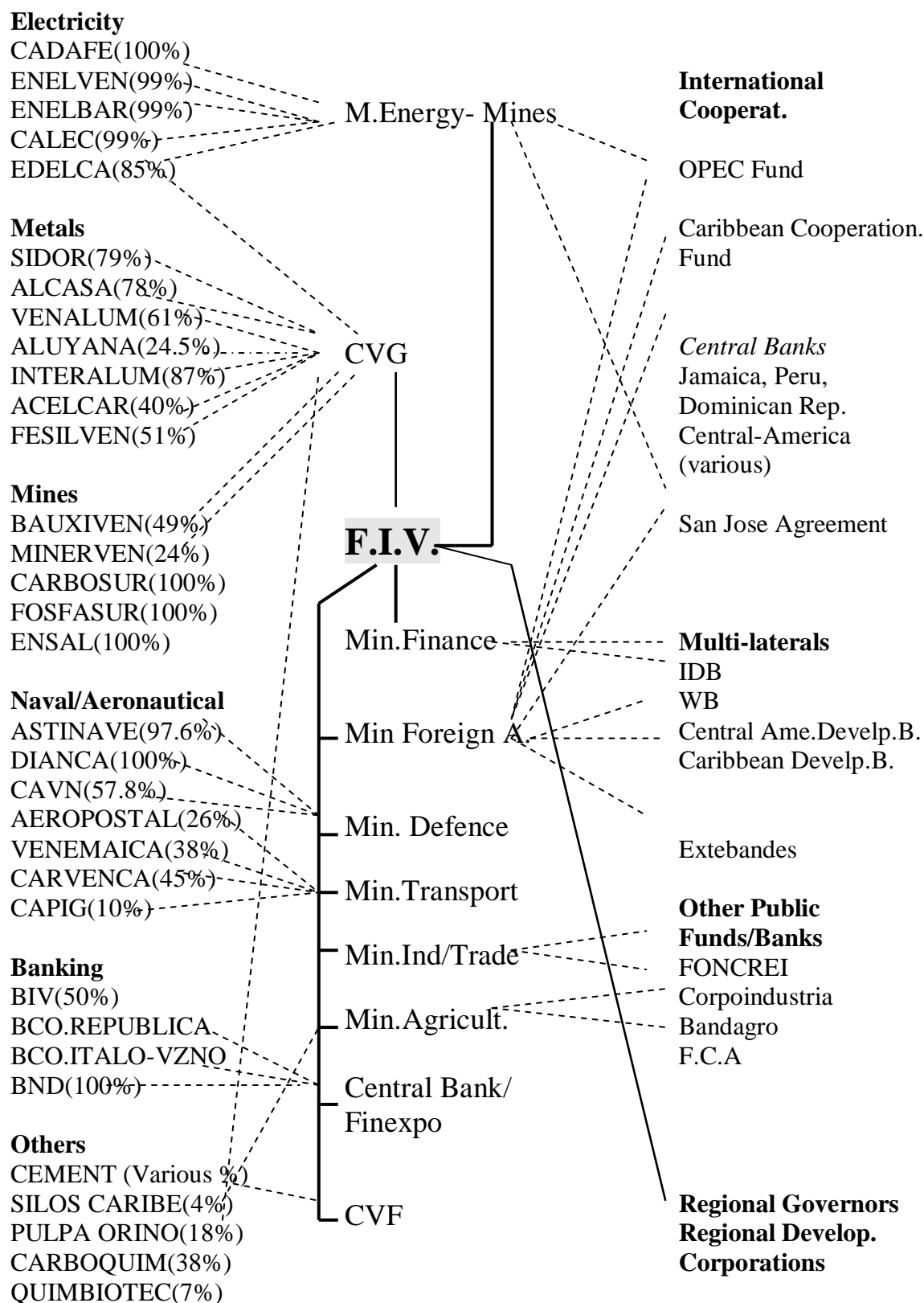
²³⁵ President Perez, Herrera and Lusinchi were all frequent travellers abroad. They signed numerous bilateral and multilateral agreements committing FIV’s funds.

²³⁶ Leopoldo Díaz-Bruzual, interview by author, Caracas, 31 March 2003

²³⁷ Luís Hinestrosa, *ibid.*

²³⁸ Luís Hinestrosa, *ibid.*

Figure 3.1 Relationships between FIV and other governmental bodies and state-owned companies.



Source: FIV's annual reports (various years)

of Minister of State. For a long period of time that position was held by a powerful AD figure, Leopoldo Sucre-Figarella. He was known as 'Tsar of Guayana' for his strong dominance over the region. He had been treasurer in most of the AD electoral campaigns and enjoyed a formidable grip on the party.

On another occasion, Carmelo Lauria, who served in several AD administrations and was also, several times, an influential Deputy, was appointed Minister of State in charge of the 'Basic Production'. This post combined oversight of many industrial projects, including several in which the Fund had capital participation or had lent significant amounts of money to. Conflicts of interest, friction and clashes were the order of the day. Carlos Rafael Silva, former president of both FIV and the Central Bank, remembered his public disagreements with Sucre-Figarella over the conduct of several companies in the Guayana industrial conglomerate. He commented, "Based on a concept of administrative hierarchy, Sucre-Figarella wanted to appoint the boards of these companies. This was the source of much dispute with him."²³⁹

On other occasions, power clearly shifted to the FIV's side. This was the case when Leopoldo Díaz-Bruzual was President of the Fund in the late 1970s. He enjoyed the trust of President Herrera Campins and exerted great influence over him. Díaz-Bruzual was known by the nickname 'Buffalo' for his strong character and reputation for stubbornness. Carlos Rafael Silva acknowledged, "Díaz-Bruzual enjoyed incomparable political power, to the extent that many of his cabinet colleagues feared him."²⁴⁰

Luís Hinestrosa, Díaz-Bruzual's Deputy, illustrated a typical power struggle. On one occasion, the Minister of Defence wrote to Díaz-Bruzual ordering the appointment of an admiral to the post of president of a shipyard company. Díaz-Bruzual strongly rejected what he considered to be an interference with the Fund's prerogatives. The admiral had been moved from his position and had left his home in one of the naval bases since his appointment to the shipyard company was considered a done deal. Díaz-Bruzual refused the appointment despite intense lobbying, including personal

²³⁹ Carlos Rafael Silva, *ibid.*

²⁴⁰ Carlos Rafael Silva, *ibid.*

visits to the Fund's offices by the admiral, during which he was ignored by the President.²⁴¹

This anecdotal evidence indicates that control over the Fund's decisions shifted over time. Moreover, decisions were made on the basis of non-institutionalised practices and informal channels and decision making points. The formal mechanisms set up for governing the Fund, the General Assembly and the Executive Board, were often overridden by 'unofficial' decisions taken elsewhere. The game of influence played around the President of the Republic to get the Fund's resources was one in which the Fund often did not even play. The rules established for the Fund's governance did not guarantee a transparent, professional, and ordered process to allocate such a significant amount of oil wealth. What is more, it was often necessary to 'bend' some of the FIV's regulations so that the outcome of those power games could be accommodated legally.

3.5 Distorting the Investment Fund

The legal framework of the FIV followed a common practice in Venezuelan legislation. Legal codes are often meticulous. They contain abundant details about less significant issues but are purposely scarce or ambiguous about major matters. This 'flexibility' commonly allows discretionary interpretation of the rules and regulations. FIV's statute was no exception to this. Relaxed interpretation, however, was accompanied by further modifications in order to suit particular needs. Two major rules, those for deposits and permitted investments, were either ignored or adapted to accommodate Presidential requests. Both changes proved sufficient to distort the Fund's original purpose.

²⁴¹ Luis Hinestrosa, *ibid.*

Deposits

On the deposit side, the Fund was conceived as the ‘money box’ to save oil revenue (a pamphlet titled ‘The Great Money Box’ was published by FIV in 1977).²⁴²

Consequently, replenishment of the Fund was critical for its purpose. The enforcement of the initial deposit rule, however, was erratic.²⁴³ In the first six years of operation, apart from the initial endowment of US\$ 3 billion, in three out of the subsequent six years the Fund did not receive any further deposit at all as can be seen in Table 3.5.

Table 3.5 Deposits to the Fund (1974-1989)

Year	Deposits (in Bs. million)	Deposits (in US\$ million)	% of that year's oil exports
1974	13,000	3,023	28.66
1975	7,532	1,752	21.05
1976	0	0	-
1977	2,500	581	6.38
1978	0	0	-
1979	0	0	-
1980	3,000	698	3.97
1981	11,609	2700	14.51
1982	5,601	1303	8.33
1983	2,696	449	3.24
1984	1,584	211	1.42
1985	1,359	94	0.73
1986	2,106	96	1.34
1987	2,777	92	1.02
1988	3,924	101	1.24
1989	0	0	-
Average			3.57%

Source: FIV annual reports (various years), BCV, Opec Annual Statistical Bulletin 2004

Constantino Quero-Morales, President of FIV during part of that period, responded to questions about why the Fund did not receive any resources, even though the law required it to do so: “There was a lot of friction inside the Executive. The Minister of Finance, Hector Hurtado, who had created the original formula for deposits to the

²⁴² Fondo de Inversiones de Venezuela, *La Gran Alcancia* (Caracas, FIV, 1977).

²⁴³ See initial Statue of the Fund, Official Gazette 30,420, 10 June 1974.

Fund, interpreted it in such a way that there was no new money for the Fund. After much struggling, I had to obtain an agreement with him in 1976. I reached a compromise. There was a budgetary appropriation to compensate the Fund for what it had given to the public enterprises.”²⁴⁴

This special contribution to the Fund was implemented through an ad hoc mechanism.²⁴⁵ In fact, the law authorising a credit to the Fund allowed FIV to receive Bs.2,500 million in 1977. Such an amount could have hardly come from applying the formula in the FIV Statute. It was a compromise solution for having ignored the FIV’s rules. More importantly, none of the other constitutional bodies (Comptroller General, Attorney General, and Legislature) initiated any action regarding the non-compliance with FIV’s rules. Jose Andrés Octavio, Comptroller General from 1976 to 1979, responded to the question of why that body did not act regarding the lack of contributions to the Fund saying, “We did not have the legal capacity to act in that matter. The Office of the Comptroller General is more concerned with the compliance with administrative procedures and regulations regulating budgetary and procurement matters. The procedure regulating the FIV contribution was not among them.”²⁴⁶

In 1979, the fall of the Iranian regime triggered another surge in oil prices. The FIV’s deposit formula was, however, changed in the middle of this second oil boom. Congress passed a reform of the FIV Statute.²⁴⁷ This new formula considerably reduced the annual contribution to the Fund. It established an automatic contribution of 5%, instead of the existing 50%, of revenues from tax on oil and gas exploitation and from income tax on those economic activities. Furthermore, worded ambiguously, the new formula defined an additional conditional contribution. The condition was based on a definition of a surplus in oil revenues. The Fund could obtain up to a 70% of that surplus in 1980 and from that year on that cap was to be reduced 1% yearly until it reached 50%.

²⁴⁴ Constantino Quero-Morales, *ibid.*

²⁴⁵ Official Gazette 1,899 Extraordinary, 26 August 1976.

²⁴⁶ Jose Andrés Octavio, interview by author, Caracas, 21 August 2003.

²⁴⁷ Official Gazette 2,709 Extraordinary, 30 December 1980.

The likelihood of this new source of funding being realised was threatened by two sources of uncertainty. First, the definition of the percentage applicable to the surplus was very broad (i.e. up to a 70%). Second, the definition of the surplus was dependent on the total budget figure. As a saving rule, this provision was feeble. It was the equivalent of defining ‘savings’ as whatever remains after one spends without restraint. In any case, as Table 3.5 shows, deposits to the Fund reached an average of 3.57% of oil exports in the following 10 years after that modification.

Investments

On the investment side, some modifications were introduced on the use of FIV resources. President Pérez, still sanctioned by the enabling law of May 1974, reformed the original FIV’s Statute less than a year after it was first passed.²⁴⁸ Among those modifications were the inclusion of two new areas for investment and the explicit inclusion of international cooperation, limited, however, to 15% of FIV’s total assets. Two other subtle but significant new rules were introduced. First, the explicit requirement to raise decisions to cabinet level although only when it ‘was required’. This euphemism allowed political oversight of ‘big’ decisions, thereby further removing the power from FIV’s senior management.

Second, the Fund was allowed to finance the so-called ‘internal’ component of projects,²⁴⁹ thereby contradicting the initial objective that only the external components could be financed. The former rule was intended to achieve the macroeconomic goal of not creating inflationary pressures, but additionally it provided the Fund authorities with a filter to apply whenever abundant requests for financing were received. Therefore, with the removal of that limitation, another crack in the original FIV edifice was opened. The original constraint for financing agriculture and manufacturing was effectively lifted, hence removing another restraint to indiscriminate spending.

²⁴⁸ Official Gazette 30,636, 3 March 1975.

²⁴⁹ By ‘internal’ component was understood all services, equipment and materials, needed for the projects, bought within Venezuela and paid in Bolívars.

Balance of FIV's operations

By 1988, before the Fund was converted to a privatisation agency by the neo-liberal second Pérez administration, the Fund had squandered a great portion of its assets. The total value of all the assets of the Fund on 31 December 1988 was US\$ 3,562 million. Tables 3.6 and 3.7 show how assets were distributed among economic sectors. More importantly, if all deposits to the Fund (see Table 3.4) are adjusted for inflation, FIV's net worth in 1988 was only 21.35% of the accumulated value of those deposits (US\$ 16,585 million of 1988).²⁵⁰

Table 3.6 FIV's assets to 31 December 1988

Assets	Main components	US\$ million	% of total
Liquid investments	Financial assets abroad	397	11.15
International cooperation	Loans under San Jose Agreement ²⁵¹	268	7.52
Domestic loans	See Table 3.7 for further details	143	4.01
Domestic shareholding	See Table 3.7 for further details	2,530	71.03
Trusts	Various Investment	139	3.90
Others	Dividends and interests	85	2.39
Total		3,562	100

Source: FIV, Special Report 1974-1988

Table 3.7 Distribution of domestic investments by economic activity

Economic activity	Domestic shareholding (% of each activity)	Domestic loans (% of each activity)	Total domestic investment as % of total assets
Electricity	33.50	74.00	49.84
Metallurgy	22.14	20.66	14.43
Mining	5.39	1.68	1.31
Naval/aeronautical	4.02	2.26	1.64
Banking	16.26	1.35	1.54
Others	18.70	0.05	0.78
As % of Total assets	4.01	65.54	69.55

Source: FIV, Special Report 1974-1988

²⁵⁰ This adjusted value was estimated based on the US Producer Price Index published in the Bureau of Labor Statistics.

²⁵¹ The San Jose Agreement was the name given to the energy cooperation scheme signed by Venezuela and Mexico with Central American and Caribbean countries.

Even allowing for some adjustment in the reported value of the FIV's assets, as a consequence of the devaluation of the Bolívar not taken into consideration by the financial reports, the enormous difference in value leaves no option but to conclude that the Fund failed to invest wisely the oil resources collected in two booms. After 15 years in operation the Fund ended up mainly concentrated in two areas: electrical (generation and distribution) and metallurgic (mainly aluminium and steel). Those two areas combined accounted for 31.15% of total assets in 1978, at the end of the first Pérez's administration. Then, at the end of the following administration in 1983 the share of electrical and metallurgic areas reached 67% of total assets and, as Table 3.7 shows. By the end of 1988 they represented 64.27%.²⁵² FIV net worth and distribution of assets in 1988 indicate that either the invested oil money was not diversified wisely or it had been translated to productive assets, as was the objective of the Fund. The Fund invested the oil revenues in a myriad of industrial projects that failed to preserve or create value for Venezuelans. It also invested in projects that violated the initial rules such as in the agricultural sector.

The FIV became almost the only shareholder (87.1% in average) in the public owned firms it invested in.²⁵³ Such high participation was possible because of the breaching of the rule that required the Fund to invest only in the external components of those industrial projects. The FIV was coerced by other ministers and the President to rescue ailing companies by injecting fresh capital, which contradicted the original 'seed' capital strategy intended when the Fund was formed.²⁵⁴ In summary, the Fund did not succeed in achieving its original goals. The neo-liberal administration that took power in 1989 realised that was the case and began work to develop a privatisation strategy to dispose of the FIV assets.

²⁵² All figures are author's estimates based on FIV's annual reports of 1978, 1982 and Special Report (1974-1988).

²⁵³ Fondo de Inversiones de Venezuela, Special Report (1974-1988).

²⁵⁴ Constantino Quero-Morales, *ibid.*

FIV's new role

President Pérez's second administration changed drastically Venezuela's economic policy, which included a new role for the FIV.²⁵⁵ It redefined the Fund's objectives not only as a disposing agency for its own assets but as executor of the policy of privatisation of other public assets.²⁵⁶ The new FIV's functions were extended to allow the Fund to act as a restructuring agent for a large number of state-owned enterprises in order to prepare them for privatisation. The FIV's Statute of 1980 was replaced with a Law passed by Congress in December 1991. This new law made official a *de facto* situation by establishing the end of all contributions to the Fund. Article 3, Section 2 of the new law phased downwards the annual contribution from the former 5% to 3%, 2% and 1% of oil fiscal revenues for 1992, 1993 and 1994 respectively. The Fund ceased to be a recipient of oil revenues from 31 December 1994.²⁵⁷

The next and final phase of the Fund's life began under President Chávez's administration. In October 1999, empowered by an Enabling Law of April 1999, the President reformed the Law of FIV.²⁵⁸ He watered down the privatisation drive that the 1991 reform had granted the Fund, although it did not completely eliminate privatisation.²⁵⁹ Furthermore, in May 2001, empowered again by another Enabling Law,²⁶⁰ President Chávez transformed the Fund into a development Bank, now called the Venezuelan Economic and Social Development Bank (Bandes).²⁶¹

FIV assets were transferred to other official entities save for some shares in public financial bodies. A special trust was established for FIV shares in two regional electricity distribution companies, apparently because they were thought to be ready for privatisation, although this did not materialise in the following years. Although it

²⁵⁵ Chapter 4 includes a lengthier discussion of Pérez's neo-liberal policies in 1989-1992.

²⁵⁶ Official Gazette 34,690, 9 April 1991.

²⁵⁷ Official Gazettes 4,350 Extraordinary, 19 December 1991; 4,927, 30 June 1995; 36,075, 30 October 1996 and 36,424, 30 March 1998.

²⁵⁸ Official Gazette 36,687, 26 April 1999.

²⁵⁹ Official Gazettes 5,396 Extraordinary, 25 December 1999; 5,463 Extraordinary, 10 May 2001.

²⁶⁰ Official Gazette 37,077, 14 November 2000.

²⁶¹ Official Gazette 37,194, 10 May 2001.

is fair to say it had been practically moribund for ten years, and in reality the Fund, as it was originally conceived in the midst of the oil boom of the mid-1970s, operated for only fifteen years, President Chávez's executive decision made the Fund officially extinct.

Conclusions

The Venezuelan Investment Fund (FIV) failed as an institutional tool to manage oil revenues on two grounds. First, it could collect only a limited amount of the oil income obtained during the 15 years it was operating (3.57% of oil exports on average). Moreover, that stretch of time included two major oil booms in 1974 and 1980. Second, it failed to create economic value within Venezuela. After its 15 years of operation, the Fund's net worth was only around 20% of what was collected by it.

The fate of the FIV was determined mainly by the failure of Venezuelan presidents to keep the numerous claims on those resources in check. Instead, they embarked on a myriad of industrial projects, spread geographically and over many sectors, which did not obey standards of financial diversification but responded to regional pressure groups and other public sector demands.

FIV clearly did not fulfil its institutional purpose. As a collecting revenue mechanism, the FIV was promptly overruled and managed to get only a small share of the vast resources coming from oil exports. Furthermore, the technically minded and fresh bureaucracy attached to the Fund was incapable of ensuring independent and economically sound decision making regarding the use of those resources.

Despite a careful design of the Fund, having obtained multilateral and other external sources of know-how in project management and a generous financial endowment in which to operate, the relatively well functioning FIV bureaucracy was not strong or effective enough to guarantee that the resources collected in the Fund were channelled to the best uses.

FIV's bureaucracy was often bypassed by other parts of the executive branch, notably the President. Decisions about FIV's investments were made externally. FIV was left only to accommodate decisions imposed from outside. Additionally, the FIV's own capacity to deal with all the projects in which it had invested in was diminished by their wide range. As the Fund became involved in many relatively minor projects, the bureaucracy had to devote resources to areas of little economic value and, at the same time, devote less attention to the monitoring of big and more valuable projects. Additionally, competence for control of those enterprises from other governmental bodies such as ministries and regional corporations contributed to lessening the FIV's capacity to exert its control.

Other constitutional bodies did not enforce the FIV. The legislative body, instead, granted Presidential petitions, directed at changing FIV rules to meet the President's preferences. Others, such as the Comptroller General or the Attorney General, did not challenge the Executive when it failed to comply with FIV's rules. Presidents were both unconstrained in their ability to influence the FIV's decisions, yet also unable or unwilling to keep the demands over funds in check. The initial decisions, governed by a belief in the need to deliver a great industrial expansion, and implemented under the 'irreversibility' strategy envisioned by President Pérez's cabinet in 1974, proved decisive in restraining the options available to the Fund after its initial set-up.

The share of the windfall from two oil booms was committed to an uncontrolled industrial expansion that resulted in, to a large extent, the squandering of those resources. The institutional arrangements designed to assure that such an industrial expansion met sound fiscal and economic rules failed completely. The Fund, created to avoid the fate of other governmental bodies such as the corporation for industrial-fostering (CVF) and to stay away from patron-client mechanisms typical of the bureaucratic Venezuelan public sector, ended up as another instrument for replicating uncontrolled State involvement in the economy. It simply served to revive a form of pork barrel politics. Venezuelans lost, with the FIV, the opportunity to make the noble and fine 'sowing the oil' dreams a reality.

Chapter 4

Governance of PDVSA: the ‘neo-liberal’ years (1989-1998)

This chapter reviews the relationship between the government and PDVSA during the period 1989-1998. The previous pattern of governance of the oil company was altered during this period. Oil institutions, largely unchanged since nationalisation in 1975, were modified both formally and in practice to allow first, private sector participation in the business and second a great deal of independence to PDVSA in setting its own directives and in influencing oil policy in general. The chapter argues that the shift of power to PDVSA was not a result of the perceived shift in ideological preferences generally attributed to politicians in the 1990s, but to a weakening in the State's capacity not only to control PDVSA but to survive political instability. Such weakening was not the design of the so-called ‘neo-liberal’ package of the early 1990s but the consequence of accumulated and unsustainable macroeconomic imbalances, earlier policy mistakes and de-legitimised political institutions.

Politicians had not changed their basic preferences toward the oil business. Old policy pillars such as the State's prevalence in the oil business, allegiance to Opec as an institutional tool to defend oil prices and suspicion toward PDVSA still characterised the mindset of politicians. Their capacity, however, to translate these traditional preferences into action was limited in the 1990s.

On the other hand, the post-nationalisation agenda regarding the oil business had been implemented successfully. New definitions in oil policy were in order. The oil conglomerate was in need of a new wave of investment and organisational reform. As these decisions needed to be dealt with, a weakened State lost much of the initiative and its technical grip, allowing the oil conglomerate to take the lead in setting policy. Although politicians resented this state of affairs, they had to accept this shift of

power as an inevitable outcome of that frail position of the political system during the turbulent 1990s. In the midst of an acute institutional crisis, the oil conglomerate emerged in a stronger position vis-à-vis its owner. Oil policy setting and implementation in effect shifted to PDVSA in a sort of ‘regulatory capture’ that altered the previous institutional arrangements. This relatively privileged position, however, prepared the terrain for a future rebalancing of the relationship between PDVSA and the State.

The chapter is organised into four sections. Section one sets out the backdrop for PDVSA-government interaction during the decade of the 1990s. Section two examines the process of setting oil policy at the beginning of the 1990s in the context of the neo-liberal reforms embarked upon by the Pérez administration. Section three explains how the political instability of 1992-1993 allowed PDVSA to advance its own policy preferences. Section four analyses the process of the ‘oil opening’ in the Caldera administration.²⁶²

4.1 Economic distress, the neo-liberal package and PDVSA

PDVSA-government interaction in the 1990s was influenced by three factors, which are scrutinised in this section. First, it examines the acute economic crisis that reached its peak in 1989. Second, it reviews the neo-liberal inspired measures undertaken by the Pérez administration to tackle the crisis and its implications for oil policy. Third, it discusses the perception most politicians and policy makers developed regarding PDVSA since its creation as an oil state-monopoly in 1976.

Economic crisis of 1989

Dubbed the ‘lost decade’ for the developing countries, the 1980s was a decade of great stress for the economies of the developing world. Although Venezuela still profited from the second oil boom in the early 1980s, it did not escape that pattern.

²⁶² ‘Oil opening’ was the term used to refer to partial privatisation of some parts of the oil business. This will be discussed in sections 4.3 and 4.4.

Despite half a decade of still healthy oil income (see Table 4.1), Venezuela's public finances were adversely hit in the 1980s. Growth in that decade was the worst since oil was discovered in the 1920s (see Table 4.2). The expansion of the public sector generated by the oil windfall in the 1970s created budgetary rigidities that reduced the margin for manoeuvre when oil income dropped. Between 1973 and 1982 the size of the budget rose six-fold in dollar term. The currency devaluation crisis of 1983 provoked a public finance collapse. The public budget shrank dramatically, reflecting oil price decline and the impossibility of shifting to external financing. The Debt crisis of 1982 had closed access to debt markets.²⁶³ To make matters worse, Venezuela's external debt had increased almost twelve-fold between 1973 and 1982.

Table 4.1 Oil exports in the 1980s

Year	Million US\$	% Paid as taxes & royalty
1980	17,562	69
1981	18,609	71
1982	15,633	65
1983	13,857	61
1984	14,824	67
1985	12,956	64
1986	7,178	56
1987	9,054	69
1988	8,158	62
1989	10,001	74

Source: Opec Annual Statistical Bulletin 2004, Ministry of Energy (compiled by Bernard Mommer)

Table 4.2 Annual rate of growth (1920-1999)

Decade	GDP per capita
1920-1930	13.7%
1930-1940	0.5%
1940-1950	7.5%
1950-1960	2.1%
1960-1970	2.2%
1970-1980	0.3%
1980-1990	-2.6%
1990-1999	-0.4%

Source: Ricardo Hausmann, "Venezuela's Growth Implosion: A Neo-Classical Story?" In Dani Rodrik (ed.) *In Search of Prosperity: Analytic Narratives on Economic Growth*, (Princeton: Princeton University Press, 2003).

²⁶³ In fact, Venezuela defaulted on its foreign debt in 1983. It regained access to financial markets with the Brady Plan in 1990.

Governments in the 1980s chose to postpone dealing with these imbalances. Table 4.3 summarises the main macroeconomic variables for the 1980's. The size of the budget tripled in nominal Bolívar between 1982 and 1989, although in dollar terms it dropped to less than a third. This was caused by constant depreciation of the currency that took the value of the Bolívar from US\$ 4.30 to US\$ 43.05 in 1989, a ten-fold devaluation. As two-thirds of fiscal income came from oil taxation in dollars, the recurrent devaluations of the Bolívar against the US dollar allowed governments to sustain increasing nominal budgets. Additionally, in six years of the decade the government faced a budget deficit with the inevitable inflation that accompanied unsound fiscal policies. Prices increased more than five-fold between 1982 and 1989 (524%). Workers felt this deterioration sharply, as nominal wages did not keep pace with inflation. Income per worker collapsed as real incomes in Bolívars in 1989 were only 41% of their 1982 value, or only 26.5% in dollar terms.

Table 4.3 Macroeconomic imbalances in the 1980's

Year	Consolidated government budget (million US\$)	Surplus/deficit (million US\$)	Inflation index (base 1984)	Exchange rate Bolívars/US\$ (to 31 Dec)	Income per worker US\$
1980	15,510	26	72.8	4.30	6,083
1981	23,657	(-) 907	80.4	4.30	6,557
1982	22,486	(-) 2,947	86.7	4.30	6,534
1983	19,038	(-) 1,019	92.8	7.50	3,949
1984	12,993	1,932	107.4	12.65	2,293
1985	13,730	3,148	117.2	14.50	2,213
1986	14,681	(-) 1,233	132.1	22.70	1,468
1987	10,662	(-) 2,173	185.3	30.18	1,420
1988	14,464	(-) 2,830	251.1	39.30	1,312
1989	8,352	58	454.5	43.05	1,734

Source: BCV; IMF Government Finances Yearbook (1990 and 1997); A.Baptista, Bases Cuantitativas de la Economía Venezolana 1830-1995 (Caracas, Fundacion Polar, 1997)

Politically, however, the strategy of postponement seemed to pay off as the country was relatively calm until 1989. General elections in 1983 and 1988 showed little abstention (12.25% and 18.1% respectively) and on both occasions the President was elected with a strong mandate (55.32% of the vote for President Lusinchi in 1983 and

52.76% of the vote for President Pérez in 1988, the two largest shares of the vote since 1958 when democracy was established). This apparent normality in the political arena was broken dramatically with the Caracazo riots on 27 February 1989, a mere three weeks into President Pérez second administration. When President Pérez took office in February 1989 Venezuela had accumulated years of acute economic imbalances that required immediate attention. To face this critical situation, his economic team adopted a different approach from traditional policies.

The 'neo-liberal' package

Venezuela's traditional policies since import substitution in the 1960s had been, barring minor deviations, driven by protectionism and the dominant role of the State in planning, delivering, controlling and regulating large parts of the economy.²⁶⁴ When Venezuelans went to vote in December 1988 there were no signs that a substantive change in these traditional policies was envisioned. The AD candidate Carlos Andrés Pérez ran his campaign based on the message that he represented the 'good times' of the early oil boom in 1974, when he served as President for five years. He gave no indication of what economic policies he would implement to tackle the accumulated imbalances.

In addition, Pérez was not the favoured candidate of the AD party machine. He got the nomination based on his high levels of popularity among the grassroots but against the preferences of senior AD officials and incumbent President Lusinchi. This fact created a tension that would explain many outcomes of President Pérez policies, including oil issues.²⁶⁵

Organisational strengths of the AD party worked, however, in Pérez's favour, to guarantee him a landslide victory in December 1988. Once elected, Pérez brought to

²⁶⁴ Sonia Barrios, El Moderno Estado Intervencionista En Venezuela. El Caso De La Corporacion Venezolana De Fomento (Caracas, CENDES-Universidad Central de Venezuela, 1998); Ricardo Hausmann, 'Venezuela's Growth Implosion: A Neo-Classical Story?' Dani Rodrik (ed.) In Search of Prosperity: Analytic Narratives on Economic Growth (Princeton, Princeton University Press, 2003); Moises Naim, Papers Tigers and Minotaurs (Washington DC, The Carnegie Endowment for International Peace, 1993).

²⁶⁵ Pedro Rosas-Bravo, interview by author, London 10 March 2003.

the cabinet an economic team, totally divorced from his party that had been preparing to assume governmental responsibilities outside the party sphere.

Pedro Rosas-Bravo, a member of that team, recalled, “The whole team was initially gathered around financier Pedro Tinoco. We regularly met Tinoco and other technocrats in his offices. There was a team of high minded professionals mainly trained abroad. The main characteristic was that none were directly connected to AD. Pérez was always adamant about excluding the AD from policy discussions and decision making.”²⁶⁶ Pérez named his technocratic cabinet and top positions favouring this team, although some concessions to AD were made, notably the Ministry of Energy. AD was still a powerful player since, among other things, it controlled Congress. Although they were short of a majority in both chambers (22 out of 46 senators and 97 out of 201 deputies) they usually succeeded in achieving a majority along with small parties.

Soon after inauguration in early February 1989, Pérez’s economic team launched the so-called ‘neo-liberal package’. The ‘package’, inspired in the Washington consensus²⁶⁷ set of policies, initially aimed at reversing many of the stances in State policies common since the 1960s. Table 4.4 shows the main goals of the ‘neo-liberal package’.

Oil policy as such was largely neglected in this initial layout of policy priorities in ‘the package’. This can be explained partly on conceptual grounds. Oil was regarded as a great distorter of the Venezuelan economy in the mindset of the principal architects of the new policies. Furthermore, traditional oil policy values such as state-ownership, allegiance to Opec and suspicion of PDVSA independence constituted one of the few points of convergence between President Pérez and his AD party. In fact, President Pérez’s apparent conversion to neo-liberalism was not deeply rooted in a pro-market stance.

²⁶⁶ Pedro Rosas-Bravo, *ibid.*

²⁶⁷ The Washington Consensus is a set of policies promulgated by many neoliberal economists as a formula for promoting economic growth in many parts of Latin America. It was first presented in 1989 by John Williamson, an economist from the Institute for International Economics, an international economic think tank based in Washington. It is so-called because it attempts to summarize the commonly shared themes advocated by Washington-based institutions at the time.

Table 4.4 The ‘neo-liberal package’

Area	Policy
Macroeconomic stabilisation	Floating exchange rate, removing price controls, liberalising interest rates, reducing real public spending, increasing prices of public sector goods.
Fiscal	Overhauling of tax system to reduce dependency on oil revenues
Public Debt	Reducing burden through negotiation
Trade	Liberalisation
Deregulation	Deregulating capital, goods and labour markets
Reform	Reforming agricultural, industrial and financial sectors
Foreign investment	Promoting capital inflows
Privatisation	Transferring to the private sector public utilities, state-owned enterprises and diverse assets
Social subsidies	Targeting the most vulnerable groups of society instead of widespread price subsidies

Source: Moisés Naim, Paper tigers & Minotaurs. (Washington, Carnegie Endowment, 1993)

In the words of Moises Naim, his Minister of Industry, “Pérez’s actions proved his determination to take whatever measures were needed to deal with the deep rooted causes of the nation’s long term economic deterioration. But more than a belief in the workings of the market per se, profound disillusion with the capacities of the State in a developing country seemed to guide his economic thinking and policy actions.”²⁶⁸

President Pérez appointed Celestino Armas as Minister of Energy and Mines. Armas was an AD member and one of the AD’s major oil experts. He had been highly critical of the internationalisation policy of PDVSA. He represented the traditional values AD had defended in oil policy. For instance, as long standing AD politicians, Pérez and Armas regarded Opec as one of the greatest achievements not only of Venezuelan oil policy but also of AD oil credo. Pedro Rosas-Bravo, a technocrat member of Pérez’s cabinet, commented, “We tried to avoid the issue of Opec with Pérez since he was very reluctant to accept a change in that area. Opec was a non-negotiable part of the policy paradigm.”²⁶⁹

²⁶⁸ Moises Naim, *ibid*.

²⁶⁹ Pedro Rosas-Bravo, *ibid*.

Moreover, some of PDVSA policies interfered with the implementation of the technocratic cabinet's policy priorities. On the one hand, PDVSA was planning a big expansion after 1990 (as discussed later in this chapter). On the other hand, one of government's priorities was to negotiate a re-scheduling of the external public debt within the framework of the Brady Plan²⁷⁰ and with support from multilateral organisations such as the International Monetary Fund and the World Bank. Pedro Rosas-Bravo recalled, "The main preoccupation of the economic team regarding PDVSA in 1989 was not to interfere with the negotiations of the debt plan with multilateral organisations, especially the International Monetary Fund. These organisations did not understand how the country could ask for the special conditions of the Brady Plan while at the same time the state-owned oil company was planning a big expansion on its own. PDVSA had such an influence on public finances that any plan that diverged from the government policy would create a large distortion in macro variables such as exchange rate, fiscal deficit, etc."²⁷¹

PDVSA: 'a state within the State'

The expression 'state within the State' became a frequent way to refer to PDVSA in political circles. PDVSA was no doubt different from the rest of the public sector. As social and economic conditions worsened in the 1990s, PDVSA became alienated from the rest of the public sector and seen as a secretive, arrogant and autonomous organisation.

Several factors account for that perception. First, PDVSA was built from a conglomerate of foreign companies that operated in an 'enclave'. The oil fields were confined to specific areas, generally apart from the great cities. The foreign companies imported not only their technological and administrative procedures but their own personnel and culture. Pablo Reimpell, who occupied high positions both under the multinationals and in the nationalised industry, said, "We were trained in a

²⁷⁰ The Brady Plan, named after US Treasury Secretary, Nicholas Brady, consisted in issuing the so-called Brady bonds in order to convert bonds issued by mostly Latin American countries into a variety or 'menu' of new bonds after many of those countries defaulted on their debt in the 1980's.

²⁷¹ Pedro Rosas-Bravo, *ibid.*

culture of responsibility for the work we did. Personal responsibility for our destiny is not a typical cultural trait of Venezuelans. We tend to rely more on external forces: the government, luck, God, to provide for our future.”²⁷² Ramón Espinasa defined the nationalisation as a “Venezuelanisation of the previous systems of personnel, management, finances, etc. Some sort of Anglo-Saxon enclave in a different culture”.²⁷³ Apart from PDVSA inheriting the ‘enclave’ nature of the former establishment it was also left with the same mistrust that engulfed former foreign companies’ operations in Venezuela. Gastón Parra, an oil sector academic who later became PDVSA president, pointed out how the historical experience of the country testifies to how the international corporations “unashamedly manipulated” accounting rules to pay less tax.²⁷⁴ Decades of struggling with them over how to divide the oil rents pie nurtured all sorts of negative views of the oil business.

A second difference between the PDVSA and the rest of the public bureaucracy was in its management of personnel. On the one hand, PDVSA managed personnel independently from public patronage. PDVSA people recognised that, by and large, political interference with personnel policy was insignificant. They considered themselves run by a system of internal meritocracy.²⁷⁵ Oscar Veracoechea, a middle manager in the oil company, said, “The meritocracy system functioned. Even if sometimes injustices might have been present, the system proved right in the long run. Many mistakes were corrected over time. One can say that the career of many managers reflected their potential and achievements.”²⁷⁶

On the other hand, patron-client relationships prevailed in the rest of the Venezuelan public bureaucracy. Politicians and other policy makers recognised the patrimonial quality of the Venezuelan public apparatus. Gumersindo Rodríguez, architect of the first Pérez administration economic policy (1974-1979) admitted as much. When they were designing the oil investment fund he said, “We did not want another

²⁷² Pablo Reimpell, interview by author, Caracas, 9 August 2003.

²⁷³ Ramon Espinasa, interview by author, Washington DC, 15 August 2003.

²⁷⁴ Gaston Parra, La apertura petrolera. Conflictos y contradicciones (Maracaibo, Centro Experimental de Estudios Latinoamericanos-Universidad del Zulia, 1999), p.26.

²⁷⁵ Various interviews by author in Caracas: Rafael Garrido, 7 August 2003; Mercedes Navarro and Victor Ramos, 2 May 2002; Oscar Veracoechea, 1 August 2003.

²⁷⁶ Oscar Veracoechea, *ibid.*

Corporación de Fomento” referring to a financial agency created to foster development that was already marred by inefficiencies and corruption charges.²⁷⁷

PDVSA employees enjoyed generous medical benefits, better salaries, holiday allowances, and even privileged access to services such as obtaining identification cards from the central government. For instance, it was common for PDVSA to arrange for public offices such as the National Identification Office (DIEX) to run special services inside PDVSA premises for their employees. Rafael Garrido, an internal auditor, illustrated this point, “We brought other parts of the Venezuelan public sector to PDVSA. We had privileged access to many services. It was clear we were living in a different State, in a place where we had benefits other parts of the State could not have.”²⁷⁸ Not surprisingly, these differences generated friction with other parts of the State and politicians. Reimpell recalled the evident animosity of members of Congress during public hearings.²⁷⁹ The media was full of stories of PDVSA managers’ excesses such as the use of the corporation’s private plane fleet.²⁸⁰

PDVSA tried to provide public works out of its core business. They embarked on projects ranging from fish preservation to large infrastructure projects such as motorways. Pablo Reimpell recalled, “Politicians and government officials usually asked for PDVSA involvement in public projects on the grounds that we were loaded with financial resources and the rest of the country was poor.”²⁸¹ Although PDVSA involvement in various public projects was rather successful,²⁸² attitudes toward the company did not change significantly.

Part of the perception followed PDVSA’s lack of reporting. Rafael Garrido acknowledged, “There was a view that not too much information should be passed to

²⁷⁷ Gumersindo Rodríguez , interview by author, Caracas, 20 March 2003.

²⁷⁸ Rafael Garrido, *ibid.*

²⁷⁹ Pablo Reimpell, *ibid.*

²⁸⁰ In the early 1990s public denunciation of these excesses even triggered an investigation by the Comptroller General.

²⁸¹ Pablo Reimpell, *ibid.*

²⁸² The so-called ‘Eastern motorway’ illustrated this point. This 250 mile-long motorway had been planned since the mid 1980s but it had not yet been completed, although a 50 mile portion of the motorway surrounding PDVSA petrochemical plants was finished on time by PDVSA.

politicians because they were likely to distort it.”²⁸³ Oscar Murillo, a former chief legal officer in PDVSA, agreed, “PDVSA did not give any more information to the government than was strictly required.”²⁸⁴

Politicians’ complaints about the degree of secrecy of PDVSA was long standing, and it was commonly referred to as a ‘black box’. Siuberto Martínez, a congressman from the opposition complained, as early as 1981, that there was a “tendency in PDVSA and affiliates to avoid control of Congress, which should not be tolerated”.²⁸⁵ This perception remained intact for decades. Earlier in 2002, in a conference in Caracas, former Senator Didalco Bolívar, affirmed, “In all my time as a member of Congress there was not a sole instance when I got the information I had requested from PDVSA.”²⁸⁶ Reflecting on the relationship of PDVSA and the State, former senior PDVSA officials, do not contradict this view of the conglomerate’s alienation. Alirio Parra, former Director of PDVSA, pondered, “PDVSA believed the State’s bureaucrats knew nothing and was not very transparent in its relations with the rest of the country.”²⁸⁷ Alberto Quiros-Corradi-Corradi admitted that PDVSA’s operations were inefficient, such as its procurement of unnecessary equipment on the grounds that “it was not worth giving the money to politicians”.²⁸⁸ Ramón Espinasa, former chief economist, also reflected, “PDVSA wanted the State to reflect the company and not the other way around. We aspired the country to be like ourselves.”²⁸⁹

4.2 Defining a new oil policy

By the end of the 1980s, the oil conglomerate had achieved all objectives set for the post-nationalisation agenda. Table 4.5 summarises the main operational goals, initially established in 1975 for the post-nationalisation period, which the industry had

²⁸³ Rafael Garrido, *ibid.*

²⁸⁴ Oscar Murillo, interview by author, Caracas, 19 August 2003.

²⁸⁵ Siuberto Martinez, cited in Gustavo Coronel Gustavo Coronel, The nationalization of the Venezuelan oil industry, (Lexington, Lexington Books, 1983).

²⁸⁶ Didalco Bolivar, speaking at a conference on State Decentralization at the Institute of Superior studies in Administration, Caracas, March 2002.

²⁸⁷ Alirio Parra, interview by author, London, 16 September 2003.

²⁸⁸ Alberto Quiros-Corradi, interview by author, Caracas, 29 January 2002.

²⁸⁹ Ramon Espinasa, *ibid.*

achieved by the late 1980s. Oil production, however, had substantially decreased. In the decade before nationalisation (1966-1975) Venezuela produced 3.32 million barrels/day on average. From nationalisation to the end of the 1990s (1976-1989) production dropped by 42% on average, to 1.91 million barrel/day. The Opec quota system had limited Venezuela's oil output during the second half of the 1980s. In fact, by 1989 Venezuela's quota was 1.81 million barrels/day and had been cut further to 1.75 million barrels/day after accepting a reduction of around 40,000 barrels/day at an Opec meeting in June 1989.²⁹⁰

Table 4.5 Main indicators of post-nationalisation agenda success

Area	Results
Oil Reserves	From 18,398 in 1975 to 59,040 million barrels in 1989 (220% increase)
Gas reserves	From 1,247 in 1979 to 2,993 billion standard cu m in 1989 (140% increase)
Refining capacity	From 1,445 in 1975 to approximately 3,000 thousands barrels / day in 1989 (40% in Venezuela and 60% abroad)
Organisational structures	From 14 operating companies in 1975 to 3 big operators in 1989
Tanker fleet	From 12 old tankers in 1975 to 14 in 1989 (mostly with new building standards)

Sources: Opec 1999 annual bulletin, Gustavo Coronel, *The nationalization of the Venezuelan Oil Industry*, (Lexington, Mass, Lexington Books, 1983), Cesar Baena, *The policy process in a Petro-State* (Ashgate, Aldershot, England, 1999)

There was a need to define policy guidelines regarding future development of the oil industry. The Ministry of Energy set up such guidelines, which PDVSA developed and updated in 1989.²⁹¹ They emphasised a gradual expansion of the production capacity²⁹² and an increase in the certification of oil reserves. It was a six-year plan (1990-1995) that included investment of about US\$ 30 billion in areas such as production (US\$ 12 billion), refining (US\$ 8 billion) and petrochemicals (US\$ 5 billion).²⁹³ The Ministry emphasised the idea of 'production potential' as distinct from 'production increase', as adherence to Opec's production ceilings was the favoured

²⁹⁰ The Economist Intelligence Unit. Country profile of Venezuela 1989-90.

²⁹¹ Rafael Guevara, interview by author, 31 January 2006.

²⁹² The potential was to be raised to 3.25 million barrel/day according to Sosa-Pietri. See Andrés Sosa-Pietri, *Petróleo y Poder* (Caracas, Planeta, 1993), p.86.

²⁹³ Special Supplement, *Euromoney*, May 1991.

policy of Minister Armas and President Pérez. Although Armas was adamant in complying with the Opec quota system, he also thought there was a need to exploit other parts of the oil business.

New oil policy

In 1989, Minister Armas set up an ad hoc task force (only partially related to the Ministry) to prepare the strategic guidelines for a renewed policy regarding PDVSA. He commissioned AD oil expert Rafael Guevara to put together a mixed group of oil experts. Table 4.6 shows the composition of that group.

This ad hoc task force, coordinated by Rafael Guevara, produced a set of recommendations for future policy that were presented to Minister Armas in January 1990 and subsequently approved by President Pérez. The recommendations were thought to complement the expansion plans already approved by the PDVSA shareholders meeting in December 1989.²⁹⁴

Table 4.6 Oil task force set by Minister Armas in 1989

Member	Affiliation
Rafael Guevara	AD advisor in oil issues
Luís Giusti	Vice President of PDVSA subsidiary Maraven
Atilio Osorio	Gas Manager at PDVSA subsidiary Corpoven
Arnaldo Salazar	Board Member PDVSA subsidiary Lagoven
Ulises Ramírez	Ministry of Energy and Mines
Ricardo Corrie	Ministry of Energy and Mines
Cesar Pieve	Private sector
Tarquino Romero	Lawyer
Joaquin Parra	Lawyer

Source: Rafael Guevara, *ibid.*, José Arrijoja, *Clientes Negros* (Caracas, Libros de El Nacional, 1998)

The proposal made by Guevara's team, however, contained a more significant recommendation. They favoured an opening up to private sector participation in the oil business for the first time since nationalisation. The rationale for this major shift in traditional oil policy was based on the need to develop three areas of the oil business

²⁹⁴ Rafael Guevara, *ibid.*

thought to be beyond PDVSA expertise or investment priorities. First, the need to make the heavy oil from the vast Orinoco basin economically exploitable; second, exploitation of the non-associated gas reservoirs in the north east of the country; and third, exploitation of matured oil fields that had been abandoned by PDVSA but were considered still to be profitable.²⁹⁵

In March 1990 a new board was appointed in PDVSA. President Pérez chose as PDVSA's president an outsider, former Senator and businessman Andrés Sosa-Pietri. Additionally, two members of the Guevara-coordinated team, Cesar Pieve and Arnaldo Salazar, were appointed to the Board. Luís Giusti was made responsible for the Strategic Planning of the conglomerate. Sosa-Pietri was not well received within the industry, which tended to resent outsiders. Sosa-Pietri had been associated in the past with the left wing MAS party but was also the nephew of Julio Sosa-Rodríguez, a traditional oil businessman strongly associated with Copei founder Rafael Caldera. Sosa-Pietri rapidly strengthened his position in the company by presiding over an organisational overhaul of the holding led by external consultants McKinsey that internally reinforced PDVSA's presidency.

The Guevara-coordinated team had suggested that the opening up of the oil business should be implemented under the legal framework of the Nationalisation Law (Article 5). This law allowed contracting private firms to provide PDVSA with a specific service under the so-called 'service contracts'. The Ministry of Energy proposed a legal mechanism known as an 'exploitation agreement', which would allow private firms to exploit oil reservoirs assigned by the Ministry. Sosa-Pietri initially rejected this on the principle that it was wrong to diminish PDVSA influence. In his own words, "To leave oil production that can be made by PDVSA with its own human resources and technical staff, in the hands of others is to condemn PDVSA to a secondary role."²⁹⁶ The Ministry went ahead with the initiative nonetheless.

²⁹⁵ Alirio Parra, *ibid.*

²⁹⁶ Andrés Sosa-Pietri, *ibid.* See also Congreso de la República, El Tema Petrolero (Caracas, Congreso de la República, 1991), p.116.

Exploitation of abandoned fields

Although Sosa-Pietri opposed the idea of the 'exploitation agreement' with private firms, the Ministry and PDVSA went ahead with them. Based on a beneficial interpretation of the Article 5 of the Nationalisation Law, they obtained the favourable opinion of the Permanent Energy Committee in the Senate in 1991. The Ministry chose 12 oil fields that had been inactive or abandoned by PDVSA and conducted two bidding rounds in 1992 and 1993. Three areas containing medium and light oil reservoirs were granted in 1992 and nine in 1993.

The contracts did not obtain approval from Congress because the interpretation given to Article 5 of the Nationalisation Law assumed that approval from the Permanent Energy Committee was sufficient. To comply with Article 5, the contracts were limited to 20 years plus a possible extension of five years where delays were caused by *force majeure*.

It was considered that the contracting companies were not producing oil as such but providing a service to PDVSA, therefore the tax regime was the same as that applicable to corporations (i.e. a rate of 34%). Similarly, as the oil fields were considered mature and not profitable under the established royalty rate of 16.67%, PDVSA obtained a dispensation from the Ministry of Energy to reduce the rate to 1%.²⁹⁷

The dispute settlement mechanism was a departure from a traditional legal stance Venezuela had maintained throughout the decades of negotiation with foreign firms. The disputes were set to be settled through national arbitration (under the International Chamber of Commerce's rules) and not the national courts.²⁹⁸ For international companies the preferred solution would have been international arbitration. The surrender of Venezuelan courts departed from the long held principle of settling disputes in the national courts established in former Venezuelan legislation after a well known legal precedent in Latin American jurisprudence known as the

²⁹⁷ Bernard Mommer, *The new governance of Venezuelan oil*, (Oxford, Oxford University Press, 1998), p.48.

²⁹⁸ Bernard Mommer, *ibid*.

‘Calvo clause’.²⁹⁹ Table 4.7 summarises the main terms of the exploitation contracts for the abandoned fields.

These bidding rounds carried out by the Ministry of Energy, with the agreement of a reluctant PDVSA, was the first step in what later became known as ‘oil opening’. The contracting terms were deemed compatible with traditional Venezuelan oil policy in general and the AD party’s stance on oil policy in particular. The qualification of inactive and abandoned fields constituted, in the eyes of AD policy makers, the ‘special case’ requirement contained in Article 5 of the Nationalisation Law.³⁰⁰ In this context, the so-called ‘oil opening’ was initiated under the auspices of the Ministry of Energy and an unenthusiastic PDVSA. Significantly, Congress agreed that exploiting abandoned fields was in the national interest and therefore compatible with Article 5 of the Nationalisation Law.

Table 4.7 Abandoned fields exploitation contracts

Topic	Contracting terms
Rationale to invoke ‘special case’ under Article 5	Contract applicable to abandoned oil fields (also known as matured fields)
Control required by Article 5	Foreign companies were considered a ‘service contractor’ therefore there were not association with PDVSA hence no control clause was required.
Tax rate	Corporate rate (34%) as contractors were not producing oil as such, they were providing a service to PDVSA.
Royalties	1% as the fields was considered mature and non-profitable with a 16.67% royalty.
Dispute settlement	National arbitration (under rules of International Chamber of Commerce) governed by Venezuelan law.
Changes in regulation	Not applicable.
Bidding parameter	Service fee and an oil fields development plan (a common plan was later devised by the Ministry).

Source: Bernard Mommer, *ibid*.

²⁹⁹ The Calvo Doctrine states that jurisdiction in international investment disputes lies with the country in which the investment is located. The principle, named after Carlos Calvo, expressed in his *Derecho internacional teórico y práctico de Europa y América* (Paris, 1868; greatly expanded in subsequent editions, which were published in French). It has since been incorporated as a part of several Latin American constitutions, as well as many other treaties, statutes, and contracts.

³⁰⁰ Official Gazette 1,779 Extraordinary, 29 August 1975.

PDVSA-government tension

PDVSA under Sosa-Pietri's direction became more defiant of Ministry of Energy directives than ever. Sosa-Pietri's strong personality is normally portrayed as a major cause of PDVSA policy at that time. First, it was his defiance of one of the more strongly held oil policy principles over several decades: the commitment to Opec. Sosa-Pietri considered adherence to Opec-imposed limitations as a 'blunder'. In July 1990, at an Oil conference, he publicly expressed the need to redefine Venezuela's position towards Opec.³⁰¹

Friction between the Ministry of Energy and PDVSA materialised, however, when Sosa-Pietri presided over a revision of the 1990-1995 plan approved by the Ministry of Energy in December 1990. The new plan, called the 'accelerated plan',³⁰² expanded previous production targets. The 1991-1995 plan required a significant investment (US\$ 48 billion over the six years). It included exploration of new fields, new refineries both in Venezuela and abroad, new petrochemical ventures, gas and carbon exploitation, updating the tanker fleet, research and testing of new heavy-oil processing technology and crucially expanding both production and, the Ministry of Energy's preferred policy, production capacity. By 1995 the total capacity was planned to reach 3.6 million barrel/day.³⁰³

Discrepancies with PDVSA's aspirations were, however, not confined to the Ministry of Energy. The so-called 'technocrats' faction of the cabinet was at odds with the plan as well. They resented the sheer magnitude of the plan on two grounds. Miguel Rodríguez, head of President Pérez's economic team referred to it as a "Father Christmas list". He was worried about the repercussions for the rest of the economy of a massive expansion of the oil sector based on the well known effect of 'Dutch disease'.³⁰⁴ Similarly, as it was mentioned earlier in this chapter, the economic team was very sensitive to the distortions that PDVSA's own actions inflicted on the main

³⁰¹ Andrés Sosa-Pietri, *ibid.*

³⁰² Andrés Sosa-Pietri, *ibid.*, p.137.

³⁰³ The Economist Intelligence Unit, Venezuela Country Profile (1991-1992).

³⁰⁴ Andrés Sosa-Pietri, *ibid.*, p.169. This was also ratified with Miguel Rodríguez, interview by author, Caracas, 22 May 2002.

macroeconomic variables and the possibilities of negotiating a public debt restructuring with the multilateral organisations on good terms.³⁰⁵

The rest of the Pérez team, so keen on liberalising the economy, were still worried about the plan and they tried to scale it down. Pedro Rosas-Bravo explained, “We had a problem with the IMF over how we should treat PDVSA. According to IMF policy PDVSA had to be considered as part of the Venezuelan public sector. PDVSA’s plan demanded substantial spending at a time when the IMF was requiring a cap on the fiscal deficit. PDVSA’s needs competed, in that context, with the rest of public spending. It was very difficult to justify a burgeoning oil investment on the one hand and public sector austerity on the other.”³⁰⁶

In addition, PDVSA expansion distorted monetary policy. The Central Bank, headed by influential Pedro Tinoco, another crucial figure of Pérez’s economic team, also pushed to limit the plan. Sosa-Pietri recalled that he tried to convince the IMF’s managing director, Michael Camdessus, to consider PDVSA as separate from the Venezuelan public sector and not to restrict Venezuela’s oil expansion.³⁰⁷

Financing the expansion plan was based mainly on the efforts of PDVSA. Sosa-Pietri favoured an expansion in Venezuelan oil production that contradicted the Opec binding agreements and collided with the Ministry of Energy’s position. As has been mentioned above, Minister Armas and President Pérez, as many other long standing AD politicians, regarded Opec adherence as ‘sacrosanct’.

Initially the compromise decision to get the plan going was to consider the expansion not as an increase in production but instead as an ‘increase in production capacity’. The rationale was that once the increased production potential was incremented then Venezuela would have been in a better bargaining position to demand a larger Opec production quota. Sosa-Pietri remembered that President Pérez personally corrected one of his speeches to stress that position.³⁰⁸ Sosa-Pietri, contradicting his political

³⁰⁵ Pedro Rosas-Bravo, *ibid.*

³⁰⁶ Pedro Rosas-Bravo, *ibid.*

³⁰⁷ Andrés Sosa-Pietri, *ibid.*, p.71.

³⁰⁸ Andrés Sosa-Pietri, *ibid.*, p.144.

masters, made clear his position that augmenting 'production capacity' was inherently linked to increasing production.³⁰⁹

The second source of financing sought by PDVSA was through a reduction in its tax obligations. The concrete proposition was to eliminate the fiscal mechanism known as 'Exports Fiscal Values' or, as they were formerly known, 'reference oil prices' ³¹⁰ that allowed the government to extract additional rent for each exported barrel. These reference prices were capped to 20% over the real selling prices. Sosa-Pietri campaigned determinedly for a reduction and ultimately the elimination of these fiscal values.³¹¹ Initially, the government agreed to reduce the cap to 15% but that decision was reverted soon after.³¹²

The expansion plan was clearly at odds with the rest of the macroeconomic restructuring intended by the technocratic cabinet. Additionally, its viability depended on modifying various pillars of traditional Venezuelan oil policy.³¹³ PDVSA was caught between a hostile AD, which had broken with old and long cultivated oil policy paradigms, and a government economic team that wanted to concentrate on restoring macroeconomic equilibrium and negotiating an agreement with the IMF.

The conflict was, however, temporarily resolved as a consequence of a fortuitous event. The invasion of Kuwait by Iraq in August 1990 brought a change in the oil market situation with important implications for Venezuela. As Venezuela was the most important oil exporter outside the conflict ridden Middle East region, it was expected to respond by increasing its production to compensate for the shortage in Iraqi and Kuwaiti exports. PDVSA seized the opportunity by promptly preparing for an immediate surge in production.³¹⁴ Sosa-Pietri stressed that the extra production and

³⁰⁹ Congreso de la Republica, *ibid.*

³¹⁰ 'Exports Fiscal Values' was a mechanism established in pre-nationalisation times to counterbalance a practice known as transferring prices, which consisted in declaring to the tax authorities a lower price for exports in order to avoid taxes.

³¹¹ Ramón Espinasa, *ibid.*

³¹² Andrés Sosa-Pietri, *ibid.*, p.154.

³¹³ See A.Sosa-Pietri, speech at the hearings at Congress in August 1990 in Congreso de la Republica, *ibid.*

³¹⁴ Congreso de la República, *ibid.*, p.123.

reduced Fiscal Export Values, which he was lobbying for intensively, would produce the financial resources to fund the expansion plan.

Minister Armas reacted more cautiously as he prioritised the diplomatic efforts to get Opec to agree on new quotas or production regimes in the light of the military conflict between two of its members.³¹⁵ Opec finally reacted by liberalising production quotas. In fact, Venezuela initially increased production by about 400 thousands barrels/day and in the subsequent years continued producing around 600 thousands barrels/day above the pre-conflict levels.³¹⁶ PDVSA had achieved the expansion initially required to finance the plan. At the same time, it did not affect its immediate fiscal contribution, thereby making the expansion palatable to the government.

PDVSA's rebellion

The consequences of the Iraq-Kuwait conflict in 1990 enabled a compromise solution between PDVSA's expansionist aspirations and the Government's more cautious position, which was motivated both from the cabinet technocrats' stance against too much investment in the oil sector and the governing AD party's traditional values regarding Opec and rent maximisation. Differences, however, soon appeared when Sosa-Pietri went ahead with the expansion plan assuming an 'accelerated' pace until reaching the production expansion he favoured.

Hostilities of the political world toward PDVSA were ventilated in a media campaign based on PDVSA excesses. Although involving relatively minor issues, such as the use of PDVSA plane fleet, the media exposure of PDVSA's supposed wrongdoings was a means of politicians seeking to contain PDVSA power. The Ministry of Energy and PDVSA openly collided in 1991. The conflict materialised as a personal dispute between Sosa-Pietri and Minister Armas.

³¹⁵ See the Minister's speech at the hearings at Congress in August 1990 in Congreso de la República, *ibid.*

³¹⁶ OPEC Annual Statistical Bulletin 1999.

In August 1991 Minister Armas sent a memorandum to PDVSA instructing them to restrain several activities that the PDVSA's board considered to be in their sphere of autonomous decision making (see Table 4.8). This triggered a crisis that illustrates PDVSA and government interaction. The Armas' directive to PDVSA prompted a reaction from the board and senior management.

Table 4.8 Main issues of the Minister Armas's directive in 1991

Area	Directive
New Subsidiaries	The Ministry must approve opening new subsidiaries.
Subsidiaries	The Ministry must approve appointments to the boards of existing subsidiaries.
Compensation policy	The Ministry must approve salaries, benefits and pension plans among other things regarding personnel compensation policy.
Debt	The Ministry must approve contracting new debt to finance new investment not included in the annual budget.

Source: Andrés Sosa-Pietri, *ibid.*

PDVSA's board sent a rebuttal letter to President Pérez who, in response, made clear it was his idea to order Minister Armas to produce the directive. Sosa-Pietri explained all concerns and said that the company could not be managed under the restrictions contained in Armas's directive. President Pérez agreed to make further consultations about the situation. Sosa-Pietri, however, did not wait for Pérez's consultations. He challenged the Ministry's orders by refusing to comply with the directive. President Pérez reacted angrily to such a defiant position. Sosa-Pietri offered to resign. Five days later, however, the Minister of Energy sent a substitute, watered down directive. The 'approval' requirement was changed to include the need to inform the Ministry about those decisions originally curtailed in the Armas's directive.

The PDVSA's board was split on how to respond although all members had signed the first letter. Sosa-Pietri, however, accepted this new version but asked PDVSA's legal department to produce a guideline on how to implement the new instruction. Some members of the board opposing Sosa-Pietri protested about the guideline. This second directive, however, settled the conflict.³¹⁷ New discrepancies between PDVSA

³¹⁷ The account of this episode relies on A.Sosa-Pietri recount of the facts in Chapter V of his

and the Ministry emerged months later when Sosa-Pietri opposed a reduction in the Venezuela's Opec quota. Soon after, President Pérez appointed a new Minister of Energy on the 28 February 1992 and new a President of PDVSA at the end of March 1992. With the replacement of both Minister Armas and Sosa-Pietri the conflict ceased. The conflictual relations between Armas and Sosa-Pietri, reflected as a clash of personalities but it also masked an increasing disagreement between the company and the Ministry over oil policy and over the roles both organisations played within the institutional arrangements responsible for policy implementation. This conflict will re-emerge later and it is discussed in following sections.

4.3 PDVSA's agenda and the political crisis (1992-1993)

The control, however difficult, exerted by the government over PDVSA during the first three years of the Pérez administration ceased in practical terms as the government's own stability was seriously shaken by critical events of 1992-1993, as summarised in Table 4.10.

Two attempted coup d'état in February and November 1992 severely debilitated the Pérez administration. Pérez bowed to the AD party's anti-reform stance. Corrales characterises Pérez's new approach as a switch "from party-neglecting to party-yielding".³¹⁸ On the oil front, the new Minister Alirio Parra and new PDVSA president Gustavo Roosen were brought in attempting to return Ministry-PDVSA relations to normality. President Pérez was finally removed from office in May 1993 when the AD led a process of impeachment that finally put a close to Pérez's presidency and halted his neo-liberal reforms.

AD, as the main political party in Congress (see Table 4.9), led the selection of Ramón Velazquez, an AD veteran, as the constitutional replacement of Pérez. Velazquez reflected on his appointment, "AD leaders approached me on several

book. See Andrés Sosa-Pietri, *ibid.*

³¹⁸Javier Corrales, Presidents without parties. The politics of economic reform in Argentina and Venezuela in the 1990s (University Park, The Pennsylvania State University Press, 2002), p.167.

occasions to offer me the Presidency. My initial reaction was to decline the offer. The situation with the Military was very tense. Minister of Defence Iván Jiménez was believed to have suggested that in the absence of a suitable candidate, someone from the military might be appointed. AD leaders insisted that I was a consensus candidate. I bowed to their pressure but I asked them not to leave me alone. I requested full congressional support for urgent measures the country needed to overcome economic crisis.”³¹⁹

Table 4.9 Composition of Congress (January 1989-January 1994)

Party	Deputies	%	Senators	%
AD	97	48.26	22	47.82
Copei	67	33.33	20	43.48
Others	37	18.41	4	8.70
Total	201	100	46	100

Source: Consejo Nacional Electoral

AD and Copei joined forces not only to appoint Velazquez but to grant him the full congressional support he asked for when he accepted the Presidency. In particular AD leaders changed their former hostile stance against some of the economic measures contained in the former President Pérez’s reform package. For instance, AD voted for granting Velazquez legislative powers to decree the Value Added Tax, a fiscal measure the Pérez technocratic cabinet had long asked for. Corrales explains this, observing that AD hostilities toward reform were more a reaction against an administration they did not trust. In Corrales words, “For most AD leaders, it was not the reforms themselves, but rather their implementation by a party hostile to the government that was objectionable.”³²⁰ Copei cooperation was understood as essential to the stability of democracy threatened by the political crisis in 1992-93. Table 4.10 shows the main events of the 1992-1993 crisis period.

³¹⁹ Ramon Velazquez, interview by author, Caracas, 22 August 2003.

³²⁰ Javier Corrales, *ibid.*, p.163.

Table 4.10 Main events of political crisis 1992-93

Date	Event
4 February 1992 (am)	Aborted coup attempt. Military insurrection led by Lieutenant-Colonel Hugo Chávez (later to be President). Although defeated, Chávez and other insurgents obtained instant popularity.
4 February 1992 (pm)	Copei's founder Rafael Caldera denounced in Congress Pérez's neo-liberal government as responsible for economic and social deterioration as the cause of conditions that explain popular appeal of insurgency.
March 1992	President Pérez called for a united government. A council of personalities was convened to reflect on the political situation. Some Copei members were brought to the cabinet that was reshuffled sidelining some of the so-called neo-liberal technocrats.
November 1992	Another aborted coup attempt. Military insurrection led by Air Force's General Visconti.
December 1992	Charges of corruption were levied against President Pérez. Attorney General Escovar Salom gathered evidence of misusing funds by President Pérez.
May 1993	Supreme Court ruled that there was enough evidence to raise a legal case against President Pérez. Congress impeached President Pérez and named an interim President, Octavio Lepage, acting President of Congress.
6 June 1993	Congress appointed Ramón Velazquez as President, ending Pérez's term.
December 1993	Elections for President were held amidst rumours of Military discontent. A coup is allegedly aborted following US State Department's strong signal of disapproval of military action. ³²¹ Rafael Caldera is elected by a narrow margin as President. Congress is split and no party got a majority although AD party remained as the largest plurality.

Source: El Nacional, El Universal, Venezuela Analítica

PDVSA's agenda during the Velazquez's interim government

Two important events took place during Velazquez's short presidency (June 1993 to February 1994). First, the long-demanded elimination of the Fiscal Export Values was passed by Congress in June 1993. Similarly, the so-called 'strategic associations' to

³²¹ See Janet Kelly and Carlos Romero, 'Getting along: issues in U.S. Venezuelan relations' (paper presented in Latin American Studies Association, Miami, 16-17 March 2000).

exploit heavy-oil reservoirs in the Orinoco basin were also approved by Congress in September 1993.

PDVSA lobbied heavily for suppressing the Fiscal Export Values since they had embarked on the expansion plan originally approved by the government in 1989, and later expanded, albeit controversially, under Sosa-Pietri's command in 1990, relying on their own funding. The temporary increase in Venezuela's Opec production quota brought extra resources that were used for financing the plan. These extra resources, however, had to be supplemented by loans. The elimination of the Fiscal Export Values was the definitive solution to restoring financial health to the company. The PDVSA's rationale was always that the Treasury was to be recompensed in the future by the extra production brought by the expansion plan.³²²

The embattled AD and the weak interim government of Velazquez were in no position to challenge PDVSA aspirations again. With an extremely deteriorated economic, social and political environment, PDVSA was thought of as the only pillar of the Venezuelan State that remained strong. AD and Copei finally granted PDVSA the elimination of the Fiscal Export Values. Congress passed a law phasing them out from 1993 to 1996.³²³ The immediate effect was mild as the exports values were capped at 16% for 1993 (originally they were 20%). That limit was cut to 8% in 1994 and 4% in 1995. They were completely eliminated after 1996.

The rationale of future compensation to the Treasury never materialised. PDVSA's fiscal contribution declined in the following years, as Table 4.11 shows, although production increased during those years. More significantly, PDVSA contributions to the Treasury as a percentage of its gross income collapsed during the 1990s. These figures supports claims made by PDVSA's critics that the elimination of the Fiscal Export Values was to favour an expansion of PDVSA at the expenses of the rent collected by the State.³²⁴ PDVSA obtained the elimination of Fiscal Export Values in similar fashion to other controversial policies such as the internationalisation policy in

³²² Ramón Espinasa, 'Petróleo y Desarrollo Económico'. Mimeo. 1997. p.12.

³²³ Official Gazette 35,243, 30 June 1993.

³²⁴ See Carlos Mendoza Potella, 'Apertura petrolera: nombre de estreno para un viejo proyecto antinacional' in www.soberania.com, 13 March 2003.

the 1980s. In both cases government acceptance of PDVSA's preferred policies largely responded to a *fait accompli*.³²⁵ In this case, PDVSA achieved a preferred policy by emphasising the urgent need created by the *fait accompli* of being already in the midst of the implementation of a plan approved only half heartedly by the Ministry of Energy.

Table 4.11 Fiscal contribution of PDVSA (1990-1999)

Year	Fiscal contribution in million US\$	As % of PDVSA gross income
1990	10,209	69
1991	8,609	64
1992	7,116	59
1993	5,250	46
1994	4,948	41
1995	4,806	33
1996	9,082	47
1997	7,059	36
1998	3,327	25
1999	5,699	32
Average 1976-1989	8,577	66

Source: Ministry of Energy (compiled by Bernard Mommer), Opec Annual Statistical Bulletin 1999

Strategic associations

The second major event during the Velazquez interim government was the approval by Congress of the so-called 'strategic associations'. Congress approved in September 1993, with AD and Copei votes, a framework contract allowing PDVSA's operating subsidiaries to enter into association with private firms for exploitation of the extra-heavy oil reservoirs in the Orinoco basin. The rationale for these associations was based on the fact that extra-heavy oil represented a special case that could be regulated through Article 5 of the Nationalisation Law. In fact, the technical case for this was widely accepted. Extra-heavy oil (characterised by a very low API gravity³²⁶) requires a further processing called 'upgrading' to make it marketable.

³²⁵ Cesar Baena, The policy process in a petro-state: an analysis of PDVSA's (Petroleos de Venezuela SA's) internationalisation strategy (Aldershot, Ashgate, 1999).

³²⁶ API Gravity is a specific gravity scale developed by the American Petroleum Institute

The technology for such ‘upgrading’ was not fully developed at that time either by PDVSA’s own research and development arm or by foreign firms. The case for exploiting such a type of crude oil was compelling based on the estimates of Venezuelan reserves. They were deemed probably one of the largest reservoirs of crude oil in the world. Venezuelan policy makers were persuaded of the need to develop both the oil fields and the technology. Equally, they were convinced that PDVSA should have concentrated on the exploitation of more profitable medium and light oils.³²⁷

Moreover, the Supreme Court ruling of 1991 that clarified the requirement of Article 5 of the Nationalisation Law regarding the control of any business association with the private sector allowed PDVSA to enter into minority shareholdings. In fact, the Ministry had included these associations in the expansion plan approved in 1989.³²⁸

Additionally to extra-heavy oil reservoirs, there were vast reserves of non-associated³²⁹ natural gas in the northeast coastal region of Venezuela. To Venezuelan policy makers this was another ‘special’ case that could be regulated by Article 5. In fact, the exploitation of those gas reservoirs was the project that motivated the Supreme Court interpretation in 1991. Consequently, Congress approved, in August 1993, the terms for the contract to exploit gas in association with foreign firms Shell, Exxon and Mitsubishi.³³⁰

The tax regime was relaxed for both gas and extra-heavy oil as these two activities were considered different from the rest of PDVSA core business. This was achieved through a modification of the Tax law applicable to corporations. Congress approved in September 1993 a reclassification of those activities (gas and heavy oil) as non-hydrocarbon enterprises, therefore obtaining a different tax treatment.³³¹ Table 4.12

(API) for measuring the relative density of various petroleum liquids. Heavy oil is defined as having an API gravity below 22.3 °API.

³²⁷ Alirio Parra, interview by author, London, 27 February 2006.

³²⁸ Rafael Guevara, *ibid.*

³²⁹ Non-associated gas is obtained from gas reservoirs that do not contain crude oil.

³³⁰ José E. Arriola, Clientes Negros. Petróleos de Venezuela bajo la generación Shell (Caracas, Libros de El Nacional, 1998), p.64.

³³¹ Bernard Mommer, *ibid.*, p.49.

shows the main characteristics of the contracts of the so-called ‘strategic associations’. The most controversial was the arbitration clause that, again, did not follow the traditional Calvo clause discussed earlier in this chapter. Furthermore, this time the contracts required ‘international’ instead of ‘national’ arbitration.

The extra-heavy oil rich Orinoco basin was not a traditional part of Venezuelan oil reservoirs administered by the Ministry of Energy. The ‘strategic associations’ was a solution envisioned by both PDVSA and the Ministry taking into account technological needs and PDVSA investment priorities. Additionally, the conditions agreed responded to demands by potential investors since this exploitation of extra-heavy oil was considered risky due to the untested upgrading technology.³³²

Table 4.12 Main terms of the strategic associations in gas and heavy oil projects

Topic	Contracting terms
Rationale to invoke ‘special case’ under Article 5	Contract applicable to abandoned extra-heavy oil and unexploited natural gas reserves.
Control required by Article 5	Shareholding majority not required. Control can be achieved through contractual terms granting special privilege to PDVSA shares (known as ‘golden shares’).
Tax rate	Applicable to non-hydrocarbons enterprises (34%).
Royalties	Flexible. Possibility that the Ministry reduce the 16.66% royalty applicable to other oil activities. Royalty was later reduced to 1%. ³³³
Dispute settlement	International arbitration (under rules of International Chamber of Commerce) governed by Venezuelan law.
Changes in regulation	PDVSA would compensate foreign firms for unexpected changes in rules that caused harm to them.

Source: Official Gazette of 9 September, 1993

³³² Alirio Parra, *ibid.*

³³³ PDVSA (www.pdvsa.com).

Alirio Parra, Minister of Energy when the associations were contracted, recalled, “It was not an easy task to attract investors to a relatively new area of the business. Even companies that were convinced about investing found difficulties in obtaining financing.”³³⁴ In any case, the legal framework approved in September 1993 allowed PDVSA to enter in four association agreements in extra-heavy oil, one in heavy oil and one in gas (see Table 4.13).

These ‘strategic associations’ together with the exploitation agreements of 1992 and 1993 for abandoned fields constituted what later was presented as a fully fledged ‘oil opening’. Each process responded to different needs, and in both cases the Ministry of Energy envisioned the ‘opening’ as a solution to problems such as abandonment of mature oil fields, the need to make exploitation of extra-heavy oil reservoirs profitable and exploration of the gas reservoirs. The ‘oil opening’ was, however, significantly expanded in the following administration of President Caldera. The next section discusses this process.

Table 4.13 Strategic associations 1993-1997

Project	Type of oil/gas	Foreign private investors	Approved in	Status
Petrozuata	Extra heavy oil	Conoco	1993	In operation (*)
Sincor	Extra heavy oil	Total and Statoil	1993	In operation (*)
Cerro Negro	Extra heavy oil	Exxon-Mobil and Veba	1997	In operation (*)
Ameriven	Extra heavy oil	Arco, Philips and Texaco	1997	In operation (*)
Boscan	Heavy oil	Chevron	1995	In operation
Cristobal Colon	Natural gas	Shell, Exxon and Mitsubishi	1993	Never entered into operation

(*) They were producing in total 600 thousand barrels/day of ‘upgraded’ oil by 2006 according to PDVSA.
Source: PDVSA; Bernard Mommer, *ibid.*

³³⁴ Alirio Parra, *ibid.*

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4.4 The extended ‘oil opening’

The so-called ‘oil opening’ process was intensified during Caldera’s administration. PDVSA took complete control of the process as the administration was in a precarious position from its very beginning. President Caldera was elected in a close election in December 1993. In the same election, the resulting Congress was divided. No party could get a majority. Caldera’s own coalition of small parties obtained only about 25% of the deputies (lower chamber) and 22% of senators (upper chamber).

A major economic event marked the first two years of the administration. Three weeks before the inauguration of President Caldera an acute banking crisis erupted, in which about 70% of the banking system collapsed. The public bail out implied a fiscal burden of about 20% of GDP.³³⁵ More importantly, facing the banking crisis consumed Caldera’s economic team for two years. No other major policy was addressed during that time bar an attempt at fiscal reform.

Caldera had campaigned on a platform of strong opposition to the previous administration’s reforms. Caldera coined a phrase that summarised his policy stance. Mocking the links of President Pérez’s policies to the multilateral organisations based in Washington, specially the IMF, Caldera promised that his priority was the ‘people’ by saying he had signed a “letter of intent with the people”. Once in power, Caldera’s economic team was left with, on the one hand, the promise of distancing itself from

³³⁵ Gustavo García et al., Lecciones de la crisis bancaria de Venezuela (Caracas, IESA, 1998), p.274.

Washington based organisations, and on the other hand, few alternative policy options, in large part owing to the unexpected bail out of collapsed banks.

Oil policy was, in this context, an area where Caldera was less tied by campaign promises. The initial signs were of a reliance on PDVSA not only for the conduct of oil policy but also to help his government to address other urgent needs. Caldera initially assigned a businessman linked to the oil industry, Julio Sosa-Rodríguez, to coordinate of the economic team. Sosa-Rodríguez, named Minister of Finance, assembled a team of close advisors that included Jose Moreno-Leon, former Minister of Energy during the Herrera administration (1979-1984) as responsible for the tax agency (Seniat) and Luís Grisanti, an executive from Sosa-Rodríguez's own oil company, as Deputy Minister of Finance.³³⁶ Some senior PDVSA officials were 'lent' to the government. Gustavo Roosen, PDVSA's president, was made responsible for administering Banco Latino, the largest collapsed bank. Soon after, another PDVSA official, Alonso Velazco, was appointed to an emergency board created to address the banking crisis (Junta de Emergencia Financiera). Other PDVSA staff was re-assigned to various public bureaucratic positions. Among others, J. J. García, former Chief financial officer in PDVSA, was named Director of Public Credit within the Ministry of Finance. Edgar Olivo, a PDVSA official, was made responsible for the technical aspects of a new office created to administer an exchange control mechanism in 1994 (OTAC). David Moran went to serve as advisor to the Deputy Minister of Finance Grisanti.

Caldera picked Edwin Arrieta as Minister of Energy. Arrieta was an oil businessman who was serving as Ambassador to Kuwait at the time. More surprising, Caldera selected Luís Giusti as president of PDVSA. Caldera was determined to name an insider in PDVSA, contrasting with his predecessor's policy. High ranking executives within the industry were considered for the job. The selection of Giusti was an unexpected one since several executives were considered to be ahead of him in the so-called system of 'meritocracy' within the oil conglomerate. Alirio Parra, the incumbent Minister of Energy, recalled, "Sosa-Rodríguez was testing possible candidates from the high ranks such as presidents of PDVSA's main operating

³³⁶ Julio Sosa Rodríguez was the main shareholder of a petro-chemical group of companies (Venoco) that was a leading lubricant manufacturer among other petro-chemical ventures.

subsidiaries. I was consulted by Sosa-Rodríguez in that regard. I gave him a list of possible candidates agreeing with the proposed contenders such as Trinkunas, Volkenborn, and Mandini. I recommended Giusti as member of the board but not for President. He had impeccable credentials but was too young and an older generation of executives was in front of him. He was certain to be President of PDVSA one day but not in 1994.”³³⁷

Giusti had been associated, as an advisor in oil matters while he was acting as PDVSA staff, first with Eduardo Fernández, Secretary General of Copei, and later to Caldera’s contender in the 1993 election, Oswaldo Alvarez Paz, the candidate of Copei. Nonetheless, Giusti was appointed President of PDVSA. He stayed in that post for the entire Caldera administration. During this time, PDVSA developed an unprecedented and orchestrated lobby campaign in political circles for the new policy ideas.³³⁸ Even before, Giusti was convinced of the need to explain PDVSA ideas about oil policy. In Giusti’s words, “We had the opinion that in order to have a long term oil strategy for Venezuela, we had to make sure that the people who will eventually lead the country knew what was going on.”³³⁹ He acknowledged that this was a new position among PDVSA’s top ranks. He also admitted having initiated consultations with the political world because “one of the problems that the oil company had long had was that it had effectively been absent from the country, even hidden from the country at times, immersed in a sort of crystal bubble...when talking to politicians was a sin”.³⁴⁰

Giusti’s public exposure caused him to be heavily identified with the main issues of oil policy during this time. He later presided over major organisational changes in PDVSA and assumed the leadership of oil policy. Internally, Giusti pushed the reorganisation of the oil conglomerate from the holding-operating subsidiaries scheme to a fully integrated oil company. Externally it was, however, the direction he took in the so-called ‘oil opening’ that represented a major shift in oil policy.

³³⁷ Alirio Parra, *ibid.*

³³⁸ José E. Arriola, *ibid.*, p.26-32.

³³⁹ José E. Arriola, *ibid.*, p.35.

³⁴⁰ José E. Arriola, *ibid.*, p.36.

Pushing the PDVSA's 'oil opening' agenda

As early as 1994 PDVSA was determined to develop the 'opening' in other areas of the oil business. Claus Graf, PDVSA's Vice President, acknowledged that although the Ministry of Energy had not approved the opening of the oil business for conventional crude oil, PDVSA had got "an authorisation to contact politicians to test the water regarding the feasibility of the project".³⁴¹

PDVSA thoroughly prepared the next 'round' of the oil opening³⁴². Juan Garantón, a lawyer from the law firm that advised PDVSA on the contracts for the round, recalled, "PDVSA assembled a very well prepared team for the negotiations with the foreign companies and for conducting the bidding process. PDVSA's professionals were at the same level as any of the big international companies."³⁴³

PDVSA developed a comprehensive rapprochement with the principal political and economic actors. PDVSA donated computer and other office equipment to the Ministry of Energy. Additionally, it paid the Ministry's staff extra bonuses to improve their salaries³⁴⁴. Alí Rodríguez, President of the Energy Permanent Committee in the Chamber of Deputies, remembered that PDVSA invited the members of the committee to visit its subsidiaries abroad. PDVSA provided the committee with information technology equipment since, as Rodríguez lamented, the committee did not have a single computer or other means to allow them to do their job.³⁴⁵

Local capital and labour welcomed the oil opening. As one of the earliest criticisms of the oil opening was that the participation of local private firms was neglected or severely limited,³⁴⁶ PDVSA later offered to reserve five exploration areas for

³⁴¹ Claus Graf, interview in *Gerente*, Caracas, October 1994, p.54.

³⁴² 'Round' was the term used to refer to the process of auctioning conventional oil fields for exploration and later exploitation.

³⁴³ Juan C. Garantón, interview by author, Caracas, 19 August 2003.

³⁴⁴ Raiza Prazet, interview by author, Caracas 7 March 2004.

³⁴⁵ Ali Rodríguez cited in José E. Arriola, *ibid.*, p.120.

³⁴⁶ Among others, Alberto Quiros-Corradi, an influential oil analyst and former PDVSA senior official, concentrated his critics on this point. He wrote numerous articles in *El Nacional* about his position regarding the oil opening.

Venezuelan companies alone or in partnership with foreign investors. Venezuela's private oil sector embraced PDVSA's auctions of new fields, if only to acquire greater participation.³⁴⁷

Organised labour supported the oil opening as well. Carlos Ortega, President of the main oil union (Fedepetrol) endorsed the oil opening as a positive measure to overcome the economic crisis of that moment.³⁴⁸ Coincidentally, the other main discussion during the time of the oil opening under Caldera's administration was the reform of the social security system, especially the severance and retirement protection regime. One of the ideas that the main labour union, CTV,³⁴⁹ was keen to explore was that the State would pay accumulated government debt to workers (related to the social security system) with shares or other financial instruments issued by PDVSA. The oil opening was in line with those aspirations.³⁵⁰ Although PDVSA never made public its institutional position regarding the transfer of shares to the workers, the implicit support of the main labour union was to its advantage.

PDVSA also approached the university sector. PDVSA offered the three main universities with oil engineering faculties three marginal oil fields allowing them to obtain financial resources for the universities as a whole and to serve as training and research resources.³⁵¹ PDVSA had successfully accomplished consultations with all important actors when it finally submitted its proposal to the Ministry.

PDVSA presented its proposal to the Ministry of Energy in November 1994 for further consultation with the President of the Republic. Luís Giusti, President of PDVSA, described this process: "We prepared the framework, bound in grey and blue

³⁴⁷ See Miguel Bocco, 'La apertura petrolera y el sector privado', El Nacional, 21 January 1996 and Hugo Hernandez-Raffalli, 'Plantea la Camara Petrolera del Zulia', El Nacional, 12 July 1997.

³⁴⁸ Carlos Ortega cited in 'Apertura petrolera', El Nacional, 21 January 1996.

³⁴⁹ CTV stands for Confederación de Trabajadores de Venezuela.

³⁵⁰ Federico Ramirez Leon, President of CTV, cited in 'Una solucion de Estado', El Nacional, 17 January 1996.

³⁵¹ Gastón Parra, La apertura petrolera. Conflictos y contradicciones (Maracaibo, Centro Experimental de Estudios Latinoamericanos-Universidad del Zulia, 1999), p.81.

books, of the opening and we went to the office of the Minister Arrieta in mid-November...Arrieta presented it to President Caldera and later to the cabinet.”³⁵²

President Caldera deemed the proposal too complex and postponed its consideration for weeks. Caldera’s objections were based on his traditional position regarding the participation of private investment in the oil business. He had opposed the infamous Article 5 in the debate of the Nationalisation Law in 1975 and was highly critical of the foreign companies during the concessions regime.³⁵³

Additionally, his political success in 1993 opposing the neo-liberal orientation of President Pérez put him at odds with the idea of privatisation of part of the oil business. On the other hand, Caldera had been warned of flaws in the PDVSA proposal by his political allies and later his Minister of Planning Teodoro Petkoff. Petkoff and a PDVSA advisor, Bernard Mommer, who opposed several aspects of the proposal, informed Caldera about the shortcomings of the proposal. Other members of Caldera’s cabinet such as Minister of Planning Werner Corrales, and PDVSA’s board member, Hugo Pérez La Salvia (who was also a former Minister of Energy and close advisor to Caldera), also voiced reservations about the project.³⁵⁴ Despite this opposition, President Caldera gave his approval to the project in December 1994.

Caldera’s administration was extremely weak. Since his narrow victory in the elections of 1993 Caldera had faced serious threats to his position. First, support from the armed forces was not guaranteed as was evident by the well known intervention of the US State Department to discourage military unrest in December 1993. Second, the banking crisis that saw almost three-quarters of the banking system disappear in less than a year brought widespread social unrest. There were numerous protests in Caracas and other large cities by pensioners, small depositors of the collapsed banks, saving associations and other groups hit by the closure of the banks.

To make matters worst, Caldera lacked a majority in Congress to back several legislative measures that were needed to attend to the unprecedented financial crisis.

³⁵² Luís Giusti cited in José E. Arrijoja, *ibid.* , p.106.

³⁵³ Gastón Parra, *ibid.* p.20.

³⁵⁴ Jose E. Arrijoja, *ibid.*

Caldera sought a political alliance with AD. AD secretary general Luís Alfaro-Ucero gave his support. This was first manifested when AD threw its full support behind the legislative measures to tackle the financial crisis.³⁵⁵

While both the banking crisis bail out and the resulting recession created a severe deficit in the public finances, PDVSA was the only immediate source of fiscal revenue.³⁵⁶ PDVSA represented not only a secure source of fiscal revenues but the best guarantee of securing international financing in such dire fiscal conditions.³⁵⁷ In light of these financial problems, the government seriously considered issuing a financial instrument called 'Oil bonds' in the international market in order to raise funds for the banking crisis bail out.³⁵⁸ The idea was that such bonds were to be directly guaranteed with PDVSA's crude oil sales. PDVSA's president Luís Giusti defended the usefulness of these bonds.³⁵⁹ The government, however, opted for financing mainly through the Central Bank and internal debt. The possibility of using PDVSA directly in the resolution of the banking crisis showed the reliance of Caldera's administration on the sole part of the public sector that remained strong.³⁶⁰

Alí Rodríguez, president of the Energy Permanent Committee in the Chamber of Deputies, suggested that the timing of the presidential approval was related to the need for opening international financial flows.³⁶¹ As President Caldera was about to attend the first presidential Summit of the Americas in Miami, USA, in mid-December, the oil opening was certainly the most concrete and immediate signal Venezuela could have sent to the international financial markets to attract the urgently needed capital inflows. The Caldera administration was in no position to reject an

³⁵⁵ I drew this observation from my own participation in meetings with AD officials and the Banking bail out agency, Fogade, in preparation for the legislative measures to face the crisis. See also, Luís Alfaro Ucero cited in 'Conversaciones con Alfredo Peña', El Nacional, 7 June 1996.

³⁵⁶ Only the central government had deficits of US\$2.04 billion and US\$1.6 billion in 1994 and 1995 respectively. See International Monetary Fund, Government Finance Statistics Yearbook, Washington DC, 1997.

³⁵⁷ Real GDP fall by 2.8% in 1994. See Gustavo García, *ibid.*, p.88.

³⁵⁸ 'Bonos petroleros' in Spanish.

³⁵⁹ Luis Giusti, interview in Gente de Finanzas, Caracas, December 1994-January 1995.

³⁶⁰ I drew the information about the Oil bonds and these conclusions from direct personal experience. I was part of the team within the bail out agency, Fogade, that participated in discussions with Central Bank and PDVSA staff about these issues.

³⁶¹ Ali Rodríguez cited in José E. Arriola, *ibid.*, p.110

initiative so strongly advocated by senior PDVSA officials that, at the same time, helped the government's efforts to solve the severe financial crisis.

In fact, the oil opening was to become one of the central points of the so-called 'Agenda Venezuela'.³⁶² This 'agenda' was an attempt by the Caldera administration to promote policies that basically was based on the same rationale as the previous President Pérez so-called 'neo-liberal package'. Similar to Pérez's policy package in 1989, the Venezuelan Agenda included the financial assistance of the multilateral organisations such as the IMF. The oil opening played a double policy role in that context. On the one hand, it signalled a policy of welcoming private investment as was discussed earlier. On the other hand, it allowed an expansion of the oil sector in particular and the economy in general without committing significant public investment. The IMF had demanded a contraction in public spending including a limitation in PDVSA investment plans.³⁶³

The 'oil opening' and the Congress (1994-1999)

Seven months after Caldera's cabinet approved the PDVSA's proposal Congress endorsed the next phase of the oil opening. Congress approved the guidelines for the contracts PDVSA used in the auctions they were preparing for 1996.³⁶⁴ The process, in a much divided Congress (see Table 4.14), was prolonged even with PDVSA's intense lobbying efforts with the main political actors.

The main political parties supported the PDVSA's proposal. Copei was content with the idea in principle. The previous personal association of PDVSA's president Luís Giusti first with Secretary General Eduardo Fernandez and later with Copei's former presidential candidate Oswaldo Alvarez Paz assured a sympathetic position to PDVSA's proposal. Secondly, Caldera's political understanding with AD secured its

³⁶² The 'Agenda Venezuela' or Venezuelan agenda was the name under which government officials grouped a series of policy announcements.

³⁶³ The IMF position in the early 1990s was discussed earlier in this chapter. I drew these conclusions from my conversation on the subject with two interviewees, Pedro Rosas (interview by author in London several times) and Teodoro Petkoff, interview by author in Caracas in March 2003.

³⁶⁴ Official Gazette 35,754, 17 July 1995.

support. AD's position, however, was not consistent. The oil opening as presented by PDVSA conflicted with AD's traditional values in oil policy. AD's traditionalists such as Carlos Canache-Mata and Luís Piñerua-Ordaz opposed the proposal. AD's Secretary General Luís Alfaro-Ucero, however, threw his full support behind PDVSA's proposal although he later opposed a possible further privatisation of the company.³⁶⁵

Table 4.14 Composition of Congress (January 1994-January 1999)

Party	Deputies	%	Senators	%
AD	55	27.1	16	32
Copei	53	26.1	14	28
Caldera coalition (Convergencia and MAS)	50	24.6	11	22
Causa R	40	19.7	9	18
Others	5	2.5	0	
Total	203	100	50	100

Source: Consejo Nacional Electoral

Major resistance to the proposal came from the 'Radical Cause' party (Causa R). This party's congressman Alí Rodríguez played an active role as co-chairman of the bicameral committee of 23 deputies and senators specially set up to discuss the proposal. Some members of Caldera's coalition in Congress, such as the President of the MAS party Gustavo Márquez, also opposed some aspects of the proposal. The measure was finally passed with the votes of Copei, AD and the parties of Caldera's coalition. The final version included minor concessions such as a proposition from Gustavo Márquez to grant the Ministry of Energy the responsibility to select the president of the committee to be created to control each association. According to Alí Rodríguez, several members of the bicameral committee voted in favour of the proposal, obeying party whips.³⁶⁶ The political agreement between President Caldera

³⁶⁵ Carlos Canache Mata, 'Una republica en venta?', *El Nacional*, 15 May 1996; Luís Pinerua Ordaz, '¿Venezuela, una republica en venta?', *El Universal*, 8 June 1997; 'Conversaciones con Alfredo Peña', *El Nacional*, 26 January 1996; 'Alfaro Ucero: AD facilitara una nueva política petrolera', *El Nacional*, 19 October 1998; 'Alfaro reitero que PDVSA y Edelca no son empresas privatizables', *El Nacional*, 4 August 1998.

³⁶⁶ Ali Rodríguez cited in José E. Arrijoja, *ibid.*, p.145.

and the AD party ensured sufficient additional votes, along with those of Copei, to proceed with the oil opening.

Although Congress consented to the PDVSA oil opening initiatives, it resisted PDVSA's privatisation drive on two occasions. First, the lower chamber of Congress passed 'an accord' to outlaw the possibility of privatising PDVSA. The 'accord' was proposed by the AD party and got the backing of Caldera's coalition (MAS and Convergencia) and Causa R.³⁶⁷ The Congress's reaction can be seen as a response to public announcements by senior PDVSA officials, President Giusti among them, suggesting the possibility of the privatisation of PDVSA. Giusti is reported to have said in a meeting with the main business association Fedecamaras in May 1996 that he preferred not to talk about the privatisation of the oil industry because "it was counterproductive at this moment. I am afraid it could get me in trouble with Congress when they discuss the oil opening contracts".³⁶⁸

Congress's accord against full privatisation in June 1996 signalled that the approval of the eight oil opening contracts was a limited legislative endorsement of the participation of foreign capital in the oil business instead of a fully fledged welcoming of that policy. Congress's cautious attitude to transferring oil business activities to the private sector was again demonstrated in 1998. PDVSA prepared a bill regarding the opening of the hydrocarbons internal market. Notably, the intention was to allow free market competition in petrol distribution and commercialisation.³⁶⁹ Even if Congress approved the bill, an important modification was introduced regarding the power to set petrol prices.³⁷⁰ The approved bill retained that power in the hands of the Ministry of Energy.³⁷¹ Internal petrol prices have always been a controversial policy issue. Congress's modification reiterated the traditional view of mainstream political parties that Venezuelans are entitled to low petrol prices. PDVSA's call for deregulating petrol prices went unheard.

³⁶⁷ See 'El Congreso rechaza venta parcial de acciones de PDVSA', El Nacional, 19 June 1996; See also Official Gazette 35,991, 1 July 1996.

³⁶⁸ 'Conversaciones con Alfredo Peña', El Nacional, 9 May 1996.

³⁶⁹ Oscar Veracoechea, *ibid.*

³⁷⁰ Gaston Parra, *ibid.*, p.52.

³⁷¹ Official Gazette 36,537, 11 September 1998.

The 'oil opening' auctions of 1996 and 1997

PDVSA conducted two rounds of auctions under the new regulatory framework. The first auctions were known as the 'profit sharing agreements' round. PDVSA chose thirty areas of light and medium oil to be auctioned although the first ten areas were relatively unexplored. As the legal framework was based on Article 5 of the Nationalisation Law, this was a loose interpretation of that article, since it was original conceived for 'special circumstances'. The previous uses of the Article in the cases of extra-heavy oil, natural gas and abandoned medium-oil fields were less controversial as these were deemed non-traditional oil activities and hence 'special cases'. The new chosen areas, however, contained oil of similar quality to the oil that constituted the core business of PDVSA.

The new agreements basically allowed PDVSA to transfer its right to explore designated plots to private companies who acted as contractors. The companies, selected in a public auction, acquired the right to explore for up to nine years. In case of successful discovery of oil, the companies would enter into a consortium in which PDVSA had the option of participating up to 35%. The consortium could exploit the plot for 20 years and a possible extension of 10 years. Table 4.15 shows the main contractual terms included in the profit sharing agreements.

The fiscal regime was flexible. In particular, the royalty could be reduced following the attainment by PDVSA of special treatment for those associations.³⁷² Additionally some accounting rules such as depreciation rates, inflation adjustments, and tax credits for investments were given a favourable interpretation to make the investments more attractive to foreign firms.³⁷³ Finally, municipal taxes were waived. This later concession triggered a legal action in the Supreme Court by opponents of oil opening, who deemed this measure unconstitutional.

³⁷² The Ministry of Energy signed on the 5 December 1995 an agreement with PDVSA's subsidiary, CVP, to make the royalty payment subject to the profitability of the exploitation measured by internal rate of return. In practice, these calculations were made by PDVSA not by the Ministry.

³⁷³ Gastón Parra, *ibid.*, p.21.

PDVSA conducted a bidding round in June 1996. Eight out of ten auctioned areas were granted to international consortiums. The eight contracts, based on the general framework approved by Congress in July 1995, were presented to Congress in March 1996 to final approval. They were all approved swiftly in June 1996.³⁷⁴

Table 4.15 Profit sharing agreements (1996) main contractual terms

Topic	Contracting terms
Tax rate	Rate applicable to conventional crude oil (67.7%).
Royalties	Flexible. Possibility that the Ministry reduce the 16.66% royalty applicable to other oil activities. Royalty to be adjusted according to profitability of the exploitation (measured by the internal return rate to be calculated for each project).
Control required by Article 5	Shareholding majority not required. Control achieved through contractual terms granting veto power to a Controlling Committee of four members, two chosen by foreign companies and two chosen by PDVSA. One of the PDVSA appointees was to be the President of the committee (In case of a tied vote, the President had a decisive vote).
Dispute settlement	International arbitration (under rules of International Chamber of Commerce) governed by Venezuelan law.
Changes in regulation	PDVSA would compensate foreign firms for unexpected changes in rules that caused harm to them.
Bidding parameter	Companies bid an excess profit levy called Participation of the State in Profits or PEG (Participation del Estado en las Ganancias) for the January 1996 bidding round. For the following round (June 1997) the bidding parameter was a Valorisation Factor (Called FDV), a lump sum paid in advance for the right to explore the auctioned plot.

Source: Bernard Mommer, *ibid.*, p.53

The next oil opening round was held in June 1997. The contracts were slightly different. The chosen areas were those requiring a “reactivation of production or incremental production”.³⁷⁵ The contracts were considered ‘services contracts’ similar to those used in the 1992-1993 bidding conducted by the Ministry of Energy. PDVSA offered 20 areas (five reserved for local investors) and received a favourable response for 18. Table 4.16 shows the principal features of the two auction rounds.

³⁷⁴ Gastón Parra, *ibid.*, p.15-20.

³⁷⁵ Heliodoro Quintero, interview by author, London 22 March 2006.

Table 4.16 Main aspects of the 1996-1997 auctions

Aspect	Auction of January 1996	Auction of June 1997
Areas	10 prospective areas to be explored.	20 productive areas that need reactivation or incremental production.
Extension (total)	17,953 Square Kilometres	7,699 Square Kilometres
Reserved for local investors	None	Five (16% of total)
Bidding parameter	PEG (participation of the State in profits). An extra levy on profits after normal tax and royalty payments).	FDV (factor of valorisation). Lump sum payment for right to exploit the reservoir.
Areas granted	8	18
Approval of Congress	All eight contracts approved in June 1996.	Not explicit congressional approval (based on 1992-1993 services contracts).

Source: Gastón Parra, *ibid.* Own estimations.

Conclusions

The relationship between PDVSA and the administrations of Presidents Pérez, Velazquez and Caldera was dictated by the increasing weakness of the government. After the worst decade of growth on record, Venezuelan governments in the 1990s tried to restore stability to the economy and to the political system. Those efforts not only failed but fostered more economic problems and more political instability. In this context, PDVSA emerged not only more independent of its political masters but the supreme force in setting and implementing oil policy. This supremacy was reached through a combination of the old strategy of advancing decisions prior to their scrutiny by the government (*fait accompli*) and taking advantage of opportunities brought by external factors such as the Iraqi invasion of Kuwait in 1991 as well as, in particular, the government's continuous need to address political and economic crises.

The increasing involvement of PDVSA in policy issues such as the administering of Venezuelan oil reservoirs brought politics to the company in an unprecedented

fashion. Two former patterns of PDVSA-government relationships were altered. First, PDVSA progressively took over the Ministry of Energy's responsibilities and second, PDVSA developed an unprecedented strategy of lobbying politicians and policy makers to advance its preferred policies.

The Ministry of Energy initially sought to implement a limited opening to private investors outside PDVSA's core activities as a solution to the specific needs of the Venezuelan oil mix (abandoned oil fields, extra-heavy oil, and natural gas). An initially reluctant PDVSA, however, assumed the leading role in implementing that initiative to the point that, in a sort of regulatory capture, it ended up controlling all aspects of the policy. Moreover, when the government was extremely weak due to political instability, PDVSA took the initiative itself.

The oil company pushed the so-called 'oil opening process' to its core business, contradicting traditional Venezuelan oil policy values.³⁷⁶ PDVSA's political masters could do very little to resist the oil company's offensive since not only were they concerned about their own survival but also because PDVSA was the only reliable source of stability and the only economic sector through which to attract immediate investment to boost the economy.

Partial privatisation of the oil business, however, was not a response to the neo-liberal reforms of the 1989-1992 period. As is illustrated by the ad hoc commission created in 1989 to set oil policy, the Ministry had lost its technical capacities long before President Pérez introduced his reform package. The Venezuelan public bureaucracy had been debilitated for decades. Having lost its capacity to steer policy, the government had to rely on its hierarchical prerogatives to appoint or to remove from office senior PDVSA officials thought to be in line with its preferences.

This state of affairs gave PDVSA enough room to advance its own preferences. PDVSA not only pushed its own expansion but it assured control of the private investment-led expansion. In the 1990s, and especially in the second half of the decade, the government had little choice but to rely on PDVSA's judgement.

³⁷⁶ It was known in Spanish as the 'apertura'.

President Caldera's permanently weak position prevented him from resisting PDVSA initiatives. Moreover, PDVSA's leading of the process of oil opening suited Caldera's immediate political needs.

Chapter 5

The Stabilisation Fund (1991–2005)

This chapter reviews the implementation of the stabilisation fund established in 1998. The motivation for the creation of this fund stemmed from a long held belief among economists that fluctuations in oil-generated revenues had, over time, harmed the Venezuelan economy. The Stabilisation Fund aimed to deal with volatile oil prices and to provide the Venezuelan Treasury with a steady income from oil taxes.

Establishing a stabilisation fund had been considered in the past by several separate administrations. In practice, however, it was attempted seriously only by the technocratic administration of President Pérez (between 1989 and 1993). Pérez, however, failed to create the fund, and it was in 1998, during the last days of the Caldera administration, that the Macroeconomic Stabilisation Investment Fund (FIEM) was finally passed into law. This chapter examines the process that led up to the creation of the Fund, and its implementation during President Chávez's years in office (1999-2005). The chapter also analyses the changes the Fund has undergone during the Chávez administration, and the extent to which it has departed significantly from the original.

The findings of this chapter support the argument that Venezuelan institutions are malleable according to the preferences of the President. They suggest that oil income tends to be depleted by the President according to his perceived short term needs, leaving no margin for allocating part of those funds for later use (i.e. inter-temporal allocation). This dynamic resulted in politicisation of the management of the fund. The executive branch disposed of the collected funds as it saw fit for the President's political needs. Established rules of the game were ignored or modified by the Executive. As on similar occasions neither the legislature, nor the judiciary, nor the

Central Bank were able to constrain the Executive's ability to implement its preferences. In this context, the Venezuelan State, during the period 1999-2005, did not allow for the institutionalisation of a stabilisation fund despite the fact that the Constitution of 1999 had a clear mandate to do so.

The chapter is organised into four parts. It first examines how the idea of having a stabilisation mechanism for the volatile oil income evolved among Venezuelan policy makers, and its evolution from a proposal in the early 1990s to legislation by the end of the decade. Second, it reviews both the events surrounding the creation of the Fund in 1998 and the modifications made to the regulation of the Fund in the first years of the Chávez administration. Third, the chapter analyses how the fund was run down between 2001 and 2003, and finally, section four explains how the Fund moved away from its original purpose.

5.1. Towards the creation of a stabilisation fund

The oil price is set in the international market. Despite efforts from producers, such as Opec, oil prices respond to complex conditions, which more often than not are beyond their control. Analysts have observed that historically the oil price follows an erratic path. The random characteristics described by Powell means that predicting oil prices is extremely difficult.³⁷⁷ This difficulty has major consequences for the Venezuelan economy. Given the importance of the oil sector to the overall economy, fluctuations in oil prices ripple throughout the economy, and impact significantly on the most important macroeconomic factors.

The economic literature suggests that 'stabilisation' mechanisms can offset some of the distortions that fluctuations in commodity prices bring to producers.³⁷⁸ This complex economic theory can be simplified in every day parlance as 'saving for a

³⁷⁷ Andrew Powell, 'A general methods of moments for estimating the parameters of Stochastic Processes for asset prices: An application to the Jump-Diffusion Process of O', Discussion Papers 76, (Oxford, Institute of Economics and Statistics, 1989).

³⁷⁸ Ricardo Hausmann and Andrew Powell, El Fondo de Estabilización Macroeconómica. Lineamientos Generales (Draft for discussion prepared for Ministry of Planning, Caracas, 1990).

rainy day'. Venezuelan policy makers first considered a stabilisation mechanism in the first decades of the Twentieth Century. During the dictatorship of Juan Vicente Gomez (1908-1935), his Minister of Finance, Román Cárdenas, floated the idea and created a similar, but short-lived mechanism for that purpose. The Venezuelan economy, even before oil was a significant economic force, depended on exports of major commodities such as coffee beans.

Later, in the so-called 'Trienio' period (1945-1948), Rómulo Betancourt, the leader of the dominant political party, AD, contemplated the idea of a stabilisation mechanism. Betancourt mentioned the need for the creation of an anti-cyclical fund for use in any crisis resulting from unfavourable oil prices.³⁷⁹ A proposal presented to Congress in 1948 was not approved because, according to Betancourt himself, it was not possible to conclude the discussions about it that year due to the accumulation of legislation being debated.³⁸⁰ In fact, in November 1948, a coup d'état thwarted the 'Trienio' agenda. Betancourt was particularly sensitive to what he characterised as the 'miner mentality' of Venezuelans. He complained that, "Venezuelan behaviour was typical of mining communities, as in the California gold rush days. There was a national urge to spend until one's pockets were empty."³⁸¹ When Betancourt became President (1959-1964) he oversaw the passing of a law by Congress, which included a form of stabilisation mechanism that would have been managed within the Central Bank. The clauses of the Central Bank Law of 1960 regarding the stabilisation fund, however, were never implemented.

The concept of a stabilisation mechanism lay dormant until the early 1990s. Hausmann explained that the Venezuelan economy adopted other mechanisms to adjust to oil price fluctuations.³⁸² He identified three periods in which Venezuela managed oil rents in a relatively orderly manner. First, the 1943-1957 period was characterised by a fixed exchange rate, free access to foreign exchange, free trade and balanced budgets. The fiscal arena was the necessary 'shock absorber' of the

³⁷⁹ Rómulo Betancourt, Venezuela, oil and politics (Boston, Houghton Mifflin, 1979).

³⁸⁰ Rómulo Betancourt, *ibid.*

³⁸¹ Rómulo Betancourt, *ibid.*

³⁸² Ricardo Hausmann, 'Venezuela 2000: el futuro de la economía no petrolera', in Héctor Silva Michelena, ed., Venezuela hacia el 2000. Desafíos y opciones (Caracas, Editorial Nueva Sociedad, 2000), p.173.

fluctuations in oil revenues. Less oil income meant reduced budgets. Second was the period 1958-1973, which witnessed the first significant shock to oil revenues, after the surge in oil prices triggered by the Suez Crisis of the late 1950s. Venezuela's government faced the challenge of fluctuating income by devaluing the currency and reducing expenditure. Additionally, import substitution policy replaced free trade. Budget prudence and protectionism served to limit the impact of oil price volatility. Third, the 1974 boom in the oil market was translated into an uncontrolled expansion of public expenditure, through both regular budgetary channels and a massive expansion of public enterprises. This increase in spending broke the pre-existing 'rule' of budgetary prudence. The steep hike in oil prices was thought of, by politicians and policy makers, as a permanent condition for the oil market. It was in this context that political leaders saw an opportunity to boost economic growth through massive public investment funded by oil revenues.³⁸³ High prices, however, proved short-lived and the oil price had levelled by 1977.

The Herrera administration, inaugurated in 1979, moved to contain this fiscal profligacy when the Iranian Revolution occurred, and oil prices again rocketed. This new rise in the oil price allowed Venezuelan politicians to postpone the need to address the obvious imbalances in the public finances. Furthermore, around this time, the worldwide abandonment of fixed exchange rates and the increase in inflation brought additional challenges to the Venezuelan economy. When, in 1982, the oil boom finished, it was clear that the divergence between public spending and Treasury receipts was unsustainable. This imbalance forced Venezuela to abandon fixed exchange rates. Her currency was devalued on 18 February 1983, thereby exposing the Venezuelan economy to volatility and the fluctuating price of oil exports. The initial policy response to this crisis was a combination of foreign exchange, price and interest rate controls. Hausmann termed these responses "the administrative prohibition of imbalances".³⁸⁴

The Herrera government's ability to manage complex macroeconomic variables, however, proved limited. Administrative incompetence led to continuous devaluation of the national currency, the Bolívar, against the US dollar. Periods of devaluation

³⁸³ Gumersindo Rodríguez, interview by autor, Caracas 20 March 2003.

³⁸⁴ Ricardo Hausmann, *ibid.*, p.173.

characterised the whole of the 1980s. The logic was painfully consistent. Once a set of macroeconomic administrative measures proved ineffectual, the government resorted to new devaluations. Devaluation, which led to an increase in Bolívar-denominated resources, created the illusion of fiscal equilibrium. The consequence of devaluation was inflation, which of itself caused further imbalance and helped manufacture the next crisis. The consequence of the collapse in oil prices in 1986, during Lusinchi's administration, was postponed by three years by raiding the foreign reserves. When the reserves ran dry, in 1989, Venezuela experienced three digit inflation and a dramatic fall in GDP.

Consequently, when President Pérez took power in 1989 he faced a disastrous and worrying set of economic conditions. He appointed a cabinet of technocrats to help manage the crisis, and one of the decisions taken was to revive the concept of a stabilisation fund. The delivery of the stabilisation fund was the responsibility of the Minister of Planning, Miguel Rodríguez, who instructed the Cornell University-educated economist Ricardo Hausmann to prepare the proposal for the fund.

The Stabilisation Fund: failed first attempt

In 1991 the government of technocrats, led by Pérez, adopted the Hausmann Report, and advanced the case for a stabilisation fund in Congress. Ministers began by testing the willingness of congressional leaders, notably the influential members of the Finance Permanent Committee in the lower chamber.³⁸⁵ This committee was controlled by two veteran congressmen: Armando Sanchez-Bueno (AD) and Haydee Castillo de López (Copei).³⁸⁶

Congressional approval, however, proved difficult because relations between the elite of the AD party and President Pérez were strained. The tension was partly the consequence of Pérez embracing neo-liberal ideals and delegating policy making to a

³⁸⁵ Permanent Committees are the equivalent to Select Committees in the British House of Commons, organised according to distinct policy fields and sitting on an on-going basis.

³⁸⁶ A typical practice of the so-called Punto Fijo pact between AD and Copei parties was to alternate the Presidency of that important committee between them according to which party was in power.

non-partisan technocratic cabinet. Underlying this policy difference was a long standing distrust between Pérez and AD, which meant that the relationship between the two was only ever distant. Despite his appeal to the AD rank and file, Pérez was not popular with the AD political elite. The traditionalists within the senior ranks of AD favoured Octavio Lepage during the contest for the selection of the candidate for President. Whilst Pérez won the nomination, by the vote of party members, his relationships with the party leaders were bitter. Not surprisingly, AD and Pérez clashed when, once inaugurated, he broke with tradition and chose to appoint to cabinet few traditional AD members. A Minister from the Pérez team recalled, “Pérez just hated AD. When we were considering appointing somebody to an important post, we usually presented Pérez with three names. Two linked to AD , usually recommended by the AD Secretary General Alfaro-Ucero, and one name not linked to AD. Pérez always chose the latter.”³⁸⁷

The government-AD relationship reached crisis levels when policy announcements emanating from the cabinet technocrats sharply contrasted with traditional AD positions. Inspired by the infamous ‘Washington consensus’, cabinet ministers promoted trade liberalisation, financial deregulation, removal of exchange controls and privatisation. It was in this context, with free market policies being promoted by the cabinet, that AD traditionalists opposed the idea of a stabilisation fund as a neo-liberal solution, despite being advocated by the AD founder, Betancourt, around 40 years earlier.

The technocrats’ agenda needed a substantial legislative effort. The scope of the intended policy reforms were well beyond the realm of administrative measures the Executive could undertake. The ‘package’, as the technocrats agenda was commonly known at the time, needed to go through AD-controlled Congress. This gave the AD elite the opportunity to check Pérez’s power. Rosas-Bravo, Deputy to Minister Rodríguez at that time, recalled bitterly, “We have to fight law by law in the Congress. By no means was AD control of the Congress a guarantee that our proposals would succeed.”³⁸⁸

³⁸⁷ Pedro Rosas-Bravo, interview by author, London, 10 March 2003.

³⁸⁸ Pedro Rosas-Bravo, *ibid.*

By the time the Stabilisation Fund Law was proposed, the rate of success, measured by how many proposals the government had managed to get approved by the AD-dominated Congress, was mixed. Trade liberalisation and privatisation laws had cleared congressional hurdles. Tax and financial sector reform, however, had not enjoyed the same success. Miguel Rodríguez admitted, “The reforms we proposed were out of tune with the political times. In a society used to having oil revenues paying for almost everything, our proposals, such as the creation of a fund to save oil money, just short circuited with the political elite.”³⁸⁹

The proposal for a stabilisation fund faced resistance. Gustavo García, a close advisor to the government at that time recalled, “Senior congressional leaders simply did not buy the idea of a fund whose functioning was regulated by a complicated formula. The law based on the Hausmann’s report was complex and written in a highly technical language that just created more scepticism about a new Pérez government initiative.”³⁹⁰ Rosas-Bravo also observed, “The Hausmann proposal was considered an exquisite policy proposal, too sophisticated for the taste of traditional legislative leaders.”³⁹¹ But not only congressional leaders resisted the project for a fund. PDVSA, the oil company, disagreed with several aspects of the proposal. Since part of the saved money that was to be in the Fund were to be at the PDVSA’s disposal, the company technocrats were also very critical of the proposal and objected to some parts of it.³⁹²

Later political events complicated matters even further. The February 1992 failed coup d’état led by Hugo Chávez, the following coup attempt in November of the same year, plus the impeachment of President Pérez in May 1993, combined to bury all Pérez initiatives, including the Stabilisation Fund.

³⁸⁹ Miguel Rodríguez, interview by author, Caracas, 22 May 2002.

³⁹⁰ Gustavo García, interview by author, Caracas, 6 July 2002.

³⁹¹ Pedro Rosas-Bravo, *ibid.*

³⁹² Carmelo Lauria, interview by author, Caracas, 9 July 2002.

5.2. The Investment Fund for Macroeconomic Stabilisation (FIEM)

The political balance of the country completely changed after 1993. The scheduled elections, for President and Congress, in December 1993 marked this shift.

Dominance by the Punto Fijo era's main political parties was seriously threatened. They could barely retain control of Congress and the results of the presidential elections emphasised their weakness. For the first time since 1958 a candidate not supported by either AD or Copei won the Presidency.

Rafael Caldera was elected after running as an independent backed by a coalition of small parties. He ran his campaign on a platform of complete rejection of Pérez policies. Although his victory was by a narrow margin, it was interpreted as a backlash against the so called 'neo-liberal experiment' of the previous Pérez's administration. On the other hand, it was understood that constant rumours from the Military regarding its support for democracy diminished Caldera's ability to govern.³⁹³

The Caldera administration obtained political support from the AD party led by its Secretary General Luís Alfaro-Ucero, who had been the most furious opponent to Pérez's reforms. Difficulties in the economic front soon appeared. Caldera faced a severe banking crisis and the subsequent bail out entailed fiscal commitments of around 10% of GDP. After two years of economic instability Caldera decided to make a U-turn, which was carefully presented as a "reform package with a human face". Branded as 'Agenda Venezuela', the new policy impetus was not very different from the rejected Pérez package of 1989.

The initial implementation of the 'Agenda Venezuela' concentrated on three areas: tax reform, the liberalisation of the foreign exchange regime and a return to privatisation (mainly of assets seized during the banking crisis bail out and a steel mill). The Stabilisation Fund was reassumed as well. Caldera delegated on the Minister of Planning Teodoro Petkoff the task of advancing the "Agenda". Minister Petkoff said, "The proposal for the Fund was an extra we offered to the multilaterals.

³⁹³ G.Philip, 'The Strange Death of the Venezuelan Party System.' (Paper presented at the Latin American Studies Association meeting, Miami 2000).

Somehow, the idea of a stabilisation fund was widely accepted among all influential economists at that time.”³⁹⁴ Hausmann also acknowledged, “The intellectual case for the fund was ripe.”³⁹⁵ The idea, once again, was yet to succeed in passing through the necessary legislative channels.

This time, however, one particular event facilitated the introduction of the proposal to Congress. One of the projects agreed with the multilaterals was the creation of an office inside Congress to provide expert advice on economic and financial matters. That office, called OAEF (Oficina de Asesoría Económica y Financiera), was set up with funds from the IDB. The first director of the office was Gustavo García, linked to the 1989 Pérez economic team. The Stabilisation Fund proposal was jointly taken by a team now including the OAEF, Central Bank, PDVSA and both the Ministries of Planning and Finance. According to Luís Rivero, a former member of the Board of the Central Bank, “The final impulse for this long standing idea was given by the Central Bank.”³⁹⁶

Nevertheless, the proposal waited for more than two years in Congress. Petkoff lamented, “There was always something more important on the legislative agenda. The proposal was stuck for a long period of time because it was not a priority for the leadership in Congress. It was still so much against their traditional beliefs.”³⁹⁷ In fact, this congressional leadership was quite the same as before when Congress did not pass the original Pérez proposal.

The FIEM Law

With less than a month to hold both congressional and presidential elections, President Caldera decreed the creation of the Investment Fund for Macroeconomic

³⁹⁴ Teodoro Petkoff, interview by author, Caracas, 26 March 2003.

³⁹⁵ Ricardo Hausmann, interview by author, Caracas, 20 July 2003.

³⁹⁶ L.Rivero, ‘Propuesta de un fondo de estabilización en Venezuela: el Fondo de Inversion para la Estabilización Macroeconomica’ in L.Rivero (eds) Fondos de Estabilización Macroeconomica (Caracas, BCV, 2001).

³⁹⁷ Teodoro Petkoff, *ibid.*

Stabilisation (FIEM).³⁹⁸ Congress had granted Caldera powers to legislate on that matter through an enabling law. Decree 2,991 of 4 November 1998 established the characteristics of the FIEM through the Law of the Macroeconomic Stabilisation Investment Fund.³⁹⁹ The most important terms of the law are described as follows.

The Fund was not established as a separated legal entity with an attached bureaucracy. Instead, it was entrusted to the Central Bank. The board of the Central Bank was the governing body of the Fund with authority to: establish the fund's budget, report annually to Congress, dictate norms of operation, establish investment policies and approve withdraws (Articles 1 and 2).

The Fund was to be endowed with the so-called excess oil revenue. 'Excess' was defined as the amount above the average oil income in the previous five years. In this regard, the formula was a simplification of the one proposed in the first draft presented to Congress in the early 1990's after the Hausmann report. The new formula for accumulation was, however, still complex due to intricacies of the way oil revenues are managed in Venezuela's public accounts. Deposits to the fund came from three different sources: the Treasury on behalf of the central government, the Treasury on behalf of the states and municipalities, and PDVSA.

This distinction originated in the way oil revenues were collected by Venezuela's public entities before the creation of the Fund. First, oil taxes went directly to the Treasury, which is managed by the Ministry of Finance on behalf of the central government (i.e. the general budget). The Venezuelan states,⁴⁰⁰ however, are entitled by the Constitution to a fixed transfer from the general budget. This entitlement gave the states an earmarked share of any revenues accrued to the Treasury. Additionally, the states were also entitled to a special transfer established in a law passed in 1996 called the 'Law of Special Transfers for States from Mines and Hydrocarbons'.⁴⁰¹ This law set aside some of the oil revenues for the states, mainly for those states where oil exploitation occurred.

³⁹⁸ Fondo de Inversión para la Estabilización Macroeconómica in Spanish.

³⁹⁹ Official Gazette 36,575, 4 November 1998.

⁴⁰⁰ Venezuela is divided by 23 states (Estados) and a Capital District.

⁴⁰¹ Official Gazette 36,110, 18 December 1996.

PDVSA retained part of its oil revenues for its investment and operational needs. The Fund's law stipulated that PDVSA was obliged to deposit in the Fund any revenue above the average of the past five years after deducting its tax obligations.

Consequently, the three sources of accumulation to the Fund were:

- 1) From the central government (Article 4): Revenues in excess from taxation of oil activities (direct taxes such as exploitation tax and income taxes to oil companies), dividends from PDVSA and revenues from associations with private firms after the subtraction of the mandatory transfers to states.
- 2) From the states and municipalities (Article 5): their proportion from excess revenues according to the constitutional provision and the law for special transfers.
- 3) From PDVSA (Article 6): the excess revenues after deducting taxes paid to the Treasury.

The Fund had to maintain separate accounts according to the sources identified above. Equally, any benefit the Fund obtained from investing these resources had to be credited in the above proportions to those accounts (Article 7). The assessment of whether the conditions for accumulating funds were met had to be done in the first thirty days of each quarter and the corresponding transfers in the following sixty days. (Article 8). In all cases resources had to be maintained in US dollars and were to be invested with the same criteria and procedures that the Central Bank applied for international foreign reserves (Article 18).

Symmetrically to the accumulation rules, when the reverse conditions applied (i.e. when oil revenues were below the average of the past five years) the three beneficiaries of the Fund could withdraw from it. The Treasury and the states had to withdraw in local currency and PDVSA in US dollars (Articles 9, 10 & 11). The states were requested to transfer to the municipalities a share of their withdrawals in the same proportion that they share the constitutional grant established in the general budget.⁴⁰²

⁴⁰² Municipalities are entitled to a fixed proportion of any income the states get from a budget

Deposits to the Fund were calculated after taxes were collected. Withdrawals, however, were based on estimates of oil revenues. All withdrawals needed the previous opinion from both the lower chamber (Deputies) of Congress and the Finance Permanent Committee of the upper chamber (Senate). Both bodies were requested to give their opinion in the following twenty days after the Executive submitted a proposal. In the case that no opinion was given in that period it was assumed to be favourable (Article 12).

This provision served as an inadequate check since, according to administrative law in Venezuela, ‘opinion’ does not mean approval. According to this wording, even with a negative opinion the withdrawals could have been made. Similarly, the Board of the Fund (Central Bank board) had to automatically approve withdrawals once the executive branch had informed them that conditions for withdrawals had been met (Article 13). Since withdrawals were based on estimates of future revenues, a degree of discretion was granted to the executive branch. Either Congress or the Central Bank did not have any participation in assessing those estimates.

Some balance was somehow achieved through the imperative that at the end of every fiscal year withdrawals made that year needed to be recalculated against revenues collected. In case the re-calculated withdrawals exceeded the withdrawals made, the Executive had to refund the Fund in the following ninety days (Article 14). This rule allowed the Executive to get short term financing from the Fund since no restrictions were imposed on how to estimate oil revenues.

Caps were imposed on both withdrawals and deposits. Withdrawals were limited to two-thirds of the amount in the Fund at the beginning of each fiscal year. Similarly, resources accumulated in the Fund could not exceed an amount equivalent to eighty per cent of the total oil exports in the previous five years (Articles 15 & 16).

In case the Fund reached those caps, the excess amount had to be transferred back to the three beneficiaries. They, however, had restrictions on how to use that money.

These restrictions were: 1) the central government's share was earmarked to pay for public debt. This had to follow a mechanism set in a law passed in December 1997 that created another fund for the anticipated amortisation of the national public debt.⁴⁰³ The share of the states and municipalities and that of PDVSA had to be returned directly to them. Finally, the Fund could not serve as financial guarantor of any sort to other governmental entities or PDVSA. Similarly the Fund could not issue any kind of debt instruments.

First amendment to the FIEM's Law (1999)

International oil prices were at a quarter of a century low when Hugo Chávez took office in February 1999. The top priority of Chávez's administration was to promote a recovery in oil prices, and Chávez took the initiative among Opec countries to restore discipline to the cartel. Chávez's economic team considered that the Stabilisation Fund's rules would potentially restrict any fiscal reward that might come from improved oil prices.⁴⁰⁴

President Chávez faced an opposition-controlled legislature. He responded to this limitation by coercing Congress to grant him enabling powers to legislate in economic matters. The possibility of a constitutional convention for re-writing the Constitution was high at that time. The opposition controlled both chambers of Congress but feared for its own existence since Chávez's proposal for a new Constitution was clearly intended to overhaul existing institutions. Congress, however, opted for a cooperative stance with Chávez instead of putting up a fight over the Constitution. They approved an Enabling law on the 26 April 1999 authorising President Chávez to legislate in economic affairs by Presidential decree.⁴⁰⁵ Less than a month later, Chávez used those powers to introduce his first modification of the Stabilisation Fund's law.⁴⁰⁶

⁴⁰³ Official Gazette 36,549, 5 December 1997.

⁴⁰⁴ Francisco Rodríguez, interview by author, Caracas, 9 July 2002.

⁴⁰⁵ Official Gazette 36,687, 26 April 1999.

⁴⁰⁶ Official Gazette 36,722, 20 May 1999.

The first Chávez amendment inserted a provision for withdrawals in case of a “re-estimation” of the revenues. Now, forty per cent (40%) of the Treasury’ share was earmarked for a new Fund called the Unique Social Fund (FUS)⁴⁰⁷ which was yet to be created. Similarly, in case the Fund reaches its accumulation limit, the share of the refund accruing to the Treasury was to be distributed as follows: 40% to the FUS, 25% to the Fund for early amortisation of Public Debt and 35% to the Venezuelan Investment Fund.

The accumulation rules were changed significantly. Chávez introduced a special regime for the period 1999-2004. Instead of the norm that refers all excess oil income to the average of the last five years, the new provisions were expressed as excess over fixed parameters. These fix referential values were established as follows:

- 1) Income tax paid by oil companies: US\$ 420 million
- 2) Oil and gas exploitation tax: US\$ 967 million
- 3) Dividends from PDVSA: US\$ 1.254 million
- 4) Average oil price (Venezuelan exports): US\$ 9/barrel
- 5) Share of states from income tax paid by oil companies: US\$ 105 million
- 6) Share of states from oil and gas exploitation tax: US\$ 323 million
- 7) States’ income from Law of Special Transfers: US\$ 323 million

More importantly, the rule for saving oil revenue in excess of those new parameters was changed. The requirement of saving 100% of the excess was relaxed to 50% (Article 25 of the modified law). The new accumulation rules for the 1999-2004 period were anticipated to facilitate the accumulation of oil revenues for that period.⁴⁰⁸ Nonetheless, the special 1999-2004 regime was aimed not only at boosting saving but at creating a legal instrument for spending outside of the budgetary process.

⁴⁰⁷ Fondo Único Social (FUS).

⁴⁰⁸ Congreso de la Republica, ‘Efectos de las modificaciones introducidas por el Ejecutivo Nacional al Fondo de Inversión para la Estabilización Macroeconómica’ in Technical notes 99-006, (Caracas, Oficina de Asesoría Económica y Financiera, 1999).

The President's discretion over withdrawal of funds was significantly enhanced. Rules regulating use of funds were modified in two ways. First, a new provision (Article 26 of the modified law) allowed the President total discretion in the use of resources in the Fund even if it had not reached the legal ceiling of 80% of the average total oil exports in the previous five years. The new regime introduced for 1999-2004 authorised the President to use the 'excess fund' at any time. Additionally, the restriction of withdrawals to two-thirds of what the fund had was removed for each of the accounts (Article 27 of the modified law).

The distribution of withdrawals was altered too. The central government's share, previously not earmarked, needed to be allocated as follows: 40% directly to the Unique Social Fund (FUS) and the rest to the Treasury (Article 9 of the modified law). In the case of withdrawals of the excess funds the new distribution rule makes mandatory the use of those funds as: 1) 25% for early amortisation of public debt (it was 100% before); 2) 35% for the investment fund (FIV) and 40% for the Social Fund (FUS). In regard to the share of PDVSA, the use of its withdrawals was now direct in the hands of the President of the Republic, instead of the total discretion that the company had over those resources before (Article 16 of the modified law).

The 1999 amendment transformed the character of the Fund. The original conception of the Fund as a neutral mechanism was drastically altered. The adopted special regime allowed a great deal of discretion to the President of the Republic with little scrutiny from other branches of the State. The Congress's economic advisors office warned about the increasing discretion and the new rigidities introduced for the allocation of those resources to an already very rigid budgetary process. They argued that these features were contrary to the main purpose of the Fund in stabilising public finances.⁴⁰⁹

Moreover, the increasing earmarking of resources from the Fund, such as the mandatory transfer to the Social Fund (FUS), out of the normal budgetary process weakened scrutiny and risked resulting in the bad practice of funding regular spending out of a non-regular source of revenue. Additionally, the discretion of PDVSA over

⁴⁰⁹ Congreso de la Republica, *ibid*.

its share in the Fund was reduced, and therefore also its independence from the political process. Finally, the original idea of using ‘excess’ funds to lower the public debt was severely altered. The overall consequences of these modifications were to increase public spending when oil prices recovered. This boost for spending turned the Fund in a much less anti-cyclical tool,⁴¹⁰ which was precisely the purpose of a stabilisation fund.⁴¹¹

Francisco Rodríguez, a former head of the congressional economic advisors office, OAEF, observed, “In retrospect, the 1999 modification had mixed implications. On the one hand it signalled that the government wanted to accumulate funds. This was, probably, intended by the Planning Minister Jorge Giordani as a message of fiscal responsibility to the markets. On the other hand, the change to save only 50% of the excess oil revenues introduced an incentive to the government to extract more revenues from the oil industry.”⁴¹²

Second amendment to the FIEM’s Law (2001)

The new Constitution, approved in December 1999, created the National Assembly as the new unicameral legislative body replacing former Congress. New members of the Assembly were elected in July 2000 together with presidential elections. President Chávez’s mandate was ratified and his supporters won a handsome majority in the new National Assembly.

The new Constitution, for the first time, included a mandate for a stabilisation fund. Article 321 of the Constitution reads, “A fund for macroeconomic stabilisation will be established by law in order to guarantee stability in spending at municipal, regional and national levels to confront fluctuations in ordinary revenues. The rules of the fund will be guided by basic principles of efficiency, fairness, and no discrimination

⁴¹⁰ ‘Anti-cyclical’ refers to the quality of an economic measure to smooth or counteract the effect of a macroeconomic variable that is altered by the effects of an economic cycle such a high prices of an exporting commodity.

⁴¹¹ Congreso de la Republica, *ibid.*

⁴¹² Francisco Rodríguez, *ibid.*

between the public entities that accumulate resources in it.”⁴¹³ This constitutional provision strengthened the existing stabilisation fund although its vague wording left enough room for discretion in interpreting the norm.

The new Constitution also augmented the scope of matters that the legislative branch could delegate to the President of the Republic (Article 236). Formerly, only economic and financial matters were permitted. The new Constitution put no restrictions. President Chávez made immediate use of this constitutional provision and asked for powers to legislate. The National Assembly passed, on 13 November 2000, a very wide ranging Enabling Law granting President Chávez those powers.

The enabling law did not explicitly mention the Stabilisation Fund. It did, however, authorise the President to “unify and order the legal regime of hydrocarbons”.⁴¹⁴ As the Fund received resources from hydrocarbons exports, Chávez interpreted this authorisation as sufficient to legislate on the Fund. Another provision of the Enabling Law provided additional justification. These additional terms read: “Legislate on the planning function of the State with the purpose of increasing government capacity for the formulation, execution and control of public policy. To ensure that the legal regime regulating planning is updated. Additionally the functions pertaining to each level of government and the new constitutional bodies related to the planning process will be defined in order to establish the interrelation between plans and their link to the public budget and the strengthening of consulting mechanisms and democratic participation in the national planning process.”⁴¹⁵

Presidential Decree 1,478 of 15 October 2001 amended the Stabilisation Fund. It substantially modified the accumulation rules by establishing a special regime for the period from the last quarter of 2001 to 2007. First, no accumulation was required for the period from the last quarter of 2001 to 2002. Additionally, the new law established that only 6% of the oil revenues were to be saved if conditions apply for the year 2003. This percentage was increased one percentage each year until the year 2007 until reaching a top level of 10%.

⁴¹³ Official Gazette 5,453 Extraordinary, 24 March 2000.

⁴¹⁴ Official Gazette 37,076, 13 November 2000.

⁴¹⁵ Official Gazette, *ibid*.

5.3 FIEM's operations

The Fund began to operate in 1999. Although rules were modified mid-year they still stipulated that the Fund was to receive resources from a prospective rise in the value of oil exports. In fact, prices went from US\$ 10.57 at the beginning of 1999 to 16.04, 25.91 and 20.21 per barrel for the average Venezuelan oil export basket in 1999, 2000 and 2001 respectively (see Table 5.1). Consequently, these three years were notionally, according to the rules initially set and later modified, years of accumulation in the Fund. In practice, this was not exactly the case.

Table 5.1 Oil prices from 1998 to 2003 (2nd Qtr)

Year	Venezuela (US\$/barrel)	Opec basket (US\$/barrel)
1998	10.57	12.33
1999	16.04	17.47
2000	25.91	27.55
2001	20.21	23.12
2002	22.18	24.36
2003	26.10	28.22

Source: Ministry of Energy

In 1999 oil prices recovered more than 50% and oil exports were US\$ 905 million above the average of the previous five years. PDVSA, however, was the only entity that accumulated resources in the Fund (US\$ 215 million), as can be seen in Table 5.2

Table 5.2 Deposits to the Fund 1999-2001 (US\$ million)

Year	PDVSA	Central government	States	Total
1999	215			215
2000	2,346	1,658	457	4,461
2001 (first three-quarters)	1,542	154	604	2,300
Accumulated	4,103	1,812	1,061	6,976

Source: BCV

Later, in 2000 and 2001, PDVSA, the central government and the states transferred to the Fund US\$ 6,761 although the process for transferring those resources was not well ordered. Minister of Finance José Rojas announced in October 1999 that the Fund was about to received US\$ 750 million in 1999.⁴¹⁶ The Fund received only US\$ 215 million. President Chávez, in November 1999, adamantly announced that his government “had faced the hike in oil prices with rationality and not with irresponsible and out of control spending, unlike any other previous government”.⁴¹⁷ The Deputy Planning Minister, however, acknowledged the need for more precise rules to calculate the exact amount of contributions although they expected these contributions to be in the region of US\$ 1,000 million for 1999.⁴¹⁸ This announcement revealed that rules for accumulation were not sufficiently clear in the Law.

Discrepancies with the deposits to FIEM

The contributions to the Fund were questioned publicly. The President of the Permanent Finance Committee of the Lower Chamber Liliana Hernández challenged these contributions. She accused the government of circumventing the legal procedures to avoid transferring money to the Fund.⁴¹⁹ The National Assembly’s economic advisors office, OAEF, also disputed the amount deposited. They suggested, according to their own calculations, that the Fund should have received around US\$ 2,500 million.⁴²⁰ The Minister of Energy Alí Rodríguez concurred with this estimate. He announced that the Fund was to receive that amount from the government.⁴²¹ Independent economists suggested other estimates for contributions to the Fund.⁴²² The Minister of Finance acknowledged that part of the extraordinary oil income in 1999 was channelled to regular spending. He admitted that those resources were needed to compensate for the fiscal deficit.⁴²³

⁴¹⁶ ‘Deficit fiscal de 1999 sera 3.8% del PIB’, El Universal, 22 October 1999.

⁴¹⁷ ‘Chavez niega haber gastado recursos petroleros’, El Universal, 23 November 1999.

⁴¹⁸ *Ibid.*

⁴¹⁹ ‘Ingresos Petroleros se gastaron’, El Universal, 24 November 1999.

⁴²⁰ ‘Fondo de Estabilizacion cuenta con \$215 Millones’, El Universal, 20 January 2000.

⁴²¹ ‘Gobierno depositara 365 Millardos en el FIEM’, El Universal, 28 January 2000.

⁴²² ‘Economistas mantienen reservas’, El Universal, 23 March 2000; ‘Que pasa con la bonanza petrolera’, El Universal, 26 March 2000.

⁴²³ ‘Ingresos extraordinarios financiaron gasto publico’, El Universal, 22 March 2000.

The Fund accumulated US\$ 4.2 billion in 2000. These contributions, however, were challenged in the same way as those of 1999. The Governor of Carabobo State, Henrique Salas-Feo, in opposition to Chávez, questioned the contributions to the Fund. Salas-Feo, acting as President of the Association of Governors, alerted the Finance Permanent Committee of the National Assembly about two negligent actions from the Executive. First, the Fund, according to a correct interpretation of the rules, lacked about US\$ 1,500 million and second, a contravention to the requirement to separate those funds belonging to the states and municipalities.⁴²⁴ The National Assembly's OAEF rejected Salas-Feo's calculations.⁴²⁵ Consequently, the Assembly did not act on Salas-Feo's claims. The Ministry of Finance, however, acknowledged delays in transferring funds but said that the bureaucratic procedures were being cleared to comply with the rules.⁴²⁶

According to the Fund's rules, deposits to the Fund have to be made every quarter if conditions apply. These conditions pertained throughout 2000 and 2001. Only in November 2001, however, as the Ministry of Finance publicly admitted, did the Executive submit to the National Assembly a request for the approval of those contributions.⁴²⁷ This minor bureaucratic delay later triggered a broader legal challenge. The governors' claims to the National Assembly activated an investigation by the Assembly's OAEF. This investigation concluded that the Executive had not followed the rules for accumulating money in the Fund.

A major legal challenge surfaced with regard to the contributions corresponding to the last quarter of 2000 and the first three-quarters of 2001. As the Budget Law for 2001 did not contain sufficient budgetary appropriations to comply with the obligations to deposit in the Fund, the government needed to seek approval from the National Assembly for the missing appropriations. Those provisions were approved in October

⁴²⁴ 'Gobierno admite atraso con FIEM', El Universal, 28 September 2001.

⁴²⁵ Asamblea Nacional. Oficina de Asesoría Económica y Financiera, Report PT-0801-008, Caracas, August 2001 and PT-0901-012, Caracas, September 2001.

⁴²⁶ *Ibid.*; 'Ejecutivo cancelara 1.2 billones que adeuda a FIEM', El Universal, 24 November 2001.

⁴²⁷ *Ibid.*

and November 2001.⁴²⁸ In fact, President Chávez decreed two additional budget appropriations for Bolívar 1.3 and 1 billion after receiving authorisation from the National Assembly.⁴²⁹ The transfers, for a total of Bolívar 2.3 billion (US\$ 2.9 billion), however, were never made to the stabilisation fund. This went unnoticed until May 2002 when it emerged publicly due to an independent report made by an ex-Comptroller General.

Former Comptroller General Eduardo Roche, while compiling an academic report, noticed that the Stabilisation Fund had not received any contributions in the first quarter of 2001. Deputy Elias Matta, from the opposition party Causa R, requested a congressional inquiry based on Roche's findings on the issue.⁴³⁰ Francisco Rodríguez, head of the National Assembly economic advisors office, OAEF, demanded the Ministry of Finance clarify the irregularity.⁴³¹ The Finance Permanent Committee initiated an inquiry on the accusations but promptly discontinued it.⁴³² Another committee, the Audit Committee, however, began a separate inquiry.⁴³³

The ex-Minister of Finance Nelson Merentes, was summoned to the Audit Committee. Merentes admitted that no contributions had been made. He justified this irregularity on the grounds of a severe deficit in the Treasury. He validated his decision not to contribute to the Fund based on the need to prioritise the use of existing resources for more urgent social needs. He cited the Constitution to support his decision of using the available funds in the Treasury for public payroll payments, Christmas bonuses for public employees and debt payments. He insisted that paying salaries for the public bureaucracy was a constitutional mandate.⁴³⁴ Merentes emphasised that he merely interpreted the law according to his best judgement. Additionally, he maintained that resources in the Treasury were not earmarked.

⁴²⁸ 'En un año se gasta 66% del FIEM', El Universal, 16 June 2002.

⁴²⁹ Official Gazette 37,312, 29 October 2001; 5,564 Extraordinary, 24 December 2001.

⁴³⁰ 'Investigaran destino de recursos del FIEM', El Universal, 16 May 2002.

⁴³¹ 'Uso del FIEM fue inconveniente', El Universal, 25 May 2002; 'Francisco Rodríguez preve malversacion en el FIEM', El Universal, 29 May 2002.

⁴³² 'Cesa investigacion del FIEM', El Universal, 23 May 2002.

⁴³³ 'Asamblea Nacional abraja averiguacion a 4 ex ministros de Finanzas', El Nacional, 28 May 2002.

⁴³⁴ 'Merentes exime de culpas a Chávez por retiro de recursos del FIEM', El Nacional, 14 June 2002.

Therefore, they can be administered according to perceived priorities.⁴³⁵ President Chávez backed Merentes's justifications.⁴³⁶

The Audit Committee continued with the inquiry despite the official explanations. The Committee comprised 15 members, seven members from the opposition, seven from the official coalition and an independent, Deputy Rafael Jiménez. The Committee summoned and heard evidence from senior officials, Deputy Matta and Francisco Rodríguez, head of the OAEF. President Chávez, who was required to answer a questionnaire sent by the Committee, opted not to cooperate with the inquiry, which is a presidential prerogative.

Deputy Conrado Pérez, President of the Committee, produced a preliminary report accusing the officials of being responsible for the mismanagement of the Fund's contributions in July 2002.⁴³⁷ This report was rejected by the official coalition faction in the Committee who produced a separate report. When both reports were put for internal vote in the committee, the Pérez's report was approved in a controversial session.⁴³⁸ The government coalition supporters were absent except for one member who demanded a postponement of the decision. His presence, though, was sufficient to validate the Committee's meeting. Deputy Jimenez joined the opposition's deputies to approve the report.⁴³⁹ The National Assembly did not proceed any further with the case. Deputy Enrique Ochoa-Antich, however, introduced a legal action in the Supreme Court on 27 June 2002.⁴⁴⁰ Deputy Matta and other members of the National Assembly backed that claim in the Supreme Court.⁴⁴¹

The Attorney General's office, through the department responsible for corruption in the public bureaucracy,⁴⁴² opened an investigation based on Deputy Matta's claims.⁴⁴³

⁴³⁵ 'Los 2,3 billones del fondo se usaron para gasto corriente el año pasado', El Universal, 1 June 2002.

⁴³⁶ Hugo Chavez, Alo Presidente 106, 23 June 2002 (reported in El Universal, 23 June 2002).

⁴³⁷ 'Chavez es responsable penalmente por caso FIEM', El Universal, 17 July 2002.

⁴³⁸ 'Nelson Merentes asegura que respondera en caso del FIEM', El Universal, 7 August 2002.

⁴³⁹ 'Aprobado informe sobre el caso del FIEM', El Universal, 8 August 2002.

⁴⁴⁰ Tribunal Supremo de Justicia, Decisión de Sala Plena, Juzgado de Sustentación, 15 June 2005.

⁴⁴¹ 'Chavez admitio que no deposito dinero en el FIEM', El Universal, 28 August 2002.

⁴⁴² Departamento de Salvaguarda del Ministerio Publico.

Comptroller General Clodosbaldo Russian announced he was about to order an inquiry on the merits of the case.⁴⁴⁴ The Supreme Court ordered the Attorney General's office to consider the merits of the case on the 16 September 2002.⁴⁴⁵

The legal claims of this case were likened to the legal case that led to the impeachment of former President Pérez in 1993.⁴⁴⁶ In both cases, the legal allegations were based on the Anti-Corruption law that outlawed the misuse of funds. Article 60 of that law stated that funds cannot be used for purposes other than those established in the appropriation bill (i.e. the approved budget and any other additional appropriation added to the budget during the corresponding fiscal year). The law set a penalty for this infringement, even if the funds were used in the public interest.⁴⁴⁷

In President Pérez's case, the Supreme Court judged that the alleged use of secret funds by the Pérez's government for the security of the Nicaraguan President Violeta Chamorro was a case of misused funds, therefore he and two ministers were found guilty.⁴⁴⁸ The jurisprudence set by the Pérez decision in 1996 established that even if the actual use of the diverted funds was legal the diversion procedure was illegal.

Three years after the claim was introduced, the Supreme Court dismissed the Stabilisation Fund's misuse case. They ruled, on 15 June 2005, that the plaintiff in the case, Deputy Ochoa-Antich, was not entitled to take legal action since he was not an injured party in the alleged wrongdoing. The Court's ruling did not address the merits of the alleged offences (i.e. misusing funds earmarked for the Stabilisation Fund). The Supreme Court consisted of 32 Justices. All Justices had been appointed since 1999 following a variety of procedures due to the special situation arising from the new Constitution of 1999. The following section discusses this particular state of affairs.

⁴⁴³ 'Fiscalia 68 abrió investigación sobre el FIEM', El Universal, 4 June 2002; 'Fiscalia investiga uso del Fondo', El Universal, 5 June 2002.

⁴⁴⁴ 'Russian asegura que Contraloría estudia el caso FIEM', El Universal, 7 June 2002.

⁴⁴⁵ Tribunal Supremo de Justicia, *ibid.*

⁴⁴⁶ 'FIEM objeto de cuatro delitos', El Universal, 25 June 2002.

⁴⁴⁷ Official Gazette 3,077 Extraordinary, 23 December 1982.

⁴⁴⁸ Corte Suprema de Justicia, Decision de la Sala Plena, 30 May 1996.

The Constitution approved on the 15 December 1999 mandated a new structure for the Supreme Court, renamed the Supreme Tribunal of Justice.⁴⁴⁹ After the new Constitution was approved the constitutional convention (National Constituent Assembly) designated provisional Justices to the new Supreme Court on the 24 December 1999.⁴⁵⁰ The 131-member Assembly was controlled by President Chávez's supporters (all but six members favoured President Chávez). When the constitutional convention was dissolved, a temporary legislative body called the National Legislative Commission was created until the new National Assembly was elected. This provisional body completed the configuration of the provisional Supreme Court by appointing all Deputy Justices.⁴⁵¹

The new National Assembly elected in July 2000, however, passed a law regulating an ad hoc procedure for appointing new Justices to replace the interim Court. This 'ad hoc' legislation, called the "Special Law for the ratification or appointment of the member of the Citizen Power and Justices of the Supreme Tribunal for their first Constitutional Term", was itself a piece of provisional legislation since it did not follow the constitutional mandate for such a type of appointments.⁴⁵² This was justified on the grounds that some of the procedures established in the Constitution were impossible to comply with since some constitutional bodies, such as the so-called Citizen Power, had not yet been implemented.⁴⁵³

The National Assembly appointed a new high tribunal following this ad hoc legislation. The appointment required a two-thirds majority. Although Chávez's coalition was short of that majority, they negotiated with other parties to agree on the Justices' names.⁴⁵⁴ Later, the National Assembly passed by a simple majority⁴⁵⁵ a new law regulating the Supreme Tribunal, including an expansion of the Court to 32 Justices.⁴⁵⁶ This new Supreme Court Law relaxed the requirements for the

⁴⁴⁹ Tribunal Supremo de Justicia in Spanish.

⁴⁵⁰ 'ANC juramento a altos funcionarios', *El Universal*, 24 December 1999.

⁴⁵¹ 'Juramentan suplentes en Tribunal Supremo', *El Universal*, 28 April 2000.

⁴⁵² Official Gazette 37,077, 14 November 2000.

⁴⁵³ Article 264 of the Constitution establishes that the 'Citizen Power' is responsible for presenting the National Assembly with nominees for justices.

⁴⁵⁴ Official Gazette 37,105, 22 December 2000.

⁴⁵⁵ National Assembly, Minutes of the session held on 18 May 2004.

⁴⁵⁶ Official Gazette 37,942, 20 May 2004.

appointment of Justices. Article 8 of that law established that if the National Assembly failed to form a two-thirds majority after putting the appointments to the vote three times, a simple majority was sufficient to make the appointments lawful. In fact, the Assembly, by simple majority, appointed 17 Justices in December 2004 to fill the newly created posts and five vacancies.⁴⁵⁷ This so-configured High Court was responsible for the decision on the alleged misuse of funds for the Stabilisation Fund.

Another decision, however, partially vindicated the misuse claims. The Attorney General's office found merits for imputing the National Treasurer, Julio Viloria, for breaking the law when he falsely certified that the Treasury had resources for depositing in the Stabilisation Fund in the last quarter of 2001. This decision, however, did not address the main thrust of the claim regarding the deposits that were never made into the Stabilisation Fund in 2000 and 2001. As the other constitutional body with jurisdiction over the issue, the Comptroller General, never acted on the claims, the issue practically remained unsettled.

Claims regarding a breach in the stipulated use of withdrawn funds in 2001 and 2002 also emerged. National Treasurer, Leyda Betancourt, admitted wrongdoings regarding withdrawn funds in 2001. During the hearings held by the Audit Committee of the National Assembly in August 2002 she acknowledged that the Unique Social Fund did not receive the resources stipulated in the Fund's law for withdrawals.⁴⁵⁸ The Unique Social Fund's budget appropriations did not correspond to the amount it should have received from its corresponding share of the Stabilisation Fund's withdrawals made in 2002.⁴⁵⁹ The National Assembly did not act on these claims.

5.4 Depleting the Stabilisation Fund

The conditions stipulated in the Fund's law for savings applied during the first three years of the Chávez's administrations. The Fund collected almost US\$ 7 billion,

⁴⁵⁷ 'Mayoría oficialista designa nuevos magistrados al TSJ', El Universal, 13 December 2004.

⁴⁵⁸ 'Fondo Único Social no recibió recursos del FIEM', El Universal, 20 June 2002.

⁴⁵⁹ 'Recursos del FIEM no tuvieron el destino previsto en la ley', El Universal, 15 March 2003.

despite the contentious interpretation of the rules. This was the highest level of resources achieved in the Fund. Not only did contributions cease in 2001 but the government, PDVSA and finally the states depleted the fund in the following two years. This section discusses this process of depletion.

The Treasury was close to a deficit in December 2001. The government had failed to obtain financing in the debt market. Consequently, the government decided to withdraw money from the Fund for the first time in December 2001.⁴⁶⁰ The Treasury withdrew US\$ 894 million, which represented about 47% of the accumulated resources available in its account. Then, in the first four months of 2002 the Treasury made withdrawals of US\$ 600, 65 and 300 million,⁴⁶¹ practically depleting all its resources in the Fund (there remained about US\$ 50 million, less than 3% of what was available in November 2001).

Both the procedures followed by the government to make these withdrawals and the use of the withdrawn funds were irregular. The head of the National Assembly's economic advisors office, OAEF, denounced the government for withdrawing US\$ 300 million without the 'opinion' of the Finance Permanent Committee of the National Assembly and for exceeding the amount permitted by law.⁴⁶² These irregularities were not addressed by any legally entitled body.

The oil company PDVSA withdrew US\$ 1604, 69, and 500 million in June, July and December of 2002 respectively (see Table 5.3). In early June, the Executive authorised PDVSA to withdraw US\$ 2,445 million, which was roughly 60% of its share in the Fund at that moment.⁴⁶³ PDVSA's President Alí Rodríguez justified the withdrawals on the basis of the company's financial needs for the investment plan already approved. He insisted that PDVSA's funds in the Stabilisation Fund were reserves the company had for its eventual needs and rejected allegations that PDVSA would pass these resources on to the Treasury via taxes.⁴⁶⁴ In fact, the political

⁴⁶⁰ 'Ejecutivo uso \$800 millones del FIEM', El Universal, 14 December 2001; Monthly report, Central Bank of Venezuela.

⁴⁶¹ Central Bank of Venezuela, Detailed Monthly FIEM report, 2002.

⁴⁶² 'El Ejecutivo solo tiene \$49 millones en el FIEM', El Universal, 9 May 2002.

⁴⁶³ 'PDVSA retira \$2.4 millardos', El Universal, 5 June 2002.

⁴⁶⁴ 'PDVSA estudia usar FIEM para planes de inversión', El Universal, 29 May 2002.

conflict that directly engulfed PDVSA in April 2002 had left the company in a vulnerable position. The post-April political consensus, however, was favourable to isolate PDVSA from the repercussions of the political crisis.⁴⁶⁵ Consequently, the Finance Permanent Committee of the National Assembly promptly gave its favourable opinion.⁴⁶⁶

Table 5.3 Withdrawals from the Stabilisation Fund (2001-2003)
(US\$ million)

Year	Treasury	States	PDVSA	Total
2001	894			894
2002	965	732	2,173	3,870
2003	51	416	1,372	1,839
Total	1,910	1,148	3,545	6,603
% of available funds	0	99.82%	77.57%	86.54%

Source: BCV

The conditions faced in 2002 were repeated in the following year, and even more acutely. A two-month strike that almost paralysed the oil industry left PDVSA financially vulnerable again. The cabinet minutes where authorisation for PDVSA withdrawals from the Fund was discussed acknowledged the “reduced capacity of the company to comply with its obligations, including the fiscal ones”.⁴⁶⁷ PDVSA went on to withdraw US\$ 1,372 million in 2003, leaving US\$ 1,025 million which represented almost 14% of its share in the Fund.

In 2002, governors and mayors asked the central government to adjust the contributions that the Treasury should have made into the Stabilisation Fund on behalf of the states.⁴⁶⁸ Governors, mayors and senior government officials met in the city of Barcelona (Anzoátegui State) in June 2002 to discuss this issue.⁴⁶⁹ They signed a declaration named “The Anzoátegui Consensus”, whereby the government agreed to

⁴⁶⁵ Janet Kelly, interview by author, Caracas, 20 July 2002.

⁴⁶⁶ ‘PDVSA retira \$2,4 millardos’, *El Universal*, 5 June 2002.

⁴⁶⁷ ‘PDVSA retirara del FIEM 1.100 millones de dolares’, *El Universal*, 13 February 2003.

⁴⁶⁸ Discrepancies with the government deposits to the Fund were discussed in section 5.3 of this chapter.

⁴⁶⁹ ‘Gobierno cancelara en tres años deuda del FIEM con las regiones’, *El Nacional*, 8 June 2002.

transfer to the Stabilisation Fund the long overdue resources on behalf of the regions. In addition, it was agreed that the local governments⁴⁷⁰ would be allowed to withdraw the states' shares of the Fund.⁴⁷¹

The agreement was promptly implemented in July 2002. The Executive asked the Finance Permanent Committee of the National Assembly to give its favourable opinion for a withdrawal, on behalf of the states, for US\$ 732 million, roughly two-thirds of what they had available in the Fund. The withdrawal was approved in two parts. In effect, states and municipalities withdrew US\$ 366 million in July and September 2002.⁴⁷² The Fund's rules (Article 6, Part B) stipulated that those resources should be used for investments. Consequently, governors announced that they were to invest these resources in infrastructure, health, education and security projects.⁴⁷³ In reality, the use of these resources is seldom monitored.

In February 2003 the government agreed to allow the states to take out the rest of the available resources. The states intended to use those resources in ordinary spending. This use, however, was outlawed. Therefore, a modification was needed to the Fund's rules in order to circumvent this restriction. This amendment was passed by the National Assembly on 20 March 2003 (these later modifications are discussed later in this chapter). The states, nonetheless, had withdrawn US\$ 208 million in February. The law's change, passed a month later, allowed governors to use the Fund's resources in ordinary spending, with effect on past withdrawals. Consequently, by March 2003 the governors' share in the Fund was reduced practically to zero.

5.5 Distorting the Stabilisation Fund

By October 2002 the Stabilisation Fund had operated for four years within a cycle of high oil prices. The Fund, however, was almost depleted. Only PDVSA had any resources available. President Chávez's administration, however, asked the National

⁴⁷⁰ The municipalities within each State were automatically entitled to a 20% share of the States withdrawals from the Fund.

⁴⁷¹ 'Establecen cronograma de pago para las regiones', *El Universal*, 9 June 2002.

⁴⁷² Monthly report of FIEM resources by Central Bank of Venezuela.

⁴⁷³ 'En 30 dias refiones reciben el FIEM', *El Universal*, 23 July 2002.

Assembly to extend the special regime that exempted the government from depositing in the Fund.

The National Assembly approved a further modification to the Stabilisation Fund Law. The amendment extended until 2008 the special regime established a year earlier for the period of 2002 to 2007. The immediate effect was that no accumulation was required for the year 2003. Consequently, the requirements of saving 6% to 10% of all oil income above the average was moved from the year 2004 to 2008. Additionally, states were authorised to withdraw up to 20% of excess funds as was stipulated in the original law.⁴⁷⁴

Two months later, in December 2002, the National Assembly modified the Stabilisation Fund again. For a period of five years, starting with immediate effect, the President of the Republic was authorised to withdraw from the Fund with the sole condition of having a positive opinion from the Finance Permanent Committee of the National Assembly. PDVSA could withdrawal without limit. The central government and the states, however, could withdrawal only the excess funds after the Fund reached the cap established in the original law and were limited to the two-thirds of accumulated funds.⁴⁷⁵

The National Assembly removed, in March 2003, the restriction of withdrawals up to two-thirds of accumulated funds when the Fund reaches its cap. This was applicable only to the central government and the states. Additionally, the states were also authorised to withdraw from the Fund without satisfying the requirement that revenues should have decreased. The requirement that the states must dedicate withdrawals to investment was also removed for the year 2003. The Permanent Finance Committee of the National Assembly, however, was exhorted to monitor the use of those resources according to “a financial programming suitable to priority spending in accordance with administrative coordination, efficacy and principles of transparency”.⁴⁷⁶

⁴⁷⁴ Official Gazette 37,547, 11 October 2002.

⁴⁷⁵ Official Gazette 37,604, 19 December 2002.

⁴⁷⁶ Official Gazette 37,665, 20 March 2003.

These latest modifications substantially altered the original aims of the Stabilisation Fund. In practice, the Fund was suspended until 2008. The degree of discretion granted to the President distorted the original purpose of having an independent mechanism for using oil revenues in an orderly a predetermined manner. The Stabilisation Fund, as was conceived in 1998, was in the end abolished in November 2003. The next section discusses the law that created a new Fund.

The November 2003 Stabilisation Fund

The National Assembly passed a law that created a new Stabilisation Fund in November 2003.⁴⁷⁷ The new Fund abolished the one established in 1998. The new Fund, called the Macroeconomic Stabilisation Fund (FEM), instead of Macroeconomic Stabilisation Investment Fund (FIEM), retained some of the characteristics of the original Fund. Significantly, it preserved the notion of saving revenues from oil exports where they were above the average of previous years. Similarly, the same notion applied for withdrawing from the Fund when oil exports decreased. The law, however, introduced a new condition for withdrawals. In case of a state of economic emergency⁴⁷⁸ the central government was authorised to withdraw from the Fund unrestrictedly.

The FEM law introduced a new governance structure intended to represent the main stakeholders in the Fund (the central government, the states and municipalities and PDVSA). Similarly, it lowered the caps for withdrawals to 50% of what was accumulated in the Fund. The caps for accumulating funds in the Stabilisation Fund were reduced to 30% of the value of oil exports in the previous three years for the central government and PDVSA and 10% for the states and municipalities. The distribution of excess resources once the Fund reached those caps was modified as well. The new law required using those funds for an Intergenerational Fund,⁴⁷⁹ early payment of public debt or investment.

⁴⁷⁷ Official Gazette 37,827, 27 November 2003.

⁴⁷⁸ Economic emergency is established in the National Constitution (Article 338) and regulated by the Law of States of Exceptions. See Official Gazette 37,261, 15 August 2001.

⁴⁷⁹ The intergenerational fund was established in the Public Sector Financial Administration

The law included a new provision establishing penalties for senior officials who did not enforce its regulations. The law (Article 27) set a penalty of around US\$ 6,000 for those officials that failed to comply with the regulations, especially those regarding deposits into the Stabilisation Fund. Finally, the law exempted the government and PDVSA from contributing for the fiscal year of 2004.

In practice, this law was never implemented although conditions for accumulating, in principle, held true. Venezuelan oil exports in 2004 were US\$ 36,200 and the average of Venezuelan oil exports from 2001 to 2003 was US\$ 26,138.⁴⁸⁰ An interpretation of the law, however, allowed 2004's oil exports to be disregarded for calculating any contribution to the Fund in 2005. The National Assembly passed a new law in October 2005 that changed the whole idea of stabilising oil income.⁴⁸¹ The next section discusses this new law.

The October 2005 Stabilisation Fund

The Stabilisation Fund created by the law of October 2005 is based on the concept of fiscal surplus. The rules for accumulation and withdrawals to and from the Fund have no direct relation to the value of oil exports. The condition for saving is now contingent to a fiscal surplus. This surplus is defined as the difference, in real and comparable terms, between total fiscal revenues and public expenditure. As no restrictions are set, either in this law or in any other law, over the level of public spending, surpluses were subject to the voluntary restraint from the Executive. The compulsory nature of the stabilisation mechanism completely disappeared in this version of the law. It is perfectly legal, within this legal framework, to spend any windfall in oil revenues.

Fund (Articles 156-158) but it has not yet been implemented. See Official Gazette 37,606, 9 January 2003.

⁴⁸⁰ Calculation based on OPEC estimates. See OPEC Annual Statistical Bulletin 2004.

⁴⁸¹ Official Gazette 38,286, 4 October 2005.

In the event that the Fund accumulates resources, the conditions for withdrawals are that fiscal revenues are lower than the average of the previous three years. Even in a year of budget surplus the funds could be withdrawn from the Stabilisation mechanism. The provision for allowing withdrawals in case of an economic emergency was maintained. Additionally, PDVSA was excluded from the stabilisation mechanism.

In terms of governance, the new fund is controlled by a board of five members, all appointed by the President. The Central Bank was removed from any involvement with the Stabilisation Fund. The new Bank of the Treasury replaced the Central Bank as the agency responsible for providing technical and administrative support. The former condition of requiring the ‘opinion’ of the Finance Permanent Committee of the National Assembly was relaxed. Now the Fund has only to inform the Committee and the Comptroller General before proceeding with any withdrawals. Caps for withdrawals were not altered. Caps for accumulation, however, were lowered for the central government to 20% of oil exports in the previous three years. Table 5.5 highlights the main characteristics of the two latest versions of the FEM. Finally, the government was again exempted from any obligation to save in the fiscal year of 2005.

Table 5.4 Main characteristics of the FEM’s law

Aspect	Law of 27 November 2003	Law of 4 October 2005
Tutulary body	Ministry of Finance	Bank of the Treasury
Administered by	Central Bank of Venezuela	Bank of the Treasury
Governance	Board of five members, appointed by: <ul style="list-style-type: none"> - Ministry of Finance - Ministry of Planning - States - Municipalities - PDVSA These appointments needed ratification of the National Assembly.	Board of five members all appointed directly by the President.
Internal administration	1) A General Council constituted similarly to the Board responsible for administrative tasks 2) A Technical Secretariat	Bank of the Treasury

Aspect	Law of 27 November 2003	Law of 4 October 2005
Deposits	<ol style="list-style-type: none"> 1) The central government had to deposit the excess amount in collected oil taxes over the average of oil taxes in the previous three years once the legal transfer to the judiciary was deducted. 2) The states and municipalities had to deposit their proportion established by law of the above income. 3) PDVSA had to deposit 50% of the excess amount in collected revenues from oil exports once all applicable taxes were deducted. 	<ol style="list-style-type: none"> 1) The central government shall deposit at least 20% of the excess amount in real terms of collected fiscal revenues over fiscal expenditures in the previous year. 2) The states and municipalities have to deposit their proportion established by law of the above income. 3) PDVSA is exempted from depositing in the Fund.
Conditions for Withdrawals	<ol style="list-style-type: none"> 1) When fiscal revenues from oil taxation were lower than the average of the previous three years. 2) Oil exports were below the average of the previous three years. 3) In case of economic emergency as established by the Constitution and the applicable laws. 	<ol style="list-style-type: none"> 1) When total fiscal revenues are lower than the average of the previous three years. 2) In case of economic emergency as established by the Constitution and the applicable laws.
Control by other branches	Withdrawals had to obtain the 'opinion' of the Finance Permanent Committee of the National Assembly (opinion was not binding). In case of economic emergency this requirement could be relaxed.	Withdrawals have to be reported to the Finance Permanent Committee of the National Assembly and the comptroller general. In case of economic emergency this requirement could be relaxed.
Caps for withdrawals	The central government, states and municipalities could withdraw up to 100% of the difference between the estimated income for the fiscal year and the average of oil income in the previous three years but never exceeding 50% of the accumulated funds in the Stabilisation Fund.	The central government, states and municipalities can withdraw up to 100% of the difference in total income up to 50% of the accumulated funds in the Stabilisation Fund.

Aspect	Law of 27 November 2003	Law of 4 October 2005
	<p>2)PDVSA could withdraw up to 75% of the difference between the estimated income for the fiscal year and the average of oil income in the previous three years but never exceeding 50% of the accumulated funds in the Stabilisation Fund.</p> <p>In case of economic emergency there is no limitation on withdrawals.</p>	
Caps for accumulation	<p>Entities could accumulate funds up to a fixed percentage of the average of total oil exports in the previous three years as follows:</p> <ol style="list-style-type: none"> 1) Central government: 30% 2) States and Municipalities: 10% 3) PDVSA: 30% 	<p>Entities could accumulate funds up to a fixed percentage of the average of total oil exports in the previous three years as followed:</p> <ol style="list-style-type: none"> 1) Central government: 20% 2) States and municipalities: 10%
Use of funds once they reach accumulation caps	<ol style="list-style-type: none"> 1) The central government's share could be allocated to an Intergenerational Fund or for payment of Public Debt. 2) States and municipalities could use excess funds for investment purposes. 3) PDVSA's funds could be allocated to the Intergenerational Fund or for investment purposes. 	No limitation was established.
Penalties for administrators	Minister of Finance, President of PDVSA and Members of the Board were responsible for enforcing the rules, otherwise they were liable to pecuniary penalties and other sanctions.	Penalties were abolished except for the obligation of the Minister of Finance, the director of the Budget Office and the National Treasurer to provide information to the Fund's Board.
No savings in	Fiscal year of 2004	Fiscal year of 2005

Source: Official Gazette

Conclusions

Venezuelan policy makers had long contemplated a stabilisation mechanism for volatile oil income when they finally implemented it in the 1990s. The Investment Fund for Macroeconomic Stabilisation proved a short-lived initiative. The institutionalisation of a saving mechanism to smooth oil revenues failed to materialise. The legal instrument eventually conceived was largely ignored or rapidly distorted by the executive branch. Other constitutional branches, the legislative and the judiciary, overlooked the operation of the Stabilisation Fund. Moreover, the legislative branch cooperated with the President to in effect annul the stabilisation mechanism.

Venezuelan oil exports boomed in the years following the creation of the Stabilisation Fund in 1998. Table 5.5 shows that in all years from 1999 to 2005 oil exports were above the average of the previous five years. The Stabilisation Fund had US\$ 733 million at the beginning of 2006. The stabilisation mechanism, instrumented through two laws and six amendments in seven years, failed to achieve its original aim.

The mechanism failed on various accounts. First, rules on contributions to the fund were only partially enforced. Second, rules on withdrawals were equally distorted. Third, withdrawals were allocated for ordinary spending.

Table 5.5 Venezuelan Oil Exports (1994-2005)

Year	Venezuelan oil exports in us\$	Difference with average exports previous five years
1994	16,089	
1995	18,457	
1996	23,060	
1997	21,624	
1998	17,193	
1999	20,190	905
2000	31,413	11,308
2001	25,353	2,657
2002	25,890	2,735
2003	27,170	3,162
2004	36,200	10,197
2005 (*)	43,588	14,383

Source: Opec Annual Bulletin 2004; (*) Opec Monthly Oil Market Report January 2006 and Ministry of Energy

The Fund's regulations were continuously modified to suit the short term preferences of the executive branch. Each modification weakened the mechanism that was originally conceived as an independent, neutral device to deal with extraordinary revenues from a period of high oil prices. The last version of the Fund bears little resemblance to an oil income stabilisation fund. Venezuelan institutions did not provide the necessary conditions for the operation of such a self governing mechanism. The case of the Stabilisation Fund proves that institutions are malleable to the President's preferences.

The fate of the Stabilisation Fund is comparable to that of the Investment Fund instituted in 1974 during the first significant oil boom. In both cases policy makers envisioned a mechanism for regulating the use of oil income according to the best technical advice. In both instances, however, regulations were largely ignored and ultimately modified to the point of rendering the initiative ineffectual. In both cases, the President's preferences for short run spending prevailed over any alternative usage of oil revenues, such as saving either for orderly investment or for stabilisation purposes.

Chapter 6

Governance of PDVSA: The ‘Chavista regime’ years (1999-2005)

This chapter investigates PDVSA-government relationships since President Chávez came to power in February 1999. It demonstrates that the governance of the oil company in this period became politicised as a consequence of a combination of long standing, unresolved issues and new political conditions, notably the non-institutionalised power struggle between President Chávez and his political opposition. As a consequence of these factors, the chapter argues, politicisation of the governance of PDVSA has been strained and taken to unprecedented levels. The oil company came under the direct control of the executive branch and decisions taken regarding the company followed the President’s immediate needs. The Ministry of Energy remains the same organisation that it was in pre-Chávez times. It has, however, assumed a direct operational role reflected in the fusion of the role of the Minister and other senior officials in the Ministry with the Presidency and other high ranking executives of the company. Despite a large overhaul of the ‘rules of the game’ regulating the oil business (i.e. a new Hydrocarbons law) the governance of PDVSA and oil policy decisions continue to depend on the President. The legislative and other branches of the State remain inconsequential for both governance of the oil business and oil policy.

Three main events marked this period. First, the new Hydrocarbons Law enacted in 2001. Second, the conflict in February to April 2002 which culminated in an attempted *coup d'état* that ousted President Chávez for two days. Third, the oil stoppage from December 2002 to January 2003. President Chávez’s response to these two conflicts shaped a substantially different post-strike institutional arrangement.

The chapter analyses those three events and the post-strike arrangement. The analysis is set against a backdrop characterised by four main factors. First, the long and widely held perception across the political spectrum that PDVSA was a ‘black box’ that has eluded proper public scrutiny. Second, Chávez’s position in the presidential campaign in 1998 against privatisation of the oil business. Third, a perception, during the years prior to Chávez’s rise to power, that PDVSA was interfering in political outcomes. Fourth, PDVSA’s declining fiscal contributions.

6.1. Old and new claims against PDVSA

During the 1998 presidential election campaign oil issues were, unusually, contentious. Formerly, as nationalist claims were highly consensual across the political spectrum, oil issues were not an important election topic, save during the 1983 campaign, when both AD and Copei candidates wanted to rectify what was, at that time, considered an inappropriate political interference by President Herrera.⁴⁸² PDVSA governance and other oil topics were important issues that were highly ventilated in 1998.

Politicians’ long standing resentment of PDVSA

In addition to the ‘state within the State’ perception discussed in Chapter 4, PDVSA was widely perceived as a ‘black box’ as well. This perception grew during the years since nationalisation. As early as the first Pérez administration (1974-1979), PDVSA was considered a ‘secretive’ organisation. Jose Andrés Octavio, Comptroller General at that time, comments, “PDVSA was very difficult to audit. Although we established a special taskforce to monitor it from within the company was very secretive. They hid information up to the point that I had to complain formally to PDVSA’s President Rafael Alfonzo-Ravard about information specifically requested and never given by the company.”⁴⁸³ The sentiment that PDVSA was a ‘black box’ became widely held

⁴⁸² President Herrera named his Minister of Energy, Humberto Calderon Berti, President of PDVSA.

⁴⁸³ Jose Andrés Octavio, interview by author, Caracas, 19 August 2003.

over decades. By 1998, this was an accepted, if not always publicly admitted, truth in the political world.

The so-called ‘oil opening’ process in the mid-1990s, examined in Chapter 4, revived the debate about PDVSA’s independence and prominent policy role. More importantly, it raised the ideological debate about the private sector role in the oil business. Opposition to the oil opening agenda arose against not only the opening process itself but to any attempt to proceed towards some sort of privatisation of PDVSA itself. The oil opening was deemed for many analysts and politicians as a ‘testing the water’ exercise for a possible full privatisation drive. Concurrently with the oil opening, there was much debate, in the big media and in business conferences, about possible financial options to allow national private capital in PDVSA.⁴⁸⁴

AD veteran leader Carlos Canache opposed any attempt to privatise PDVSA.⁴⁸⁵ He represented AD’s old guard, which had remained faithful to AD’s traditional nationalist stances, and fiercely opposed the liberalisation agenda of Pérez’ second administration. Ironically, ex-President Pérez also opposed the oil opening on the grounds that “it violates the country’s strategic interests with regard to the subsoil ownership”.⁴⁸⁶ It was, however, an organisation called Fundapatria that went through legal channels to challenge the oil opening. Previously, Alí Rodríguez, president of the Energy Permanent Committee of the lower chamber in Congress, had denounced the unconstitutional nature of the contract.⁴⁸⁷ Fundapatria were the most active voice among opponents to oil opening. Both the Ministry of Energy and the President of PDVSA denied that full privatisation was seriously considered.⁴⁸⁸

⁴⁸⁴ See for example, Francisco Monaldi and Alberto Quiros-Corradi’s proposal about individual capitalisation of PDVSA ownership presented in the umbrella business association (Fedecamaras) annual meeting in 1998.

⁴⁸⁵ Carlos Canache Mata in ‘No a la privatizacion de PDVSA’, El Nacional, 21 February 1996 and ‘Una republica en venta?’, El Nacional, 15 March 1996.

⁴⁸⁶ Carlos Andrés Perez in ‘La apertura petrolera causara un grave daño al pais y a PDVSA’, El Nacional, 21 January 1996.

⁴⁸⁷ Ali Rodríguez in ‘Reitera presidente de Minas en Diputados: contrato marco de apertura petrolera es inconstitucional’, El Nacional, 20 January 1996.

⁴⁸⁸ Luis Giusti in ‘La venta de acciones de PDVSA no esta planteada’, El Nacional, 27 April 1996.

Fundapatria coordinated a group of Venezuelans who demanded the annulment of oil opening contracts in the Supreme Court in December 1995. They claimed that the process suffered from several legal flaws. First, they equated the new form of the contracts to the extinct concession system explicitly abolished by the Nationalisation Law. Therefore, such new contracts were deemed illegal. Secondly, an exception to paying municipal taxes granted in the Congress's approval was also judged unconstitutional. Thirdly, they questioned the arbitration mechanism set up in the contracts. It was, for them, a violation of the sovereign right of Venezuela to settle any dispute in its own courts. Fourthly, they also questioned the transfer of regulatory duties from the Ministry of Energy to a PDVSA subsidiary.⁴⁸⁹

A second lawsuit was introduced by the same group on 23 January 1996. They included new allegations of illegality that complemented the first legal action. When this new lawsuit was introduced to the Supreme Court, the presidential candidate Hugo Chávez and hundreds of supporters joined the plaintiff group in a demonstration in front of the Court's building.⁴⁹⁰

Fundapatria asked Congress to delay approval of individual oil opening contracts until the Supreme Court ruled over the annulment request.⁴⁹¹ They asked the Attorney General to intervene as well.⁴⁹² Eighteen months later, Fundapatria's president, Luís Vallenilla, insisted that the Supreme Court speed up a decision on the lawsuits.⁴⁹³ The Attorney General, Iván Badell, rejected Fundapatria claims. He stated that "the oil opening process complied with all constitutional and legal requirements, therefore Fundapatria's claim should be considered invalid".⁴⁹⁴ The Supreme Court finally decided on the subject in 1999, ruling against Fundapatria's petitions.

⁴⁸⁹ Simon Munoz Armas in 'Objeciones patrióticas y legales', El Nacional, 21 January 1996, see also 'Una demanda de nulidad', El Nacional, 18 January 1996.

⁴⁹⁰ 'Impugnaran por segunda vez acuerdo de apertura petrolera por segunda vez', El Nacional, 24 January 1996.

⁴⁹¹ 'Plantean venezolanos de Fundapatria: el congreso debería esperar decisión de CSJ sobre los contratos petroleros', El Nacional, 15 June 1996.

⁴⁹² 'Piden pronunciamiento de la Fiscalía ante violación de ley petrolera', El Nacional, 11 October 1996.

⁴⁹³ 'En Sala Plena de la CSJ Fundapatria solicitó detener proceso de apertura petrolera', El Nacional, 20 June 1997.

⁴⁹⁴ Ivan Dario Badell in 'Badell descarta ilegalidad de la apertura petrolera', El Nacional, 19 November 1997.

Although a relatively isolated effort, the Fundapatria lawsuit had important connotations. It galvanised those who support the oil opening on the one hand and those who opposed the PDVSA agenda on the other. 1998's presidential campaign further demarcated these two camps. All presidential hopefuls other than Hugo Chávez aligned themselves with the opening agenda, although they were cautious about full privatisation of PDVSA.⁴⁹⁵ Chávez's position on PDVSA and other oil policy issues such as the support for Opec was clearly different. He promised to revise oil opening contracts as early in the campaign as December 1997.⁴⁹⁶ Both Alí Rodríguez and Bernardo Álvarez, Chávez's oil policy advisors, called for a change in the orientation of the oil opening.⁴⁹⁷ Another advisor, Alvaro Silva-Calderón, opposed anti-Opec stances and equally requested a revision of oil opening.⁴⁹⁸ Oil policy positions were clearly established by contending candidates when Venezuelans elected Chávez in December 1998.

PDVSA's interference with political affairs

PDVSA was not only considered independent from political control and of being too influential in oil policy but was also perceived as interfering in electoral politics in 1998. As the campaign was progressing all candidates, including Hugo Chávez (an outsider in politics at that time), with a realistic prospect of winning came from non-partisan platforms as anti-party sentiments in public opinion had grown substantially.

The AD party, the dominant political organisation for more than four decades, was under threat, with polls suggesting a significant decline in the party's electoral prospects. AD secretary general, Luís Alfaro-Ucero, sought an unexpected alliance with PDVSA president Luís Giusti. Both had become close political allies when PDVSA, under Giusti's presidency, intensively lobbied political elites for the

⁴⁹⁵ For example, main candidates expressed their ideas on a series of interviews published by *El Nacional* as followed: Henrique Salas Romer on the 15 October 1998, Irene Saez on the 17 October 1998 and Luis Alfaro Ucero on the 19 October 1998.

⁴⁹⁶ 'Chavez prometio un jonron con las bases llenas', *El Nacional*, 16 December 1997.

⁴⁹⁷ Bernardo Alvarez in 'Reorientar la apertura petrolera, una necesidad', *El Nacional*, 16 February 1998; Ali Rodríguez in *Debates IESA*, October to December 1996.

⁴⁹⁸ Alvaro Silva-Calderon in 'Chavez defenderia precios del crudo y Salas Romer volúmenes de producción', *El Nacional*, 29 November 1998.

implementation of its corporate strategy in the 1990s. Additionally, PDVSA had invested significant resources in Monagas and other states,⁴⁹⁹ AD's traditional strongholds and Alfaro-Ucero's local constituency.

Paulina Gamus, a former congresswoman and a member of Alfaro-Ucero's campaign team in 1998, confirmed, "Alfaro-Ucero and Giusti maintained a fluid and constant communication. Alfaro-Ucero was close to Giusti despite the fact that he was commonly associated with 1993's Copei candidate Alvarez Paz. A Giusti candidacy supported by AD was certainly a possibility considered by Alfaro Ucero although never formalised in the party's internal bodies."⁵⁰⁰ Alfaro Ucero ordered an internal survey that, however, showed little grassroots support for a possible Giusti nomination.⁵⁰¹ Similarly, Rafael Garrido, internal auditor in PDVSA, admitted, "The self-promoting activities carried by Giusti to position himself as a presidential candidate were *sotto voce* within the company."⁵⁰²

Luís Giusti was a charismatic manager whose leadership in PDVSA had been heavily associated with the oil opening process. Bernardo Alvarez, former Deputy Minister of Energy, pointed out, "Giusti was very successful selling that PDVSA strategy to the mainstream political elite, mainly based on a great expansion in oil production, designed to pay for the external debt, public sector labour debt, and for foreign reserves to pay for imports. The political elite threw their support behind this vision in the campaign. Chávez's alternative vision was bound to generate political conflict."⁵⁰³

Giusti denied, on several occasions, his intentions to become a candidate.⁵⁰⁴ The hypothetical Giusti's candidature was, however, deemed as unprecedented intrusion into politics by a senior PDVSA official. The proposed use of the ample resources of a

⁴⁹⁹ In 1997 PDVSA created a special unit for that region called 'Cordinacion de Oriente' under a closed associate of Luis Giusti, Lombardo Paredes. Sixty per cent of total planned investment until 2007 was destined to that region. See Jose E. Arriola, Clientes Negros. Petroleos De Venezuela Bajo La Generacion Shell (Caracas, Los Libros de El Nacional/Editorial CEC, SA, 1998).

⁵⁰⁰ Paulina Gamus, interview by author, Caracas, 22 August 2003.

⁵⁰¹ This survey is reported by Jose Vicente Rangel in his weekly column in El Universal, 10 May 1998.

⁵⁰² Rafael Garrido, interview by author, Caracas, 7 August 2003.

⁵⁰³ Bernardo Alvarez, interview by author, Washington DC, 12 August 2003.

⁵⁰⁴ Luis Giusti, interviewed in El Nacional, 8 March 1998 and 16 April 1998 (reacting to a report attributed to Merrill Lynch suggesting his candidature).

corporation as powerful as PDVSA to promote the prospects of an individual was not well received among contenders. Although these claims were never proved, such a perception lingered on during the presidential campaign.

Collapse in PDVSA's fiscal contributions

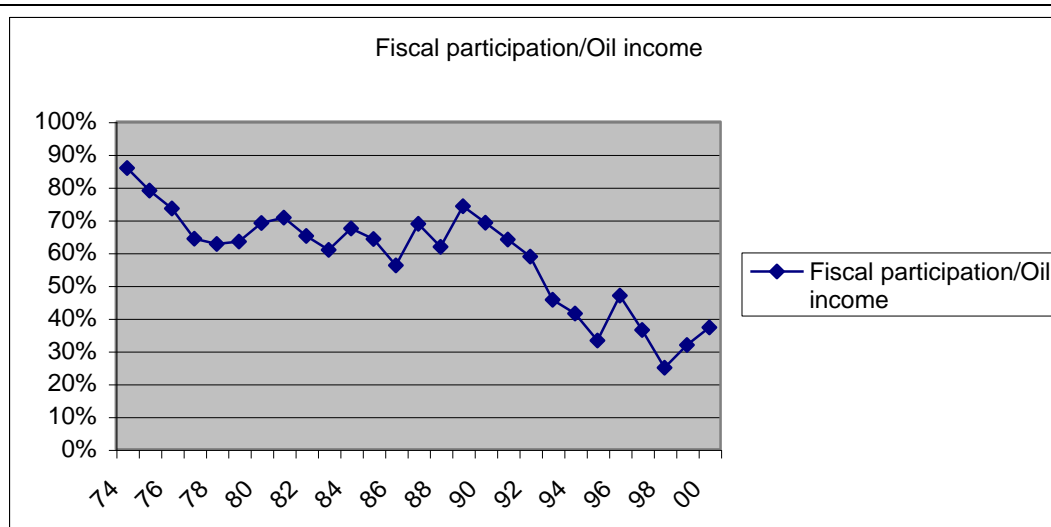
PDVSA's contribution to the Treasury had been declining significantly for years. Figure 6.1 shows how the fiscal share in relation to oil revenues had declined to 25% in 1998. This decline has occurred even as oil revenues have increased over the years as can be seen in Figure 6.2. This contrast was widely considered as being the outcome of a 'tax avoidance' strategy by PDVSA.

Ramón Espinasa, former PDVSA's chief economist explained, "From 1975 to 1985 there were enough resources to inject new capital to PDVSA without diminishing fiscal contributions. In the 1990s, however, this was not the case. Fiscal pressure on the company had to decrease in order to pay for the expansion plan and other necessary investment. In some sense, all accusations against PDVSA in that regard were true. The fiscal contribution went from 18% of GDP in the 1970-1980s to 8% in 1995 and 1996. At the same time PDVSA increased its production potential by one million barrels per day. The idea was to pay less tax per barrel but to get an expanded production volume to compensate for it."⁵⁰⁵

PDVSA's fiscal contribution was, on average, 65% of its revenues since nationalisation in 1975 until 1993. In other words, two-thirds of gross PDVSA income was always captured by the Venezuelan Treasury. Historically, this participation had been 45% for the whole period of commercial oil exploitation (1938-2001) and 37% during the multinationals exploitation era (1938-1974). From 1994 until 1998, however, PDVSA fiscal contribution dropped to 36%.

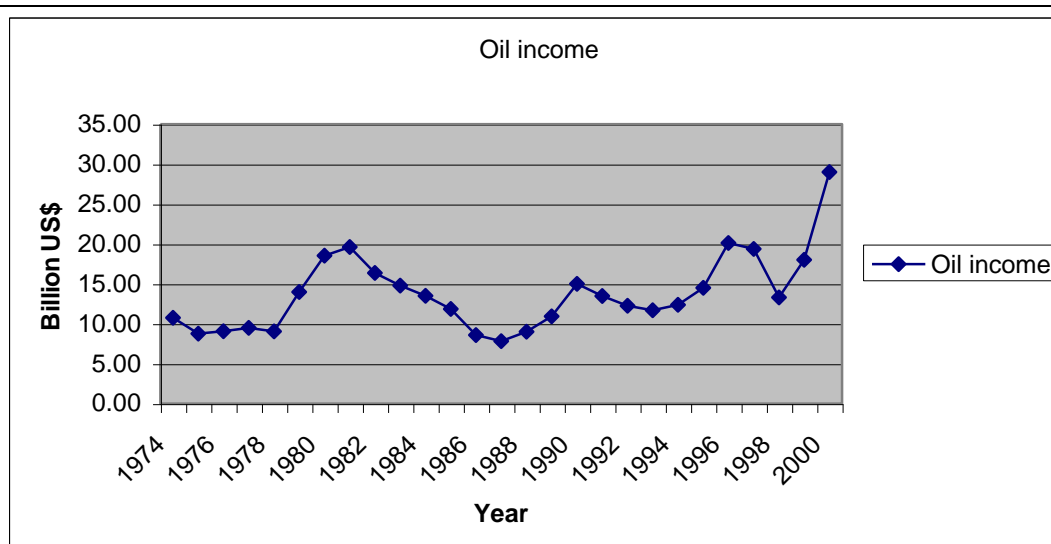
⁵⁰⁵ Ramon Espinasa, interview by author, Washington DC, 15 August 2003.

Figure 6.1 Fiscal Participation as % of Oil income



Source: Ministry of Energy (compiled by Bernard Mommer)

Figure 6.2 Oil income (1974-2001) in Billion US\$



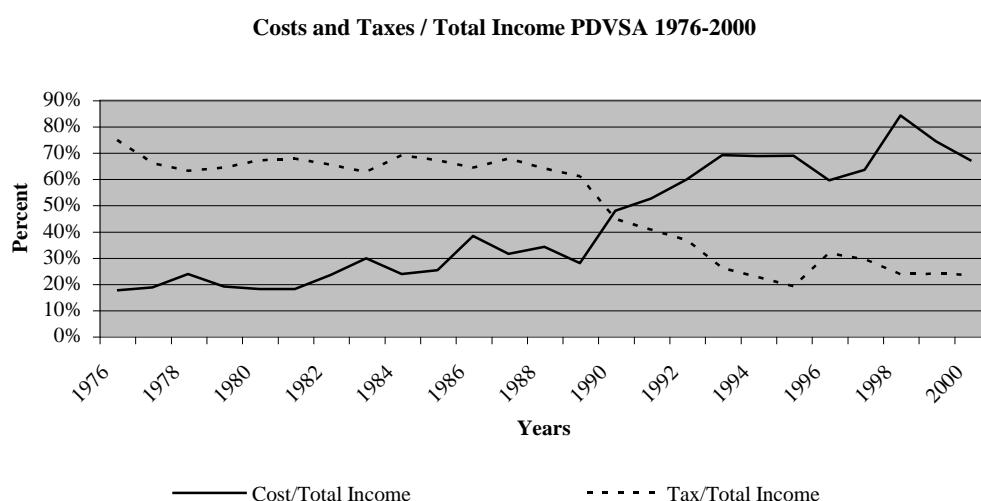
Source: Ministry of Energy (compiled by Bernard Mommer)

Although associated to Giusti's term as President of PDVSA, reduced fiscal contributions followed, among other factors, changes in the taxation regime passed earlier. The elimination of the Fiscal Value for Exports, passed in 1993, gave PDVSA significant tax relief. PDVSA had obtained this from its weakened political masters when PDVSA's President Sosa-Pietri imposed, in practice, an expansion plan in the early 1990s. Ramón Espinasa explained, "There was a tension between the owner of the resources who wanted more rents and the manager who wanted to produce more.

PDVSA imposed its position in solving that tension at a time of unfavourable market conditions.”⁵⁰⁶ This state of affairs was, however, unattainable as Bernardo Alvarez pointed out: “This was simply politically unsustainable.”⁵⁰⁷

This significant decline in PDVSA’s fiscal payment exposed the company to two claims. The explanation given by Espinasa about PDVSA investing part of its surplus in its own expansion was not shared by many in the political world. On the contrary, other explanations were believed. Either the company had a bloated cost structure (see Figure 6.3) or tax avoidance strategies were deliberately in place to dry up fiscal commitments.

Figure 6.3 Ratios of Costs and Taxes to Total PDVSA income



Source: Ministry of Energy (compiled by Bernard Mommer)

The issue of escalating costs and declining fiscal contributions was never settled. In the absence of a formal mechanism to address those matters, explanations were formed through non-official channels and through anecdotal evidence. For instance, a widely circulated ‘joke’ among top officials in the company after the restructuring in 1998 cast some light on the ‘bloated bureaucracy’ argument: top executives joked about the company being ‘Hollywood’ because ‘everybody had a double’, in a clear

⁵⁰⁶ Ramon Espinasa, *ibid.*

⁵⁰⁷ Bernardo Alvarez, *ibid.*

reference to the fact that the big restructuring led by Giusti in the mid-1990s had maintained widespread duplications in many managerial posts.⁵⁰⁸

On the tax avoidance argument, a senior PDVSA official, said, “Yes, we did fiscal planning.”⁵⁰⁹ ‘Fiscal planning’ is used here as a euphemism for avoiding tax, in this case, in Venezuela.

Venezuela’s limited technical and administrative capacities and PDVSA’s secrecy combined to create a sort of ‘witchcraft’ situation. Politicians who did not trust PDVSA simply accepted those claims as absolute truth. PDVSA, in turn, distrusted the political world intensely. Furthermore, as Alirio Parra, former PDVSA board member and Minister of Energy, reflected, “PDVSA believed the Venezuelan State knew nothing.”⁵¹⁰

6.2 Chavez administration’s initial oil policy

President Chávez’ s oil policy during his first three years in office was more externally oriented than directed to control PDVSA. The government concentrated on an international agenda to revitalise Opec and international oil prices. PDVSA remained, operationally and institutionally, untouched by governmental initiatives. President Chávez, however, filled top ranked positions both in PDVSA and in the Ministry of Energy with his most trusted oil advisors.

Chávez named an oil liaison commission during the transition to power (December 1998 to February 1999) with his main advisors, notably Alí Rodríguez, Alvaro Silva-Calderón, Hector Ciavaldini and Bernardo Alvarez. They announced a total revision of PDVSA plans and oil policy in general.⁵¹¹ Members of this commission went to the most senior positions in the governmental oil hierarchy, as shown in Table 6.1. These new senior officials were all former veterans in oil policy with large congressional

⁵⁰⁸ Rafael Garrido, interview by author, Caracas, 7 August 2003.

⁵⁰⁹ PDVSA senior staff, who requested anonymity; interview by author, Caracas, August 2003.

⁵¹⁰ Alirio Parra, interview by author, London, 16 September 2003.

⁵¹¹ ‘Revisan gastos e inversiones en PDVSA’, *El Universal*, 6 January 1999.

and long standing party experience. Chávez was faithful to his campaign promises to bring a ‘nationalist’ tradition to oil policy.

President Chávez used his prerogative to name a new PDVSA board, even when the term of the existing board had not expired. On 18 February 1999 he named a new PDVSA board (see Table 6.2). Notably, he chose Roberto Mandini as Giusti’s replacement. Mandini, a respected top executive with a solid and extended career within the industry, was then vice chairman of PDVSA’s largest foreign subsidiary CITGO. He had been at odds with Luís Giusti and had been maintained in a foreign position. He had previously presided over PDVSA’s former subsidiary Corpoven for eight years until 1994.⁵¹² That year Luís Giusti was appointed President over the heads of the usual hopefuls, such as those presiding over the main operating companies, as was the case of Mandini.

Table 6.1 Chávez administration’s top oil policy officials

Name	Position	Background (most relevant positions)
Alí Rodríguez	Ministry of Energy	Congressman; President of Energy Select Committee in Congress; Member of Causa R (left wing party).
Alvaro Silva-Calderón	Deputy Ministry of Energy	Member of the Nationalisation Law Committee in 1975; Congressman in various terms; Member of Energy Select Committee in Congress; Member of MEP (left wing party).
Bernardo Alvarez	Deputy Ministry of Energy	Congressman; Member of Energy Select Committee in Congress; Member of Causa R (left wing party)
Hector Ciavaldini	Member of PDVSA board	Former middle-level staff at a PDVSA subsidiary.

Source: Official Gazette, various issues, compilation by author.

⁵¹² Among Lagoven and Maraven, Corpoven was one of the three nationalised operators controlled by PDVSA.

Table 6.2 PDVSA's boards (1999-2001)

February 1999 to August 1999	August 1999 to February 2001	March 2001 to February 2002
Roberto Mandini (President)	Hector Ciavaldini (President)	Guaicaipuro Lameda (m) – President since Oct 2000
Hector Ciavaldini	Aires Barreto	Jorge Kamkoff
Eduardo Lopez-Quevedo	Domingo Marsicobrete	Karl Mazeica
Eduardo Praselj	Eduardo Praselj	Vincenzo Paglione
Oswaldo Contreras (m)	Oswaldo Contreras (m)	Arnaldo Rodríguez (m)
Alfredo Carneiro (m)	Carlos Jorda	Juan Torres (m)

Note: (m): military

Source: Official Gazette, various issues, compilation by author.

Mandini's appointment was widely regarded as a cautious move by President Chávez. Other presidential appointments, such as Maritza Izaguirre, ratified as Minister of Finance (she had served in the previous Caldera administration) were viewed as a prudent stance by the Chávez' administration, intended to calm those expecting a radicalisation of the government. Another appointment in PDVSA, however, was not well received among the conglomerate's senior officials. Hector Ciavaldini was named Vice President. He was a controversial figure because he was a former employee of the company who terminated, in 1995, his working relations in contentious circumstances. Ciavaldini sued the company on the grounds of unfair dismissal.⁵¹³ The company alleged that Ciavaldini asked for an early retirement on the grounds of psychological stress. The legal action had not been settled by 1999.⁵¹⁴ In any case, the Ciavaldini appointment and his later influence in PDVSA internal management was the only significant interference by President Chávez with the status quo prevailing in the conglomerate prior to his coming to power.

Chávez administration's Opec revitalisation agenda

Minister Rodríguez and other oil policy makers went on an international offensive focused on an Opec revitalisation agenda. It was widely accepted at that time that prevailing weak oil prices during the previous years was partly caused by Opec

⁵¹³ He actually sued Bariven, the PDVSA's subsidiary for which he was working.

⁵¹⁴ 'Por que Hector Ciavaldini se fue y regreso a PDVSA?', *El Nacional*, 14 February 1999.

indiscipline over production quotas. Moreover, Venezuela was considered one of the ‘undisciplined’ producers despite its tradition of strong enthusiasm for Opec policies. It was believed that PDVSA maintained unreported reserves of oil in Caribbean deposits, among other tactics, to exceed Venezuelan production quotas⁵¹⁵.

President Chávez and his oil team gave top priority to restore discipline among Opec producers. Chávez himself embarked on a personal diplomatic effort to bring Opec members to agree on better coordinated actions. Table 6.3 shows the main events promoted by Venezuela in that direction. Opec heads of state met in Caracas for the first time in decades. The strategy came to fruition as oil prices recovered (also shown in Table 6.3).

Table 6.3 Venezuela’s Opec revitalisation agenda (1999-2000)

Date	Event	Oil Price (\$/Barrel)
March 1999	Participate in Amsterdam meeting of Opec and independent producers to lower production.	9.96
June 1999	Venezuela suggested a presidential level summit of Opec countries to boost new strategy (last summit of that kind held in Argel, 1975).	15.61
July 1999	A top level Venezuelan delegation (lead by Deputy Minister of Energy and Mines Silva-Calderón and Deputy Foreign Affairs Minister Jorge Valero) visited 10 Opec countries to muster support for summit and new strategy.	18.28
November 1999	Venezuela suggested a global action plan for Opec	23.75
August 2000	President Chávez visited ten Opec countries	28.30
September 2000	Summit of Opec countries’ presidents is held in Caracas	31.48

Source: El Nacional and El Universal , Opec Annual Statistical Bulletin 2001.

Chavez administration-PDVSA’s initial relationships

President Chávez’s administration policy toward PDVSA did not significantly change its preceding status despite the fact that PDVSA’s performance had not improved

⁵¹⁵ This was explained to me by a PDVSA official who requested anonymity.

from the previous year. Changes in the composition of the board (see Table 6.2) had little influence over the running of the company. Roberto Mandini, the first Chávez appointee, was undermined by the increasing influence of another Chávez nominee, Hector Ciavaldini, who had direct access to Chávez most trusted advisors.⁵¹⁶ Mandini resigned in August 1998, only seven months into his term. In September 1999 Ciavaldini was appointed the next PDVSA president.

Ciavaldini's tenure was brief though. He had to negotiate a labour contract with the main workers union, led at that time by Carlos Ortega.⁵¹⁷ Negotiations were troublesome. Industrial action threatened the company's traditionally peaceful labour relations. In October 2000 the company's functioning was seriously threatened. Ciavaldini agreed a deal with the unions that was deemed a failure. This triggered his sacking by Chávez.

PDVSA's third president in twenty months was appointed suit. Chávez resorted this time to a military man. This was a usual practice of Chávez, as he filled many of the important posts in his administration with both retired and active military personnel. In fact, the PDVSA board already had members from the military when General Guaicaipuro Lameda was appointed to replace Ciavaldini.

PDVSA's activities and the oil opening ventures remained intact throughout this period. Although Minister Rodríguez had insisted that oil opening would have to be modified he likewise gave the assurance that the government would honour contracts signed under previous administrations.⁵¹⁸

Similarly, Chávez's team's intentions of reviewing PDVSA's escalating costs did not translate to effective results, despite Ciavaldini's early announcements regarding a cost reduction strategy.⁵¹⁹ PDVSA's cost structure followed similar patterns as the recent past, during 1999-2001, as Table 6.4 shows, although improving oil prices in

⁵¹⁶ Ciavaldini was a close associate of Minister of Planning Jorge Giordani. They used to gather to discuss public policy issues in a group known as 'Grupo Garibaldi'.

⁵¹⁷ Ortega went afterwards to lead the main national labour union and became very influential in the general strikes of 2002.

⁵¹⁸ Ali Rodríguez in 'Apertura se hizo al margen de la Constitución y las leyes tributaries', El Nacional, 4 March 1999.

⁵¹⁹ 'PDVSA revisara su estructura de costos', El Universal, 7 September 1999.

2000 and 2001 enabled a better cost/income ratio. In addition, the oil opening was not affected, as an opponent of Chávez, former Minister Calderón-Berti, recognised.⁵²⁰

Table 6.4 PDVSA cost and income per barrel (1999-2001)

Cost Income	Average 1994-1998	1999	2000	2001
Cost per barrel (\$)	5.10	6.77	4.87	5.36
Income per barrel (\$)	15.28	16.73	26.25	20.95
Cost/Income ratio	40%	44%	20%	28%

Source: Ministry of Energy, compiled by Bernard Mommer

While PDVSA was left practically untouched, other oil issues and political events evolved satisfactorily in favour of Chávez and his early objectives. On the one hand, oil prices recovered in 2000. Minister Alí Rodríguez was appointed Secretary General of Opec, and Alvaro Silva-Calderón the new Minister of Energy. On the other hand, the 1999 Constitution had mandated new elections for all posts. President Chávez got elected in July 2000 for a new constitutional term of six years. A new legislative body was instituted. The National Assembly was also elected in July 2000. Chávez obtained a handsome majority. In November 2000, the National Assembly granted President Chávez power to legislate by decree. A new overarching legislation for the oil industry was top priority in Chávez's agenda.

6.3 Reshaping oil's rules of the game

Once Chávez was able to legislate by decree, the top oil policy makers of his administration sought the opportunity to craft a regulatory framework that addressed all their former concerns about the sector: governance of PDVSA, possible privatisation and PDVSA's dismal fiscal contributions.

⁵²⁰ Humberto Calderon Berti in 'La politica petrolera venezolana', *Venezuela Analitica*, 17 September 2001.

PDVSA's new constitutional status

The first change was at the constitutional level. In fact, the Constitution of 1999 introduced an important innovation regarding ownership of PDVSA. State rights over PDVSA were elevated to the constitutional level. Any possible privatisation scheme was explicitly blocked in the constitutional text. In fact, Article 303 establishes: “For sovereignty, political and national strategic reasons, the State will keep the totality of shares in *Petróleos de Venezuela, S.A.*, or of any other entity created to manage the oil industry, except those of subsidiaries, strategic associations, companies or any other that have been formed or will be formed to develop *Petróleos de Venezuela, S.A.* businesses.”⁵²¹ This constitutional provision settled the debate about a possible partial or total privatisation of PDVSA during the previous decade. Gastón Parra, the member of the constitutional convention who pioneered the legal provision, had opposed private participation in the oil sector since the discussion of the Nationalisation Law in 1975.⁵²²

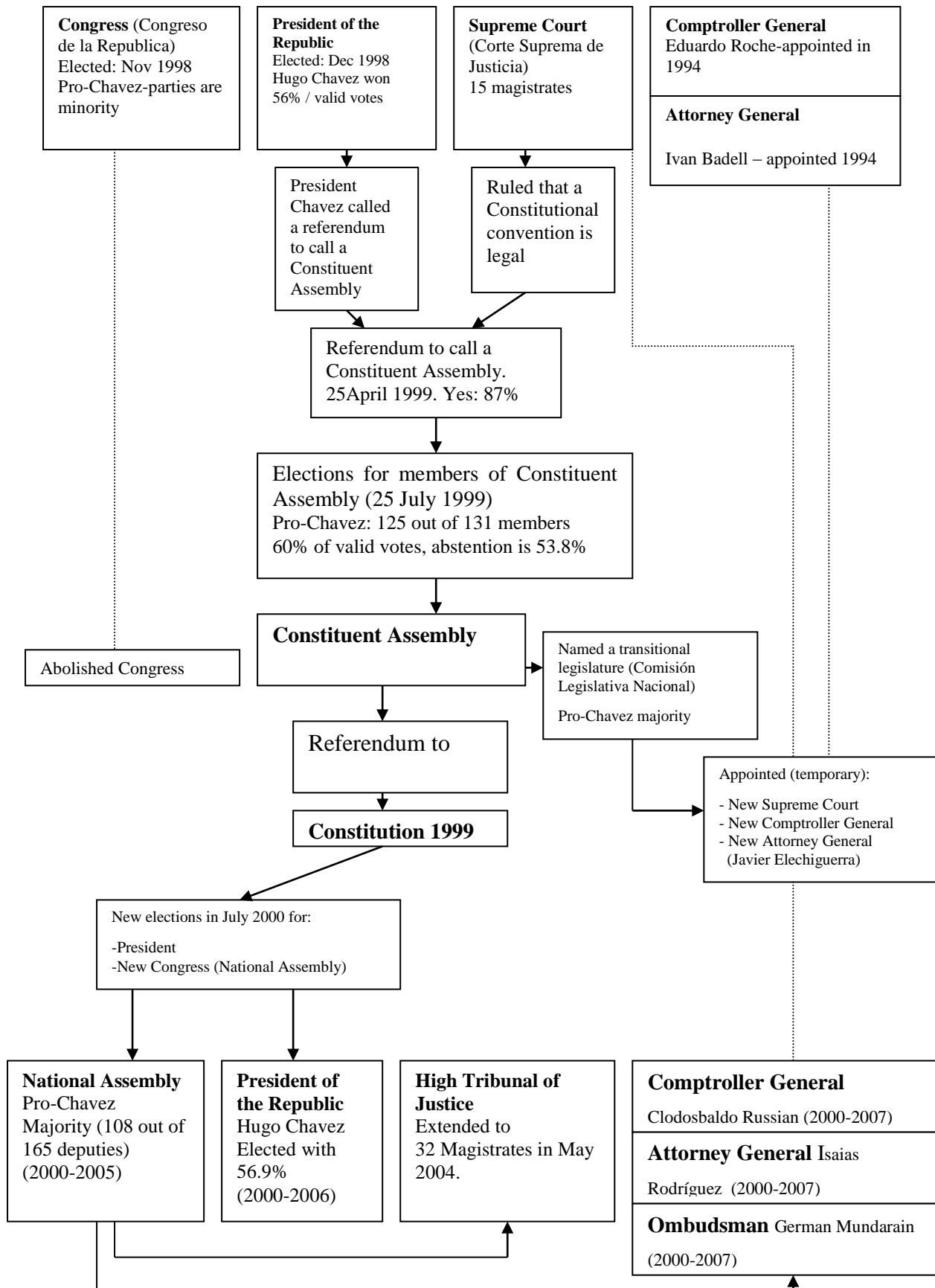
The new Constitution mandated new elections for all elected posts and a renewal of all other constitutional posts. Chávez got elected with 59.5% of the votes. In the new legislative body, the National Assembly, Chávez supporters got a majority of 108 out of 165 deputies. Justices and other high constitutional posts were filled directly by a transitional body created by the Constituent Assembly called the National Legislative Commission, which was amply dominated by Chávez's supporters. Figure 6.4 shows the extensive process of institutional overhaul conducted in less than two years (February 1999 to December 2000).

Additionally, the new Constitution augmented the scope of matters that the legislature was entitled to delegate on the President. The so-called ‘enabling’ laws authorise the President to legislate by decree. Article 230 of the 1999 Constitution put no restrictions regarding which matters can be delegated to the President.

⁵²¹ Official Gazette 5,453, 24 March 2000.

⁵²² D.Maza-Zavala, ‘Gaston Parra-Luzardo y el Petroleo’ ,*El Nacional*, 27 February 2002.

Figure 6.4 Institutional overhaul (1998-2000)



It requires only a three-fifths majority to approve and to limit the duration of the delegation.⁵²³ In fact, on 11 November 2000, the National Assembly passed an ‘Enabling law’ granting Chávez the widest authority to legislate by executive decree that a Venezuelan President had ever enjoyed since democracy was reinstated in 1958.⁵²⁴ The ‘enabling’ law specifically authorised the administration to unify regulations on all hydrocarbons activities and to preserve public ownership over oil reserves (Article 1, Section 2.e)

Rebalancing PDVSA-government relationships

For Chávez’s senior officials, reversing the balance of power vis-à-vis PDVSA was the top priority. Bernardo Alvarez, closely involved in the drafting of the law, commented, “Reversing PDVSA power seemed an impossible task, but that was exactly what we wanted to achieve with the new law, knowing that it would be contentious.”⁵²⁵ They were especially concerned with three aspects of the relationship with PDVSA.

1) Declining the Ministry of Energy’s regulatory capacities

The Ministry had, in practice, given away its policy setting role and its capacity to administer oil reservoirs to PDVSA. Additionally, its diminished role to monitor, control and direct oil activities was evident to all. PDVSA had also taken increased responsibility over areas such as petrochemicals, gas and carbon. The oil opening process had only highlighted this developing state of affairs. The new administration was concerned to reverse this trend and re-establish the primary role of the Ministry of Energy.

⁵²³ Official Gazette 5,453, 24 March 2000.

⁵²⁴ Official Gazette 37,076, 13 November 2000.

⁵²⁵ Bernardo Alvarez, *ibid.*

2) PDVSA's low fiscal contribution

The Ministry of Energy was not only an ineffectual regulator but in addition the senior officials in PDVSA who had been appointed by Chávez had not succeeded in getting PDVSA in check. By 2001, three years into Chávez's administration, reviewing costs within PDVSA was yet to be done. Alí Rodríguez, Minister of Energy at that time and later President of PDVSA pointed out, "PDVSA was practically impossible to audit. Former management had created an extremely complex web of companies both nationally and abroad. The limited resources available in PDVSA could not be devoted to carry on with the task of reconstructing old practices. We had to concentrate on the future and in halting old practices that went against the interest of Venezuela. We had to concentrate on keeping costs down. The company had accumulated a vast amount of managerial waste."⁵²⁶

Additionally, the government's tax collecting body was deemed unprepared to monitor PDVSA tax payments. In fact, both the former structure within the Ministry of Finance (called the Division for Sector Rents) and its successor (called Servicio Nacional Integrado de Administracion Aduanera y Tributaria, or Seniat) were poorly prepared for supervising a corporation of the complexity and magnitude of PDVSA.

In 2004, the unit directly responsible for supervising PDVSA tax payments was the Unit for the Energy Sector within the Supervision Division of the Regional Unit (Capital Region) for special taxpayers. This organisational structure placed this Unit in the fifth layer of the Seniat hierarchy, as it is showed in Figure 6.5.

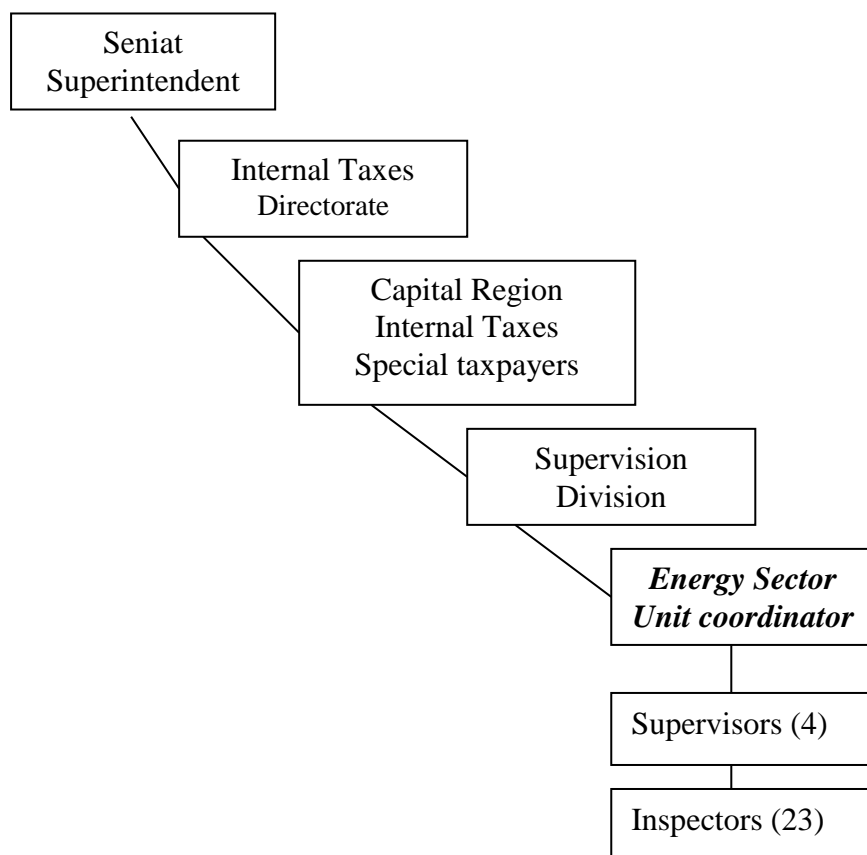
Edelmira Durán, the Energy sector unit coordinator commented, "Our unit supervises all companies of the energy sector in the country, including refining, transport and commercialisation of hydrocarbons. PDVSA is only one of them. With the opening of oil exploitation to the private sector, the division has focused on those companies. We have limited resources and inspections are concerned with general accounting principles and not on the substantial nature of their economic activities. We do not

⁵²⁶ Ali Rodríguez , interview by author, Caracas, 26 February 2004.

have the personnel to carry out such tasks. We plan to prepare personnel for that purpose in the future but it has not been possible so far.”⁵²⁷

Bernard Mommer, who was very influential in drafting the hydrocarbons law, recognised, “The Venezuelan government is an inefficient regulator; it is better to have simple but applicable regulatory rules such as the royalty, which is a flat tax.”⁵²⁸

Figure 6.5 Seniat’s organisational structure (Energy sector Unit)



Sources: Seniat. Official Gazette Extraordinary 4,881, 23 March 1995 and 36,233, 23 June 1997

3) Path initiated with ‘oil opening’

Objections to the ‘oil opening’ abounded. First, oil opening contracts exercised control over the associations through a ‘Control Committee’, instead of the traditional

⁵²⁷ Edelmira Duran, interview by author, Caracas, 20 February 2004.

⁵²⁸ Bernard Mommer, interview by author, Caracas, 5 March 2002.

majority shareholding.⁵²⁹ In practice, this represented some sort of ‘golden share’ scheme commonly used in business associations. Although the Supreme Court had ruled that ‘golden share’ schemes were sufficient to guarantee state control (and comply with legal requirements), oil opening opponents deemed them unfit to ensure control.

Second, auctioned areas during the oil opening were, according to PDVSA, those of low productivity. Oil opening opponents were at odds with that. They believed that this was a façade to grant access to exploration and exploitation of the reservoirs, largely the most profitable part of the value chain in the oil business. Finally, the participation of national private capital was deemed to be hindered by the high qualifications required for bidders.

Drafters of the law, led by Minister of Energy Alvaro Silva-Calderón, wanted to use the new legislation to correct flaws that had been denounced for a long time. They had total discretion over the draft, because of the legislative delegation in the enabling law.

The new Hydrocarbons Law

The Ministry of Energy produced a first draft of the law eight months after the Enabling Law’s authorisation. In August 2001 Chávez appointed a presidential commission in charge of revising the draft. Table 6.5 shows the composition of the Commission. It included four former members of the commission which wrote the Nationalisation Law in 1975.

The commission set a deadline for 15 October that year to submit a final draft to President Chávez’s cabinet. In principle, the new hydrocarbon law was aimed at unifying the scattered legislation that regulated the sector, a purpose agreed by all members. Although the commission met with experts from various sort, most of the debate took place through the media.

⁵²⁹ Juan Carlos Garanton, interview by author, Caracas 19 August 2003.

Table 6.5 Members of the Revising Commission for the Hydrocarbons Law

Member	Relevant position (background)
Alvaro Silva-Calderón	Minister of Energy and Mines (*)
Nelson Merentes	Minister of Finance
Jorge Giordani	Minister of Planning
Guaicaipuro Lameda	President of PDVSA
Hugo Hernández R.	Oil Business association (Private sector)
Domingo Maza Zavala	Central Bank of Venezuela (*)
Gastón Parra Luzardo	Oil expert, University professor (*)
Mazhar Al-Shereidah	Oil analyst, Private Sector
Anibal Martínez	Ex-PDVSA staff (expert in Geology) (*)
Jose Giacopini Zárraga	Ex-PDVSA staff

(*) Former members of the Nationalization commission in 1975

Source: El Universal

Business and former supporters of PDVSA's agenda in the 1990s disagreed with the draft. As was discussed in Chapter 4, PDVSA had imposed its agenda of production expansion, private sector participation and a new Venezuelan position toward Opec on an albeit reluctant Punto Fijo establishment.

On the other hand, political forces that gathered around Chávez in the 1998 election threw their full support behind the draft, which was not surprising, since the draft followed long held views about how the oil industry should had been organised after the end of the concessions system in 1975. Bernardo Alvarez, referring to the provision in the draft that suppressed PDVSA's exclusivity to operate the oil state-monopoly, said, "We specifically included an article that allowed the Ministry of Energy to carry on with oil business activities either directly or through one or more public companies. PDVSA people were very angry at the possibility of its loosing its exclusivity."⁵³⁰

Another common objection from business associations was that the new royalty tax rate was too high and would hinder the profitability of any potential joint venture with PDVSA. Bernard Mommer responded, "The 30% royalty is the easiest way to collect

⁵³⁰ Bernardo Alvarez, *ibid.*

the oil rent given the very poor capacity of the State to supervise and control tax payments.”⁵³¹

Former objections to oil opening were also addressed. Exploitation activities were open to private capital but limited to 49% of the shareholding. The controversy about whether ‘golden share’ schemes guaranteed state control was solved by imposing a majority (51%) requirement for all potential ventures of private-public capital. National capital participation was only loosely encouraged in the law (Article 18). The possibility of considering national capital as part of the 51% majority required for public shareholding was ignored.

The Hydrocarbon Law revising commission was opened to hear objections but, according to opponents, never discussed them. Two members of the commission publicly denounced the lack of discussion. First, PDVSA president, General Lameda sent a ‘private’ letter that was promptly leaked to the public. He later admitted, “The commission thoroughly went through all past issues that troubled some members of the commission.”⁵³²

Hugo Hernández, another member, said that “he opposed the ‘working methodology’ of the commission because they were presented at the beginning with a draft to be discussed instead of policy guidance to stimulate an open debate starting from a more neutral position”.⁵³³ He publicly expressed his discontent: “Various proposals made by different organisations were heard but never discussed or analysed. The commission should have thought about legislation for the next fifty years instead of focusing on correcting the past.”⁵³⁴

Silva-Calderón defended the government’s position: “We heard all voices but obviously we had to reach decisions which were not always what opponents wanted.”⁵³⁵

⁵³¹ Bernard Mommer, *ibid.*

⁵³² Guaicaipuro Lameda, interview by author, Caracas, 1 March 2002.

⁵³³ Hugo Hernandez, interview by author, Caracas 7 February 2002.

⁵³⁴ Hugo Hernandez, *El Nacional*, 8 November 2001.

⁵³⁵ Alvaro Silva-Calderon, interview by author, Vienna, 7 July 2003.

The law was decreed by Chávez just before the enabling powers were about to expire in November 2001. The final version was very close to the Silva-Calderón draft. Notably, the controversial 30% royalty regime was supplemented with a provision to lower the royalty to 20% for heavy oil exploitation when it was sufficiently justified that the 30% level made that exploitation unprofitable.

Lameda's opinions made his position as President of PDVSA untenable. Silva-Calderón, the Minister of Energy at that time, said, "Lameda was totally absorbed by PDVSA's former culture. When he expressed such a dissident position from the government I told President Chávez that his position as president of PDVSA had to be reconsidered."⁵³⁶ President Chávez did not ratify General Lameda as President of PDVSA in February 2002.

Along with the Hydrocarbon Law, President Chávez decreed another 48 laws, ranging from minor issues to land reform. The so-called '49 Laws Package' unleashed a militant opposition push by anti-Chávez groups. This opposition drive resulted in two years of acute political conflicts with direct repercussions for PDVSA-government relationships.

6.4 PDVSA and the political crisis (2002-2003)

The passing of '49 Laws Package', including the new hydrocarbon law, triggered a chain of events that escalated into two acute conflicts involving the oil company. The intensity and gravity of both conflicts represented a disproportionate response to the changes introduced by Chávez. As a consequence of these conflicts, PDVSA-government relationships reached unprecedented levels of politicisation.

⁵³⁶ Alvaro Silva-Calderon, *ibid.*

The conflict of February 2002

In February 2002, President Chávez decided to change the PDVSA board in a striking way.⁵³⁷ PDVSA's President Lamedo had been considered by Chávez's senior administration officials as "absorbed by the prevailing culture of PDVSA and not capable of representing the administration's policies".⁵³⁸ Consequently, President Chávez resorted to a proven oil nationalist, Gastón Parra, who was a former academic and oil expert who was a member of the Nationalisation commission in 1975, the constitutional convention in 1999 and the new Hydrocarbons Law writing commission in 2001. President Chávez named Gastón Parra as the new President on 8 February 2002.⁵³⁹ He also appointed a new board on 25 February 2002.⁵⁴⁰ The new board is shown in Table 6.6.

Table 6.6 Board of PDVSA appointed in February 2002

Board member	Background
Gastón Parra	Academic, oil expert. Former member of Nationalisation commission (1975) and constitutional convention (1999).
Jorge Kamkoff	Various top positions in PDVSA. He also directed the Social Security agency (as part of PDVSA special status transferring top executives to other government posts on a temporary basis).
Carlos Mendoza Potella	Academic, oil expert. Former ambassador to Saudi Arabia. Militant opponent of privatisation schemes for PDVSA.
Gral. Arnoldo Rodríguez	Military. Only member of former board ratified.
Alfredo Riera	PDVSA official (not ranked in top positions according to PDVSA personnel ranking system).
Luís E. Dávila	PDVSA official (not ranked in top positions according to PDVSA personnel ranking system).
Argenis Rodríguez	PDVSA official (not ranked in top positions according to PDVSA personnel ranking system).
Felix Rodríguez	PDVSA official (not ranked in top positions according to PDVSA personnel ranking system).
Jesús Villanueva	PDVSA official (not ranked in top positions according to PDVSA personnel ranking system).
Rafael Ramírez	Gas regulator (Ministry of Energy and Mines).
Clara Coro	Ministry of Energy and Mines.

Source: Official Gazette, compilation by author

⁵³⁷ In his annual address to the National Assembly on the 17 January 2003, President Chavez reflected on the February 2002 appointments in PDVSA by saying he wanted to provoke a crisis within the oil company.

⁵³⁸ Alvaro Silva-Calderon, *ibid.*

⁵³⁹ Official Gazette 37,382, 8 February 2002.

⁵⁴⁰ Official Gazette 37,391, 25 February 2002.

The Presidential announcements immediately triggered strong opposition from PDVSA's top ranks. On the same day as the announcements, they issued a communiqué against the appointments. On 25 February, 34 top PDVSA's executives signed a petition rejecting the 'politicisation' of the industry. The main thrust was the alleged breaking of the so-called 'Meritocracy'. According to them, the merit-based personnel system that had prevailed in PDVSA since its creation in 1975 was being severely affected by the appointment of board members that did not correspond with the necessary qualifications in that system.

A mid-ranked PDVSA manager commented, "The Parra and new board appointments were just the last drop to fill the glass in the government attempt to control the industry. The three years of the Chávez administration had been full of controversial internal appointments such as the main internal security official, a military officer closed to Chávez, who had implemented a state of terror inside the company. Numerous rumours of sackings, internal reorganisations and new directives were abundant over the last years, up to a point that a large proportion of the managerial ranks were extremely anxious and fearful about their future in the company."⁵⁴¹

An historic review of former appointments reveals that 'Meritocracy', as the personnel system had traditionally been presented, had not in fact been properly adhered to in the past.⁵⁴² Table 6.7 shows a summary of previous appointments to the board.

⁵⁴¹ Victor Ramos, interview by author, Caracas, 2 May 2002.

⁵⁴² The 'Meritocracy' argument was presented as suggesting that the Board of PDVSA should be filled with top-ranked officials from within PDVSA.

Table 6.7 Members of PDVSA's board (1975-2002) by background

Main background in:	Number of members	% of Total	% of total weighted by time in office
Oil industry (both pre- and post-nationalisation)	41	50.6	49.4
Non-Oil industry (details below)			
<i>Public Sector (including Ministry of Energy)</i>	13	14.8	19.4
<i>Private Sector (including oil industry suppliers)</i>	15	18.5	16.0
<i>Other (Unions and Military*)</i>	12	16.1	15.2
<i>Sub-Total Non-Oil Industry</i>	40	49.4	50.6
Total	81	100	100

*Until 1999 it was customary to have two members of the board chosen by Labour. Since 1999, President Chávez has resorted to members of Military to fill many bureaucratic positions

Source: PDVSA annual reports, Rafael Quiróz in Meritocracia Petrolera: Mito o Realidad (Caracas, Panapo, 2003). Estimates by author.

Table 6.8 Presidents of PDVSA (1975-2002)

President	Period	Background
Rafael Alfonzo-Ravard	August 1975 – August 1983	Military (General); Guyana Development Corporation (President)
Humberto Calderón B.	August 1983-February 1984	Ministry of Energy and Mines
Brígido Natera	February 1984-November 1986	President largest PDVSA subsidiary (Lagoven)
Juan Chacín	December 1986-March 1990	Director PDVSA subsidiary Meneven
Andrés Sosa P.	March 1990-March 1992	Entrepreneur (oil industry supplier)
Gustavo Roosen	March 1992-March 1994	Top manager in private conglomerate Polar; Ex-Minister of Education
Luís Giusti	March 1994-February 1999	Strategic Planning Director at PDVSA
Roberto Mandini	February 1999-August 1999	President PDVSA third largest subsidiary (Corpoven); Vice President PDVSA's largest foreign subsidiary (Citgo)
Héctor Ciavaldini	September 1999-October 2000	Middle rank staff in PDVSA subsidiaries (Bariven, Intevep)
Guaicaipuro Lameda	October 2000-February 2002	Military (General); Director of National Budget Office

Source: Official Gazette, various issues, PDVSA annual reports, compilation by author

Only five out of 10 previous Presidents of PDVSA, as shown in Table 6.8, came from within the industry. Notably, only two of them, Natera and Mandini, were considered top-ranked at the moment of the appointment. Selections such as that of Juan Chacín in 1986 or Luís Giusti in 1994 were criticised. Chacín on the grounds that an alleged blood relationship with the acting President of the Republic (Jaime Lusinchi) prevailed over professional qualifications and, Giusti on the grounds that there were many other officials better ranked than him at that time.⁵⁴³

On the other hand, ‘internal discontent’ seems to better explain the virulent reaction, disproportionately to past experiences, against the Board’s appointments. Although PDVSA’s presidents in the first years of the Chávez administration had not significantly altered the way PDVSA was operating, internal rumours were rife about imminent changes within the company. The main issue, however, was an investigation conducted by an internal control office called the ‘Losses Control and Prevention Corporate Unit’.⁵⁴⁴ This unit, commonly referred to by its acronym in Spanish, ‘PCP’, was headed by a military man, closely associated to President Chávez, called Colonel Gustavo Pérez-Issa.

There was a report leaked to the press that implicated 68 top executives in wrongdoings.⁵⁴⁵ Although no specific actions had been taken, the mere existence of the investigations was a disturbance for many in senior positions. The secrecy involved in the scrutiny of former practices, and the alleged espionage methods used by PCP, created an uncertain working environment, which explains the widespread anxiety among top officials. A revision of the role of PCP was high on the agenda of the dissenting technocrats, as was revealed in a published confidential document.⁵⁴⁶ The document details the strategic plan discussed in the Assembly held by PDVSA managers on 6 March 2002.

⁵⁴³ There were 18 top officials ranked above Giusti when he was chosen as PDVSA’s President. See Rafael Quiróz, Meritocracia Petrolera: ¿Mito o Realidad? (Caracas, Panapo, 2003).

⁵⁴⁴ Gerencia corporativa de prevención y control de perdidas.

⁵⁴⁵ Published in a weekly newspaper called ‘Quinto Dia’ by Miguel Salazar in his column ‘Las verdades de Miguel’ in two consecutive editions (282, 22-29 March and 283, 29 March to 5 April 2002). The list is reproduced in a book called F.Mieres (various authors) PDVSA y el Golpe (Caracas, Fuentes, 2003).

⁵⁴⁶ F.Mieres (various authors), PDVSA y el Golpe (Caracas, Fuentes, 2003).

Top PDVSA officials, however, made the 'Meritocracy' claim the centrepiece of a swiftly organised collective action. The former 'veil of secrecy' normally associated with internal affairs in PDVSA, and widely cherished by technocrats, was broken.⁵⁴⁷

The conflict promptly crossed the company's frontiers. It received enormous backing from business, the principal labour union and the 'big media'. Fedecamaras, the top business federation, offered support for PDVSA technocrats on 25 February.⁵⁴⁸ Later, on 1 March, Fedecamaras president Pedro Carmona demanded the resignation of PDVSA's president Gastón Parra.⁵⁴⁹ The largest union, CTV, similarly backed PDVSA officials by offering help in turning the protest into a broader industrial action.⁵⁵⁰ Similarly, several small organisations of the so-called 'civil society' joined rebellious PDVSA managers in their protest.⁵⁵¹

On the other hand, President Chávez's supporters became equally organised to counteract the technocrats' actions. The 'Frente Bolivariano de Profesionales y Técnicos', an association of PDVSA professionals sympathetic to Chávez, led various demonstrations to back official policy and to support the appointment of the PDVSA's board questioned by the anti-Chávez forces.⁵⁵²

'Big media' (the main TV channels and top newspapers) gave extensive coverage to the rebellious PDVSA technocrats' actions. These included frequent stoppages during working hours usually accompanied by gatherings in front of PDVSA's main corporate buildings in Caracas and other parts of the country.⁵⁵³

⁵⁴⁷ A saying in Spanish 'los trapos sucios se lavan en casa' ('You don't wash your dirty linen in public')

⁵⁴⁸ 'Fedecamaras brinda su respaldo', El Universal, 26 February 2002.

⁵⁴⁹ 'Tiene que renunciar Parra', El Universal, 1 March 2002.

⁵⁵⁰ 'CTV apoyara huelga petrolera si los trabajadores la convocan', El Universal, 7 March 2002; 'CTV esta asesorando a trabajadores de la nomina mayor', El Universal, 15 March 2002.

⁵⁵¹ Organisations such as 'Mujeres por la libertad', 'Asamblea ciudadana', 'Vision emergente', 'Queremos elegir', 'Alianza por la libertad', 'Frente institucional military' and 'Sinergia' gathered in a top hotel (CCCT) to show support (reported in El Universal, 16 March 2002).

⁵⁵² 'Lanzan ultimatum en PDVSA', El Universal, 5 March 2002; 'Bolivarianos tomaron PDVSA', El Universal, 7 March 2002.

⁵⁵³ Such as headquarters in La Campiña neighbourhood and a major office building in Chuao,

The conflict peaked when two senior officials were sacked by PDVSA's President Parra.⁵⁵⁴ During the previous fortnight a conciliation commission of National Assembly deputies, led by Deputy Luís Salas had tried to mediate in the conflict.⁵⁵⁵ The commission met the Vice President of the Republic Diosdado Cabello and dissenting managers, both separately and together, to no avail. The rebellious managers gathered in a general assembly held in a top hotel in Caracas on 24 March.⁵⁵⁶ They gave the government an ultimatum to rectify both appointments and annul the sackings by 1 April.⁵⁵⁷

The PDVSA quarrel was, by then, beyond the control of the rebellious officials. Fedecamaras and CTV both announced that further measures were to be taken if the technocrats' demands were not met. Fedecamaras president Pedro Carmona visited PDVSA offices.⁵⁵⁸ CTV called for a general strike in support of the PDVSA workers. Fedecamaras quickly joined the labour union's call.

It was, however, a direct intervention in the conflict from President Chávez that triggered a broader response. On his weekly TV programme 'Alo Presidente', held on 7 April, President Chávez publicly sacked seven PDVSA top managers and ordered the early retirement of another seven.⁵⁵⁹

The PDVSA internal conflict irrevocably expanded to national levels when Fedecamaras and CTV called a general strike for the 9 April. An acute broader conflict unravelled the following week. Table 6.9 shows the main events during that week.

a corporate building district.

⁵⁵⁴ This episode is not clear. Press reports stated that Oscar Murillo, Chief Legal advisor and Armando Izquierdo, Director of Public Affairs, were sacked by Parra (see 'Gaston Parra exigio la salida a dos gerentes de PDVSA', *El Universal*, 23 March 2002) but another version was that they asked for early retirement benefit.

⁵⁵⁵ Deputy in the National Assembly for a small party called 'Vamos'.

⁵⁵⁶ For the first time, non administrative staff joined the conflict.

⁵⁵⁷ 'Empleados dan plazo de una semana a la Junta Directiva', *El Universal*, 25 March 2002.

⁵⁵⁸ As denounced by Deputy Arnaldo Marquez in 'Diputado Marquez rechaza presencia de Fedecamaras en PDVSA', *El Universal*, 5 April 2002.

⁵⁵⁹ The sacked managers were: Eddie Ramírez, Juan Fernández, Horacio Medina, Gonzalo Feijoo, Edgar Quijano, Alfredo Gómez and Carmen Hernández.

Table 6.9 Main events 8 to 14 April 2002

Date	Event
Monday 8	Fedecamaras and CTV called for a general strike.
Tuesday 9	General strike commenced. Additionally, numerous protesters gathered in PDVSA's office in Chuao to support PDVSA senior management.
Wednesday 10	Gathering in Chuao escalated. Chávez' supporters also surrounded the area. Municipal policemen were deployed to protect the gathering. ⁵⁶⁰
Thursday 11- (AM)	A significant march summoned to finish in Chuao is diverted to the Presidential palace to demand President Chávez's resignation. ⁵⁶¹
Thursday 11 – (PM)	The march approached the Presidential palace. Bloodshed followed when both Chávez opponents and supporters collided nearby.
Thursday 11 – midnight	Top army officers rebelled against President Chávez (Chief commander of the army). Army Inspector General Lucas Rincon announced Chávez had resigned. Chávez is arrested and taken to a naval base.
Friday 12 – early hours	Fedecamaras' president Pedro Carmona is called by the rebel army offices to serve as President of the Republic.
Friday 12 – (PM)	Carmona sworn in as President in the Presidential Palace accompanied by future cabinet members and businessman. Neither the National Assembly nor other constitutional powers are present. In fact, the Carmona proclamation decree included the dissolution of all those powers.
Friday 12 – late hours	Chávez supporters gathered in various areas of Caracas demanding his return to power.
Saturday 13	Rebel army officers made a U-turn and re-installed Chávez as President.
Sunday 14	Reinstalled President Chávez addressed the nation on network TV.

Source: El Nacional, El Universal. TV Stations (compilation by author)

President Chávez returned to power on 14 April on a conciliatory stance.⁵⁶² The PDVSA situation was the first issue to be addressed. Chávez decided to reinstate the sacked top managers and to appoint a new Board (the PDVSA board had resigned on 11 April). He brought acting the Secretary General of Opec and former Minister of Energy Alí Rodríguez to lead the company, an appointment well received by all political actors.

Chávez set up a 'council of personalities' and called a 'dialogue roundtable' to host talks with all conflicting sectors. Several commissions were formed within that

⁵⁶⁰ Both Baruta and Chacao municipalities (where Chuao is located) and the Metropolitan (Capital) district were controlled by Chavez-opposing majors.

⁵⁶¹ Estimates of people who joined that march range from half a million to 1 million.

⁵⁶² He publicly apologised to the sacked PDVSA senior managers for his public announcements of 7 April. See F.Mieres (various authors), *PDVSA y el Golpe* (Caracas, Fuentes, 2003).

framework to address contentious issues, including a revision of the hydrocarbon law. Several meetings were held and although some recommendations were drafted no reform of the hydrocarbon law was passed by the National Assembly.

PDVSA's post-April climate was very tense. Political activism had been introduced in different forms. First, the April crisis had created the incentives for an unprecedented collective action at the managerial level. The informal gatherings and decision making assemblies were followed by the creation of two organisations. First, they formed a managerial union called 'Unapetrol'.⁵⁶³ Second, they also set up a 'civic association' called 'Gente de Petróleo' (Oil People) to advance oil-related interests.⁵⁶⁴

Gente del Petróleo played a dual role. On the one hand they intervened in internal affairs within PDVSA. For example, when PDVSA's board relocated some of the top managers who had been very active in April's conflict, they demanded that the Board "not let political factors affect organisational decisions".⁵⁶⁵

At the same time, Gente del Petróleo was active in national politics. They joined an ad hoc political body called 'Coordinadora Democrática' (Democratic Coordinator). This political vehicle was formed by forces opposing President Chávez such as the traditional political parties AD, Copei and MAS, and several of the so-called 'civil society' organisations.

Similarly, Chávez supporters inside the company formed a parallel association called 'Asopetroleros'. Additionally, discrepancies flourished between the radical wing of Chávez supporters and the new PDVSA president. Late in 2002, recently appointed Minister of Energy Rafael Ramírez admitted the existence of some sort of parallel board of PDVSA, which convened in an informal parallel shareholders Assembly. Ramírez disqualified that meeting on the basis that it was political act. Members of parallel board included former Vice President Adina Bastidas, PCP's manager

⁵⁶³ This union was never legally recognised by the Ministry of Labour. Unapetrol asked the Supreme Court to decide on that recognition. See 'Unapetrol interpuso recurso ante el TSJ', El Universal, 29 November 2002.

⁵⁶⁴ This is a typical legal form used for Non for profit organisations in Venezuela.

⁵⁶⁵ 'Cuatro directores rebeldes fueron reubicados', El Universal, 29 August 2002; 'Rechazan cambios en PDVSA', El Universal, 30 August 2002.

Gustavo Pérez-Issa and former PDVSA board members Gastón Parra, Carlos Mendoza Potella, Alfredo Riera, Argenis Rodríguez and Felix Rodríguez.⁵⁶⁶ Although the Minister denied knowing details of that group's recommendations, it was public knowledge that this 'parallel board' was very critical of Alí Rodríguez's conciliatory position vis-à-vis the April's rebellious managers. In any case, it was evident that PDVSA was functioning amidst an unprecedentedly politicised internal environment.

The conflict of December 2002

By late 2002 the various factions opposing Chávez radicalised their positions. Fedecamaras and CTV called for a general strike on 2 December, demanding Chávez's resignation and fresh elections. Juan Fernández, President of Gente de Petróleo, admitted that there were pressures on PDVSA to join the strike. He said that joining the strike was an individual decision that had to be taken individually on the basis of each person's consciousness as a citizen and not as oil workers.⁵⁶⁷

Since rebellious PDVSA officials in April had been pardoned by President Chávez as a consequence of the external pressures, it seems plausible they felt obliged to support the Democratic Coordinator's actions.⁵⁶⁸

The General Strike commenced on 2 December, PDVSA workers joined the strike in large numbers in the following days. They succeeded in paralysing oil operations on a large scale. Production of crude oil and refining products was severely affected, as Table 6.10 illustrates.

⁵⁶⁶ 'Talibanes petroleros piden la remocion de Ali Rodríguez', El Nacional, 29 November 2002.

⁵⁶⁷ 'Animos se caldean en PDVSA por posibles detenciones', El Universal, 27 November 2002.

⁵⁶⁸ This observation follows a conversation with various PDVSA's staff who requested anonymity.

Table 6.10 PDVSA crude production (2001-2003)

Period	Monthly production (000) Barrels
Average year 2001	85,523
Average year 2002 (January-November)	70,884
December 2002	19,860
January 2003	15,535
February 2003	30,380
March 2003	62,055
April 2003	66,734
May 2003	51,481
Average June-December 2003	76,362

Source: PDVSA Form 20F/SEC, 2003

PDVSA production during the two-month long strike was only 25% of the level of production in the previous year. Petrol had to be imported when local supply dried up leaving the country at an almost complete halt. The two-month long paralysis was extremely costly. The price differential of imports caused a US\$ 504 million loss to the company. Additionally, damages to installations and malfunctioning equipment were estimated at US\$ 209 million.⁵⁶⁹

Collateral effects, however, are more difficult to quantify. PDVSA's report to the Security Exchange Commission in 2003 states, "The work stoppage of operations also caused other effects that, although they cannot be quantified or valued accurately, significantly affected the operations of PDVSA and its Venezuelan subsidiaries. Among other factors, there were delays to the environmental remediation plans; the loss of sensitive operating information; interruption of the information systems; delays in compliance with obligations to creditors; a deterioration of PDVSA as a reliable supplier of oil; failure to comply with financial, legal and contractual obligations; loss of market share; delays in execution of plans and projects; and the loss of human resources and intellectual capital with an average specialised experience of 15 years."⁵⁷⁰

⁵⁶⁹ PDVSA, Form 20F, US Security Exchange Commission, 2003.

⁵⁷⁰ PDVSA, *ibid.*

In fact, the most dramatic effect of the strike was the “termination of employment, effective 1 January 2003, of approximately 18,000 employees”.⁵⁷¹ Although this represents 40% of the estimated total, its impact was much broader. The lost personnel were in the top end of the organisational structure. An estimate of the personnel loss indicates that 75% of top executives, 51% of professionals and senior technical staff and 7% of operators were dismissed as a result of the strike.⁵⁷²

According to PDVSA, the total number of employees in Venezuela by 2003 was 28,841. This represents 63% of the total number of employees of the previous year (see Table 6.11). In addition, there have been allegations that sacked employees were blacklisted for jobs in supplier companies. An official in one of the foreign companies that operated in association with PDVSA corroborated that rumour.⁵⁷³ In any case, the loss of trained personnel was significant.

Table 6.11 PDVSA employees (2001-2003)

As 31 December of	Total number of employees	In Venezuela	Abroad
2001	46,425	40,945	5,480
2002	45,683	40,133	5,550
2003	33,998	28,841	5,157

Source: PDVSA Form 20F, US SEC, 2003

6.5 Post-conflict PDVSA

After the government rode out the two-month strike, President Chávez’s political control over the company was total. A new board was appointed in March 2003 (see Table 6.12)

⁵⁷¹ PDVSA, *ibid.*

⁵⁷² Report by Gente de Petroleo and Unapetrol, 2003, similar estimates were given by Alberto Quiros-Corradi in his weekly collaboration to *El Nacional*, 6 July 2003.

⁵⁷³ Interview with an executive of a foreign company located in Caracas who requested anonymity.

Table 6.12 PDVSA boards (2003-2005)

Board appointed 6 March 2003	Board appointed 11 March 2004	Board appointed 13 January 2005
Alí Rodríguez (ratified)	Alí Rodríguez	Rafael Ramírez (previously appointed on the 22 Nov 04 as Minister of Energy) ⁵⁷⁴
Luís Marín	Iván Hernández	Luís Vierma
Félix Rodríguez	Félix Rodríguez	Alejandro Granado
Dester Rodríguez	Dester Rodríguez	Eudomario Carruyo
Aires Barreto	José Rojas	Jesús Villanueva
Luís Vierma (Deputy Minister of Energy)	Luís Vierma (Deputy Minister of Energy)	Dester Rodríguez
Nelson Núñez (Unions)	Nelson Martínez	Eulogio del Pino
Rafael Rosales (Unions)	Rafael Rosales (Unions)	Asdrubal Chávez
	Nelson Núñez (Unions)	Ivan Orellana
	Victor Álvarez (Deputy Minister of Industry)	Bernard Mommer (Deputy Minister of Energy)
	José Luís Prieto ⁵⁷⁵	Carlos Martínez

Source: Official Gazette, various issues

Subsequent months were consumed with several restructuring efforts to adjust to the massive loss in personnel. Alí Rodríguez commented, “We concentrated in reconstituting information systems, filling the most sensitive posts and in eliminating the enormous administrative waste we found. The company had several administrative buildings in Caracas and outside the operating areas. This situation was unsustainable. Our task was to rebuild the company and to make sure we could operate it with substantial cost reductions, allowing improved fiscal contributions and prioritising social projects.”⁵⁷⁶

Table 6.13 shows the distribution of PDVSA personnel according to their functions. According to the same source, 17.6% of total personnel were placed in the capital city of Caracas. These personnel were exclusively for administration purposes, since no operating areas were located in the capital.

⁵⁷⁴ Official Gazette 38,070, 22 November 2004.

⁵⁷⁵ Appointed on the 20 April 2004, Official Gazette 37,920 of that day.

⁵⁷⁶ Ali Rodríguez, interview by author, Caracas, 26 February 2004.

Table 6.13 PDVSA distribution of personnel before December 2002

Top Executives (Executive payroll)	Professionals (Major payroll)	Administrative support and technical (Major payroll)	Unionised operators (daily payroll)
2.4%	47%	32%	19%

Source: PDVSA (Human Resources Department) published in Rafael Quiróz, *Meritocracia Petrolera: ¿mito o realidad?* (Caracas, Panapo, 2003)

Internal personnel movements and other readjustments, however, triggered politically motivated tensions among Chávez administration loyalists. Alí Rodríguez was constantly accused by the Bolivarian movement (MVR⁵⁷⁷) sympathisers of taking decisions in the company on partisan lines. They alleged Rodríguez favoured former associates from his party (PPT⁵⁷⁸). Constant denunciations regarding PDVSA internal decisions were made through two websites associated with radical Chávez supporters, www.aporrea.org, run by an organisation called ‘Asamblea Popular Revolucionaria’, and www.soberania.org, associated to oil pundits that published abundant information on oil-related issues. Although these channels were rather informal they signal how politically sensitive business decisions had become within PDVSA.

Former secrecy in PDVSA internal affairs gave way to a politicised environment in which decisions were taken beyond technical considerations and unusually exposed to public scrutiny and manipulation. On the other hand, PDVSA top management were instructed by the Executive to address contentious issues that were not attended before despite previous orders by government officials. Silva-Calderón, former Minister of Energy recalled, “Alí Rodríguez as president of PDVSA had to execute orders that he gave as Minister of Energy three years earlier.”⁵⁷⁹

⁵⁷⁷ MVR (Movimiento Quinta Republica) was the party founded by Chavez.

⁵⁷⁸ PPT (Patria para todos) was one of the parties that supported Chavez.

⁵⁷⁹ Alvaro Silva-Calderon, *ibid.*

Reversing the 'oil opening'

The reversing of 'oil opening' and other decisions made by former administrations regarding association with private capital was the top priority. Oil opening contracts were revised. Table 6.14 shows major changes in rules regulating the so-called oil opening introduced by PDVSA since 2003.

Table 6.14 Major changes to 'oil opening' regulations

Changing rules regarding:	Foreign companies involved	Major changes
Associations to exploit heavy crude oil in the Orinoco Belt	Four strategic associations where PDVSA is minority shareholder	Royalty went from 1% to 16.66%
'Operating agreements' to exploit marginal oil fields	32 agreements with foreign led consortia (13 out of 32 have been change amicably until October 2005)	Conversion of former legal contract to associations with PDVSA according to new Hydrocarbon law
'Operating agreements' to exploit marginal oil fields	32 agreements with foreign led consortia (those who still function as operating agreements)	Limit payments to the foreign companies up to 66.67%
'Operating agreements' to exploit marginal oil fields	32 agreements with foreign led consortia	Revision of Tax payments through the life of the contracts signed during 1992-1997

Source: PDVSA Corporate bulletin "Avances" 5 May 2005

The 'operating agreements' were finally terminated in March 2006. The agreements were converted to joint ventures between PDVSA and former contract holders.⁵⁸⁰ The National Assembly approved a new contractual framework to regulate the joint ventures on 30 March 2006. Later, the Assembly sanctioned 21 contracts with the former foreign companies who agreed to convert their agreements to joint ventures. The Ministry of Energy announced that the government finally approved the new scheme in June 2006. Particularly, the joint ventures formed to exploit the fields

⁵⁸⁰ Not all former beneficiaries of the 'operating agreements' formed joint ventures with PDVSA. Notably, Exxon-Mobil pulled out from one of the agreements and Total and ENI challenged PDVSA for terminating their agreements.

auctioned in the oil opening process in the 1990s received similar tax treatment to PDVSA (i.e. a Royalty of 30%, a Corporate Tax rate of 50%).

Fusion of roles of Minister of Energy-President of PDVSA

The most important institutional change, however, introduced by the Executive concerned the Minister of Energy and his role vis-à-vis PDVSA. First, both positions of Minister of Energy and President of PDVSA were merged. Chávez's Presidential Decree 3,264 appointed Minister Rafael Ramírez as PDVSA's president. This appointment was however not permitted, at the time, by PDVSA bylaws approved on 10 December 2002.⁵⁸¹ In fact, the government corrected the illegality by modifying PDVSA's bylaws again on the 7 December 2004, allowing the Minister to sit as PDVSA president.⁵⁸² Similarly, from March 2003, the Deputy Minister of Energy also sat in the board of PDVSA. In 2005, three acting officials from the Ministry were part of the Board (Minister Ramírez, Deputy Bernard Mommer and Iván Orellana, Opec governor).

Later in January 2005, the Ministry of Energy was restructured. Attributions concerning regulation of mines were taken away from the Ministry (passed to the Ministry of Industry). The Ministry was renamed "Ministry of Energy and Petroleum".⁵⁸³ This later modification, however, has not accompanied by other organisational changes in the Ministry.

Fiscal contribution of PDVSA since 2002

Since the government took complete control of the oil company after surviving the oil strikes in 2002, PDVSA has paid taxes in the same proportion as it did before the strikes. Table 6.15 shows a comparison between oil taxes and the value of oil exports.

⁵⁸¹ Official Gazette 37,588, 10 December 2002.

⁵⁸² Official Gazette 38,081, 7 December 2004.

⁵⁸³ Official Gazette 38,109, 18 January 2005.

Table 6.15 Fiscal contribution of PDVSA (2000-2006)

Year	Fiscal contribution in million us\$	As % of value of oil exports(*)
2000	10,800	37
2001	6,865	31
2002	8,099	40
2003	8,193	44
2004	7,504	26
2005	12,155	28
2006 (estimated)	15,460	33
Average 1990-1999	6,611	45

(*) Figures of PDVSA gross income were not available since 2002, Value of oil exports, as reported in Opec statistics were used instead.

Source: Opec Annual Statistical Bulletin 2004, Onapre.

Although the government oil officials had previously been very critical of PDVSA's diminishing fiscal contributions, they adopted a strategy of limiting PDVSA's contributions to the National Treasury 2002. They achieved that by underestimating the price of oil in the national budget calculations submitted to the National Assembly for approval. Since real oil prices were well above those estimates the resulting surplus has been captured through other mechanisms, which will be discussed in Chapter 7.

Conclusions

Old issues regarding the governance of PDVSA, the role of private investment in the oil business and PDVSA's fiscal contributions had troubled political elites for decades. PDVSA had emerged largely independent from political interferences. Punto Fijo policy makers had succumbed to PDVSA pre-eminence. Although dubbing PDVSA a 'black box' or a 'state within the State', Punto Fijo politicians had accepted an increasing role for PDVSA in policy setting, a movement towards increasing privatisation of the business and a reduced fiscal contribution. The substitution of this established political elite by Hugo Chávez in 1998 triggered an inevitable revision of those issues.

President Chávez, however, adopted a cautious stance towards PDVSA in the first three years of his administration. Chávez's political agenda was concentrated on overhauling the constitutional order. Once that endeavour had been achieved, he promoted a similar overhaul in the regulations of the hydrocarbons sector. He made use of his handsome majority in the National Assembly in 2001 to obtain special legislative powers to legislate by decree. He then produced a new hydrocarbon law that had a paradoxical reception among the displaced elite. The new law was deemed as a unilateral exercise by Chávez's oil advisors, most of them linked to the left wing parties that had been critical of governmental oil policy since nationalisation. The new law, however, was more open to private investment than the nationalisation law.

On the other hand, the government's intention to revise the 'oil opening' process provoked controversy. Government officials wanted to produce a new framework for private participation that corrected the flaws of the oil opening they had denounced when they were in opposition. Disagreements about the regulation of private capital, however, were not to translate into immediate action when the law was passed. It was political opposition to Chávez on other policy issues that engulfed PDVSA-government relations. Chávez's new oil policy was implicitly challenged by the PDVSA's technocracy when they rebelled against Chávez's appointment to the board in February 2002.

Discontented technocrats allied with broader opposition forces. In the absence of organised opposition following the collapse of the traditional Punto Fijo parties AD and Copei, opposition to Chávez was led by an alliance of the traditional media, the private sector through Fedecamaras, and the unions formerly linked to AD. The PDVSA's internal conflict rapidly escalated to a national conflict. Protests by PDVSA senior managers were used in the power struggle between Chávez and anti-Chávez forces. Notably, in April 2002, the PDVSA executives' rebellion disproportionately spiralled into a constitutional crisis. Only eight months after the crisis was overcome, the PDVSA technocracy became yet more militant in challenging Chávez's rule. A two-month oil stoppage provoked by the rebellious managers ended in a major shake up of the company. Eighteen thousand administrative employees were sacked for participating in the strike. President Chávez filled top positions with loyal executives.

Later, he merged the role of Minister of Energy and President of PDVSA, among other changes, to ensure total control of PDVSA policy decisions.

Chávez's responses, albeit different in gradation, followed a similar pattern to those in the past: being unable to challenge PDVSA through technical regulation and policy setting because of the weak Ministry of Energy, Venezuelan presidents used their prerogative to appoint officials in the hierarchy of the company as a way to exert their power. Yet politicisation reached an unprecedented level. Not only are decisions tightly controlled by the Executive, but PDVSA's internal management is subject to political considerations.

Ironically, the main banner of the protests by senior PDVSA officials had been to say no to the politicisation of the company's affairs such as the appointment of senior officials. The resulting conflicts, during February to April 2002 and December 2002 to February 2003, brought national politics, perhaps for a long time, to the core of the industry. President Chávez's response to the challenge was to tighten political control of the oil business. This degree of control completely departed from the post-nationalisation agreement of keeping politics out of the management of the oil company.

PDVSA was, after the 2002-2003 conflicts, finally brought under the control of its political masters. This new character of the governance of the oil company was, however, attained at a high cost and in a way that does not guarantee an institutionalisation of PDVSA-government relationships. So much was still subject to Presidential discretion and to the imperatives of political conditions.

Chapter 7

The development funds (2003-2005)

This chapter analyses the institutional arrangements established by President Chávez's administration to channel a significant part of the extraordinary oil revenues the country obtained during the period between 2003 and 2005. The chapter describes how the institutional structure regulating the public finances was modified to bow to President Chávez's preferences on how to spend the oil windfall. It argues that President Chávez's administration responded to his preference for State-led development and, crucially, to his perceived electoral needs.

Chávez's administration opted to implement its strategy through ad hoc and makeshift spending programmes funded by extra oil revenues. After a series of provisional measures and organisational reforms, the Chávez administration consolidated the extra-budgetary spending mechanisms in the so called Development Funds. The findings of this chapter corroborate the hypothesis that Venezuelan presidents are able to alter pre-existing institutional arrangements in order to implement their short term preferences. The chapter shows how in practice, institutions that regulate public spending, were altered under presidential pressure. The chapter also demonstrates how President Chávez's administration established 'parallel structures' in response to the limits that were imposed by the weak public apparatus.

7.1 The recovery in revenues from oil export

International oil prices in the first six years of the Chávez administration developed favourably. Oil exports, however, faced disruption as a consequence of political events. This meant that the international oil price recovery did not immediately fully

translate into a major boost in oil income. Table 7.1 shows how the Chávez administration's first three years compared to the previous four years of the Caldera administration.

Average oil prices in Venezuela were 33% higher in the first three years of the Chávez administration. During this time oil exports grew by 38%. Oil revenues for the following three years, however, did not follow the same pattern. While international prices for Venezuelan oil almost doubled from the price in Caldera's times (by 96.65%), oil exports grew only 50%. This difference is explained by the disruption caused by the escalating conflict that involved PDVSA.

Table 7.1 Oil prices & oil exports (Caldera's v. Chávez's administration)

Administration	Average Oil price (US\$/barrel)	Variation vs. Caldera's administration (%)	Average oil exports (US\$)million	Variation vs. Caldera's administration (%)
Caldera's (1994-1998)	15.82	-	15.217	-
Chávez's (1999-2001)	20.94	+32.68	21.047	+38.31
Chávez's (2002-2004)	31.11	+96.65	22.824	+49.99

Source: Ministry of Energy

The political conflicts that occurred in the years between 2002 and 2004 took place against a backdrop of a steady recovery in international oil prices. As Table 7.2 shows, the average price in 2003 for the Venezuelan 'oil basket' was 17.4% higher than the previous year. Despite the damage that the oil strike inflicted on Venezuelan production, oil exports in 2003 dropped only 7.77% from the level in the previous year.

By 2004 it was evident to the government that oil prices were to reach a new plateau, as prices again improved, year on year, by almost 27%. In spite of the strikes that hit PDVSA, Venezuela experienced a boom in oil exports and a windfall in oil revenues. As a consequence of a recovery in the international oil market, the State could limit

the effect of the general strike on the economy, although it could not prevent GDP dipping during that period, as is shown in Table 7.3. In 2004, the political climate did not encourage private investment, either domestic or foreign. The oil sector was to be relied upon as the source of any economic recovery.

Following the oil strike President Chávez decreed an exchange control mechanism that severely limited the transfer of reserves in US\$ from the public to the private sector. Additionally, the economic recession, suffered for two consecutive years (15.9% from 2002 and 2003 combined), lowered the demand for imports. These two factors, combined with high oil prices, caused the Central Bank to accumulate international reserves at an accelerated pace.⁵⁸⁴ As Table 7.4 shows, international reserves went from US\$ 13.898 million at the end of the oil strike in late January 2003 to US\$ 21.332 million by the end of November that year.

Table 7.2 Venezuelan oil prices & oil exports (1998-2005)

Year	Venezuelan oil average/barrel (US\$)	Variation previous year (%)	Venezuelan oil exports (million US\$)	Variation previous year (%)
1998	11.44		12.007	
1999	16.31	42.57	16.465	37.13
2000	26.31	61.31	26.629	61.73
2001	20.21	-23.19	20.047	-24.72
2002	21.95	8.61	20.337	1.45
2003	25.76	17.36	18.756	-7.77
2004	32.61	26.59	29.379	56.64
2005(*)	44.14	35.36		

Sources: Venezuelan oil prices: 1998-2000 Tia Juana Light in Opec Annual Bulletin 2004; 2001-2005 Ministry of Energy. Venezuelan Oil Exports in Opec Annual Bulletin 2004.

⁵⁸⁴ Foreign currency denominated reserves are accumulated in the Central Bank through a mechanism discussed later in this chapter.

Table 7.3 Venezuela's GDP (1997-2005)

Year	Variation on previous year
1997	-
1998	+0.29%
1999	-5.97%
2000	+3.69%
2001	+3.39%
2002	-8.86%
2003	-7.72%
2004	+17.85%
2005	+9.33%

Source: BCV

Table 7.4 International reserves in Central Bank

At the end of year:	US\$ million
1998	14,849
1999	15,379
2000	20,471
2001	18,523
2002	14,860
2003 (31-Jan)	13,898
2003 (28-Nov)	21,332
2003	21,366
2004	24,208
2005	29,636

Source: BCV

This 54% increase in the level of international reserves contrasted with an average of 5.5% inter-annual increases in the last six years. This situation was rather unusual. The fact that the Central Bank had an unprecedented level of foreign reserves during a time of internal economic depression attracted the attention of government officials. By the end of November 2003, President Chávez decided to act. His aspiration to relieve the Central Bank of its reserves will be discussed at length later in this chapter.

7.2 Government programmes (2003-2004)

The general strike, which took place from December 2002 to January 2003, was followed by months of political turmoil. Although the end of the general strike reinforced the government's position and authority, political instability continued to threaten violent outbursts and the possibility of a military coup.⁵⁸⁵

International organisations such as the Organisation of American States (OAS), the United Nations Programme for Development (UNDP) and the Carter Center intensified their mediation efforts to avoid political conflict tipping over into violence. These efforts saw the 'Declaration against violence, for Peace and Democracy in Venezuela' signed by government, opposition organisations and the international mediators on 18 February 2003.

After failing to force President Chávez's resignation by orchestrating the general strike, the political forces opposing the Chávez regime regrouped and organised themselves to collect signatures for a petition to hold a 'recall referendum' to force President Chávez from office. This constitutionally permitted event focused all political activity in the country for the following eighteen months (February 2003 to August 2004). During that period numerous intermediate steps were taken by the Electoral authorities, opposition organisations and the government as each political actor manoeuvred to defend its position. This lengthy road to the recall referendum is summarised below in Table 7.5

The economic contraction inflicted by the general strike and the oil stoppage left President Chávez's administration in a weak position from which to fight the calls for a recall referendum. Table 7.6 shows quarterly GDP data from the last quarter of 2002 to the third quarter of 2003. Although, the recall referendum had been legally activated early in 2003, the chances of it succeeding became more real throughout 2003. The process of appointing new electoral authorities allowed the government to avoid the referendum being held in the middle of the severe economic contraction. When, at the end of November 2003, the possibility of the recall referendum was

⁵⁸⁵ The Carter Center, Report, 2005.

imminent, the Chávez administration was urgently needed to improve economic prospects and its popular appeal in order to fend off the revoking of its mandate.

Table 7.5 Main events leading to the Recall Referendum

Date	Event
Sept-Oct 2002	Collection of signatures to request a 'Consultative' referendum (allowed in Art.71 of the National Constitution).
2 Feb 2003	Collection of signatures to request a recall referendum (allowed in Art.72 of the National Constitution).
23 May 2003	Government and opposition signed an agreement that included the commitment to name a new electoral authority and to fill the constitutional requirements to allow a recall referendum.
August 2003	A new Electoral Authority (National Electoral Council-CNE) is appointed by the Supreme Court of Justice (TSJ) after the National Assembly failed to agree on the composition of the Council following months of legislative manoeuvring.
12 Sep 2003	The new Electoral authority declared invalid the signatures that had been gathered during the previous February.
16 Oct 2003	President Chávez and political organisations supporting him named a high political taskforce called 'Comando Ayacucho' to carry on with activities to counteract a possible Recall Referendum.
Nov 2003	New collection of signatures to request a recall referendum is held under strict CNE supervision with international observers monitoring.
Jan 2004	CNE invalidated 45% of the collected signatures and called for a 'Repair process' for the invalid signatures in order to correct detected irregularities.
29-30 May 2004	Invalid signatures were 'repaired' in a CNE-supervised process with international observers monitoring.
June 2004	CNE declared that there were enough valid signatures to activate the Recall Referendum as stipulated in Art.72 of the National Constitution.
8 June 2004	Chávez dissolved Comando Ayacucho. Government-supporting political organisations named a new taskforce called 'Comando Maisanta' to campaign for the 'NO' vote in the Recall Referendum (The 'No' option was to favour President Chávez staying in power).
15 August 2004	Recall referendum is held. The 'NO' option got 59% of votes, according to CNE. Opposition organisations claimed fraud. CNE ratified Chávez as entitled to finish his presidential term (ending in January 2007).

Source: El Nacional, El Universal, TV Stations (compilation by author)

Table 7.6 Quarterly GDP (2002-2003)

Quarter	Variation on previous quarter (%)
2002-3 rd	-
2002-4 th	-9.6
2003-1 st	-14.3
2003-2 nd	20.9
2003-3 rd	-1.2
Variation 2003-3 rd -2002-3 rd	-7.5

Source: BCV

By May 2004, the likelihood of the government facing a recall referendum was extremely high. President Chávez reorganised his campaign team. The task force that was responsible for coordinating the government's response to the recall referendum, called Comando Ayacucho, was summarily dismantled. Another taskforce was created to work directly with President Chávez. Table 7.7 shows the members of the new electoral unit called 'Comando Nacional Maisanta' at the national level.

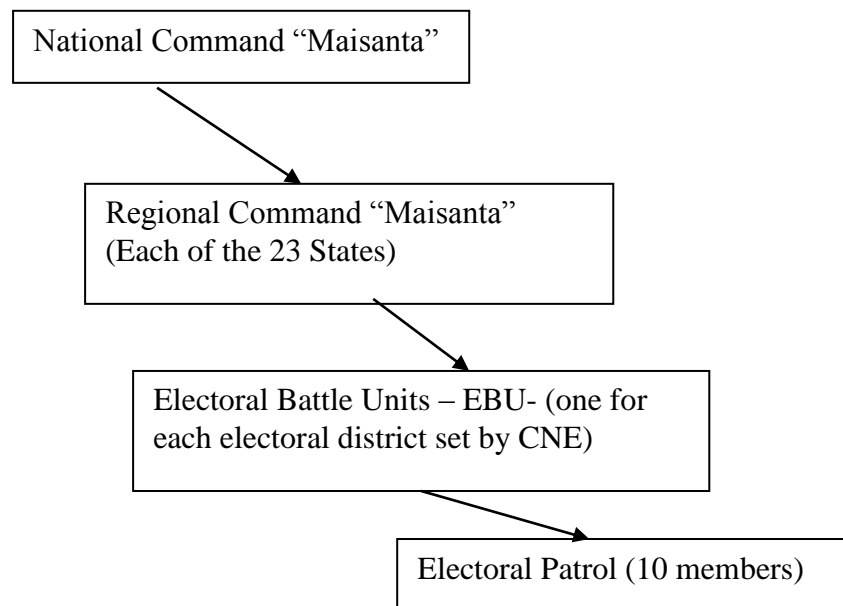
Figure 7.1 shows how the national command was organised from top to bottom. The Electoral Battle Units (EBU) were integrated with the so-called 'Missions', the umbrella name of various social programmes including, literacy, high school enrolment, primary medical attention and the issuing of Identity cards. The 'Missions' are explained in the next section.

Table 7.7 Members of 'Comando Nacional Maisanta'

Member	Position
Jorge Giordani	Cabinet member
Diosdado Cabello	Cabinet member
William Lara	Congressman
Samuel Moncada	MVR
Jessé Chacón	Cabinet member
MariPili Hernández	MVR
William Izarra	MVR
Tania de Amelio	Congressman
Haiman El Troudi	MVR
Simón Pestana	MVR
Nelson Merentes	Cabinet member
Rafael Ramírez	Cabinet member (Ministry of Energy)

Source: El Nacional, El Universal

Figure 7.1 Chávez's organisational structure for campaigning for the Recall Referendum



Source: El Nacional, El Universal, Transcripts of “Alo Presidente” by Minci

The Social Programmes (Missions)

Venezuelan's State bureaucracy was highly inefficient when President Chávez took power in February 1999.⁵⁸⁶ Additionally, as an outsider to the political elites who had run the State for forty years, Chávez met with resistance from the largely politicised bureaucracy. Moreover, the political groups that supported Chávez lacked an extended organisational network across the country. Chávez's initial response was to resort to the military for implementing makeshift programmes targeted to alleviate the urgent needs of the population.⁵⁸⁷

⁵⁸⁶ Despite abundant fiscal resources, Venezuela scored very low when it was compared to other Latin American countries in terms of efficiency in social spending. See Alan Angell and Carol Graham, 'Can social sector reform make adjustment sustainable and equitable? Lessons from Chile and Venezuela', *Journal of Latin American Studies* 27:1, 1995, p.189-219. See also M.Penfold and J.M.Puente, *Mitos y realidades del gasto social en Venezuela* (Caracas, IESA, 2000).

⁵⁸⁷ Plan Bolívar 2000 and a similar follow-up programme were implemented with military personnel. The plans undertook activities from school refurbishment to primary health care.

On the other hand, Venezuela had a tradition of international cooperation with the Caribbean and Central American countries, orientated around the financing of oil purchases by those countries and bilateral commercial exchanges.⁵⁸⁸ President Chávez used that framework to deepen cooperation ties with Cuba. The first fruit of this collaboration was an exchange of crude oil for educational material and training for a programme targeted at the eradication of illiteracy.

The literacy programme was launched in April 2003 under the name of ‘Misión Robinson’.⁵⁸⁹ The Robinson mission extended throughout the whole country and reached many poor areas. This programme was the centrepiece of the government’s public communications. ‘Misión Robinson’ was widely welcomed and supported by the general public.⁵⁹⁰ The use of the word ‘mission’ to name other social programmes followed suit.

The ‘missions’ were not planned as an integral governmental initiative. They responded, instead, to the necessity to address specific needs that were entirely within the scope of the Venezuelan, albeit collapsed, bureaucratic apparatus. Its implementation beyond the existing public bureaucracy followed the government’s strategy to prevent resistance, to speed up results and to bypass the inefficient bureaucratic channels.⁵⁹¹

The ‘missions’ served communication purposes but were not coordinated by any central authority. Nonetheless, they were presented collectively as the key governmental action plan. Table 7.8 shows a list of social programmes implemented under the ‘mission’ umbrella in 2003 and 2004.

The ‘missions’ were managed separately and following distinctive financing and organisational schemes. Each mission was usually managed by a Foundation created specially to execute its main purpose. Resources were put together according to the

⁵⁸⁸ There was a treaty signed in the 1980s by Mexico and Venezuela with the Caribbean and Central-American countries known as the San Jose Treaty, which regulated this cooperation.

⁵⁸⁹ This was to honour Simon Rodríguez, a 19th century intellectual who was Simon Bolívar’s tutor and used the pseudonym of ‘Robinson’.

⁵⁹⁰ See Luis V. Leon, ‘Vender el sofa’, *El Universal*, 28 December 2003. Leon was President-Director of one of the leading poll firms in Venezuela (Datanalisis).

⁵⁹¹ Dester Rodríguez, interview by author, Caracas, 12 September 2005.

characteristics of each programme. Typically: personnel and other resources are specially contracted for each programme; some existing facilities within the public apparatus are used; and there is supplementary collaboration from the Armed Forces, voluntary participants within the local communities that are recipient of the services provided by each programme. Three missions used personnel provided by the government of Cuba. In fact, Missions 'Barrio Adentro', 'Ribas' and 'Robinson' were implemented through the participation of Cuban doctors and teachers whose costs were paid by the exchange of crude oil.

The 'missions' as such were not reported in the national budget. In the 2005 budget, for instance, direct references to the 'missions' programmes accounted for only 0.32% of the total budget (US\$ 103.46 out of US\$ 32,244 million). The same budget contains references to 2003 and 2004 where the 'missions' only accounted for 0.06% and 0.38% of those budgets respectively.⁵⁹² Nor are there public accounts of the payroll or detailed budget for each 'mission'.⁵⁹³ Government's official information reported some data about the 'missions' in the form of, for example, number of patients treated by the health programme 'Barrio Adentro' (updated to November 2004) or graduates from the literacy and high school education programmes but not official public information on the finances of the programmes.

These programmes became the most important issue for President Chávez's campaign during the recall referendum. The President's campaign slogan used the 'missions' as the main piece of evidence of the benefits the government was delivering for its citizens. 'Defend the missions' was the centrepiece of the Chávez campaign. Opinion poll surveys from the country's main polling companies showed that the 'missions' were well regarded, and people felt they were both a necessary policy and a successful Chávez initiative.⁵⁹⁴ The opposition repeatedly announced that the

⁵⁹² Ministry of Finance, Budget Law of 2005.

⁵⁹³ In the 'official' website of the 'missions' there some imprecise statistics about payroll of some 'missions'. For instance, it informs that 'more than 20,000' doctors and nurses are operating under 'Barrio Adentro' mission. See <http://www.misionvenezuela.gov.ve/01BarrioAdentro/01MisionAmor.htm>

⁵⁹⁴ As a sample see Datanalisis survey reported in El Nacional, 24 June 2004; Greensberg Quinlan Rosner Research reported in El Universal 3 July 2004; and Keller and associates reported in El Nacional, 30 July 2004.

‘missions’ were to be maintained and even improved.⁵⁹⁵ Minister of Energy Rafael Ramírez emphasised the electoral significance of the ‘missions’ for the government. He stressed the Chávez administration’s commitment to those programmes, arguing, “Although the opposition has announced that they will keep the missions, we know they do not believe in this. We believe in the missions. We are not going to turn our back on these programmes. PDVSA has to adapt itself to these new responsibilities.”⁵⁹⁶

Table 7.8 Social programmes under the umbrella of ‘Missions’

Mission	Area	Started in:	Work in conjunction with:
Robinson	Literacy	April 2003	Military/ government of Cuba/ Ministry of Education
Ribas	Secondary education for drop-outs from high school	November 2003	PDVSA and Ministry of Energy/ government of Cuba
Sucre	Access to tertiary education	2004	Ministry of Superior Education
Barrio Adentro	Primary health and social assistance	December 2003	Military/Ministry of Health/government of Cuba
Mercal	Food distribution	2004	Armed forces
Identidad	Identity cards	October 2003	Military/Ministry of Interior (Onidex)
Vuelvan Caras	Employment & training programmes	2004	Ministry of Popular Economy/ National Institute for Capacitating Education (INCE)
Guaicaipuro	Indigenous population assistance	October 2003	Ministry of Environment
Miranda	Military training	2005	Ministry of Defence/ armed forces

Source: Minci

The political importance for the government of the missions was publicly emphasised by President Chávez in his weekly TV programme on the 13 June 2004. In that programme he outlined his strategy for the campaign to defeat the recall referendum. He set out an organisational structure, shown in Figure 7.1. The ‘EBU’ and the Regional Maisanta’ commands were to work with the missions. He publicly instructed

⁵⁹⁵ Enrique Mendoza, interview in *El Universal*, 8 June 2004.

⁵⁹⁶ Rafael Ramírez, interview by *El Universal*, 4 July 2004.

Minister Ramírez to run these programmes: “The missions have to be represented in the units of electoral battles. Minister Ramírez had been assigned the task of integrating the Missions with the Maisanta Command and with the representatives of each unit.”⁵⁹⁷ In the same programme, Minister Ramírez publicly reported to President Chávez, “We held a special event in which all the national authorities of the missions were unified in a command to defend them.”⁵⁹⁸

One scheme that required particular attention was the Identity Mission (national identity cards and electoral registry enrolment programmes), and that scheme was accorded special priority. President Chávez insisted that a national identity card scheme was an important public policy goal. The issuing of those cards was deemed important to ensure that the lower strata of the population, usually without such cards and excluded from the electoral register, were recorded and enrolled to vote. He denounced the former administration for the corrupt National Identity Registry and was adamant about the need to press ahead with trial runs and pilot schemes to speed up the scheme. He also assigned responsibility to coordinate the project with the Armed Forces to Minister Rafael Ramírez.

Financing the ‘missions’ and other government programmes

The ‘missions’, as the flagship programmes of the Chávez administration, needed speedy and effective funding. As they were parallel structures, independent or loosely attached to the normal public bureaucracy, budget allocation was complicated. Normal bureaucratic agencies had absorbed most of the annual budget and the rigidities of budget procedures had obstructed resources being made available to boost the missions. Minister Rafael Ramírez announced in his first public appearance, after taking an oath on TV as member of the ‘Comando Maisanta’, that the government was committed to allocating US\$ 600 million to the missions.⁵⁹⁹

⁵⁹⁷ Hugo Chavez, Alo Presidente 193, 13 June 2004 (Transcripts by Ministry of Communication).

⁵⁹⁸ As a sample see Datanalisis survey reported in El Nacional, 24 June 2004; Greensberg Quinlan Rosner Research reported in El Universal 3 July 2004; and Keller and associates reported in El Nacional, 30 July 2004.

⁵⁹⁹ Hugo Chavez, *ibid.*

Dester Rodríguez , member of the board of PDVSA and President of its social development subsidiary Palmaven, explained, “The annual budget is passed using a fixed set of assumptions regarding oil prices, the US dollar-Bolívar exchange rate and expected inflation. The budget was calculated cautiously. When oil prices were higher than expected, there was room to distribute more fiscal income. Extra oil revenue did not affect those budget obligations already set therefore the use by PDVSA for the missions or other programmes did not diminish any other governmental or sub-national units.”⁶⁰⁰

In regard to the use that PDVSA was to decide for those extra resources he said, “The missions had no resources. Therefore, we had to create an office for social development within PDVSA. I was a member of the post-strike restructuring team and was called on to implement the social development area. We needed to reinforce the missions that were targeted on the excluded and most needy part of the population.”⁶⁰¹

President Chávez was determined to provide extra funding for his flagship programmes. Some institutional constraints, however, were interfering with that goal. Notably, rules regulating central banking and the way oil exports were managed. The need for a swift disposal of extra revenues dictated the Chavez administration next steps in altering the pre-existing institutional arrangements.

The rules regulating the functioning of the Central Bank and the legal framework for the handling of oil revenues constituted an institutional obstacle to President Chávez’s desire to swiftly allocate extra revenues from booming oil exports in 2003. The Central Bank of Venezuela had been created in 1939 as a mixed entity (public and private). In 1974, the Bank was completely nationalised.⁶⁰² Accordingly, the Bank’s authorities (President and Board) were appointed exclusively by the President of the Republic. This presidential prerogative was strengthened further in a reform to the Central Bank law that was passed in 1987. This change meant that the President of the

⁶⁰⁰ Dester Rodríguez , interview by author, Caracas, 12 September 2005.

⁶⁰¹ Dester Rodríguez, *ibid.*

⁶⁰² Official Gazette 30,142, 31 May 1974.

Bank could be removed by presidential decree (i.e. no legislative approval was required). The consequence of the nationalisation of the bank and the change of rules over a decade later meant that the Bank's board was dominated by members of the executive branch of government. The board had seven members, one of whom was the President of the Bank, and three of whom were cabinet ministers. The shareholders' assembly was configured solely by the Ministry of Finance.⁶⁰³

In 1992, in the midst of the neo-liberal reforms, a new law regulating the Central Bank was passed.⁶⁰⁴ The new law was intended to grant the Central Bank greater independence, and to prevent the Bank from financing the government (i.e. financing fiscal deficits). New procedures for the President and Board appointments were crafted. Congress was given powers to scrutinise nominees and veto powers over appointments. The appointment of the Bank President required an affirmative vote by two-thirds of the Senate. Similarly, the 1992 law laid out clear objectives for the Bank, with regard to monetary stability, and also introduced mechanisms to protect the Bank from government pressures to eschew long term stability in favour of short term electoral pressures.⁶⁰⁵

The National Constitution, passed in 1999, further elevated the legal stature of the Central Bank. The Bank was given constitutional status, being explicitly recognised as an independent agency of the State. Similarly, the Bank's mandate was included in the Constitution. Article 318 of the Constitution reads, "The fundamental objective of the Central Bank of Venezuela is to achieve price stability and to preserve the value of the currency, both nationally and internationally."⁶⁰⁶ Consequently, the National Assembly passed a law in 2001 in order to comply with the new constitutional mandate. The new law was based on the 1992 version although some changes regarding the authority to make appointments were modified. Notoriously, the existing qualified congressional majority required for the approval of Board appointments was reduced to a simple majority. Similarly, the National Assembly was

⁶⁰³ Official Gazette 3,998 Extraordinary, 21 August 1987.

⁶⁰⁴ Official Gazette 35,106, 4 December 1992.

⁶⁰⁵ A.Barrios et al., 'Un estudio sobre la autonomía administrativa del Banco Central de Venezuela', Research Network Working Paper #R-414 (Inter-American Development Bank, Washington,DC, 2000).

⁶⁰⁶ Official Gazette 5,453 Extraordinary , 24 March 2000.

made responsible for the direct appointment of two members of the Board. Later in 2002, a new law was passed to allow the government to collect net profits from the Bank twice a year.⁶⁰⁷

Both the constitutional mandate and the 1992 law, reformed in both 2001 and 2002, conferred a legal basis for the Central Bank to act independently from the executive branch of government. This legal framework, however, was to be tested when a major conflict arose between the Bank and the government. The Central Bank opposed the government policy on how to handle the extraordinary oil revenues between 2003-2005. The institutional framework was to be modified in order to allow Chávez's administration to implement its policy preferences.

7.3. Extracting resources from the Central Bank

The Chávez administration's implementation of its preferences about how to use extraordinary oil revenues went through various intermediate steps before materialising in the form of the Development Fund. First, President Chávez sought to extract resources from the Central Bank, which as a consequence of high oil prices had accumulated PDVSA export revenues due to the legal procedures regulating the management of oil export revenues. Later, the administration resorted to an ad hoc mechanism that allowed President Chávez to dispose of oil revenues directly from the oil company PDVSA. Finally, Chávez requested that the legislative branch regularise the previous mechanism. The resulting mechanism, the Development Fund, established by the National Assembly, permitted the Executive to collect oil revenues before they entered the existing taxation-budget procedures, therefore ensuring absolute Presidential control over those resources.

Long standing regulations had made it mandatory for the oil companies (even before nationalisation in 1975) to sell foreign currency denominated income from oil exports to the Central Bank. At the time of nationalisation, PDVSA was exempted from that obligation. This exceptional status, however, lasted only a few years and in a

⁶⁰⁷ These profits were usually the result of the exchange market operations of the Central Bank due to its monopoly in administering foreign currency inflow generated by oil exports.

controversial regulation passed by the executive branch in 1982, PDVSA was forced to sell its revenues from oil exports to the Central Bank.⁶⁰⁸

Figure 7.2 shows the flow of resources from its origins in oil exports to international markets until they are converted to public spending. This institutional route confers on the Central Bank a type of ‘quasi-monopoly’ as provider of foreign currency to the Venezuelan economy.⁶⁰⁹ This has two effects: first, the Central Bank usually obtains significant profits from the foreign exchange market; second, the unsold foreign currency is held by the Bank in the form of ‘international reserves’. When crude oil prices rise on the volatile international oil market, the accumulation of international reserves tends to accelerate, as was the case during 2002-2005 (see Table 7.4).

Chávez’s administration and the Central Bank clashed over both the transferring of profits from the foreign exchange market operations to the Treasury, and over how to dispose of some of the international reserves.

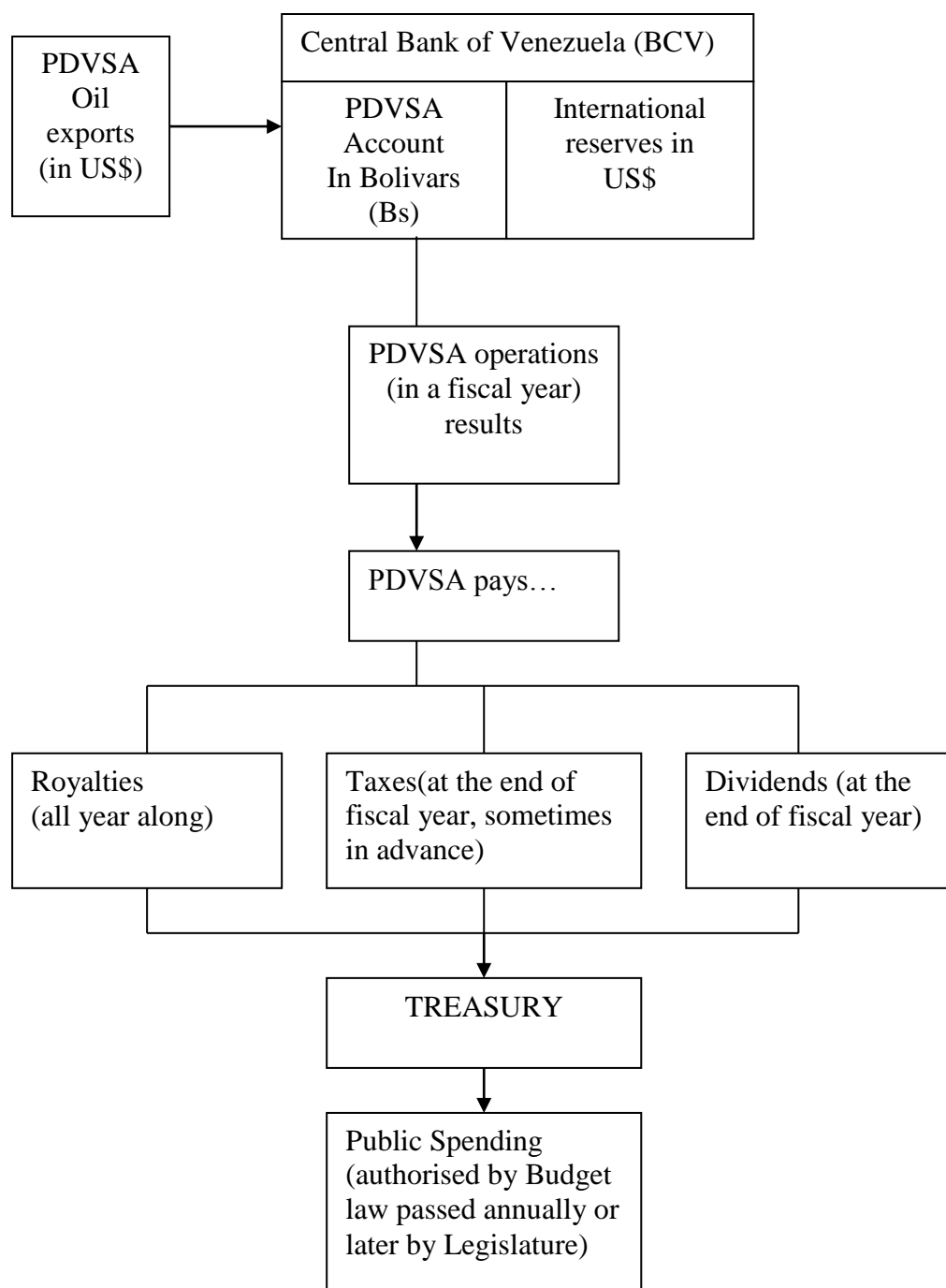
The ‘foreign exchange profits’ case

Conflict over transferring to the government the Central Bank’s profits emerged in early 2004. Traditionally, the profit made by the Central Bank was kept by the bank. This practice was, however, altered after 1999. Table 7.9 shows how transfers from the Central Bank, where the revenues originated from profit made in the exchange market, grew steadily after 1999. Although this practice had been occurring since that date, the calculus of these transfers became a controversial issue between the government and the Central Bank in 2003. This coincided with the conflict about President Chávez’s request to use resources from the international reserves held by the Central Bank, which is discussed in the following section.

⁶⁰⁸ This conflict between PDVSA and the Central Bank and the Executive Branch was discussed in Chapter 3.

⁶⁰⁹ It is sometimes a monopoly, when exchange controls are imposed by the government as it is the case from February 2003.

Figure 7.2. Flow ‘Oil exports->Public spending’



Source: Law of the Central Bank of Venezuela, compiled by author

Table 7.9 Central Bank's transfers to government

Year	Transfers in cash from BCV to Treasury in million Bolivars
1999	12.194 (1)
2000	131.574
2001	989.870
2002	1.202.863
2003	3.045.812
2004	4.774.377
2005	1.638.762 (2)

(1) Amount decreed, no information about payment

(2) 1st Semester only

Source: BCV

Officials from the Ministry of Finance accused the Central Bank of incorrectly calculating the profits made in the exchange market. The Minister of Finance asked the bank regulator (Bank Superintendent), the office of which had jurisdiction over the Central Bank regarding applied accounting principles, to investigate Central Bank calculations.⁶¹⁰ On 28 April 2004 the Bank Superintendent, Trino Díaz, announced his agency was to supervise the Central Bank.⁶¹¹ Superintendent Díaz declared on 2 May 2004 that the Central Bank had consistently miscalculated profits from the exchange market. In an independent civil action, the office of the Attorney General (Fiscalía de la República) began an investigation into Central Bank practices. In addition, members of the legislative branch who supported the government's initiative began to consider ways to reform the Central Bank Law.⁶¹² As Chávez's supporters could command a majority in the National Assembly this was a credible threat. The supervision of the Central Bank by the Bank Regulator continued for months. Superintendent Díaz publicly suggested he would take the case to the Supreme Court of Justice (TSJ) if the Central Bank continued to refuse to change its accounting practices.⁶¹³

⁶¹⁰ 'BCV y Finanzas difieren en cálculos de utilidades', El Universal, 4 April 2004.

⁶¹¹ 'Sudeban fiscalizara al BCV la próxima semana' El Universal, 29 April 2004; 'BCV y Sudeban están coordinados' El Universal, 29 April 2004.

⁶¹² 'BCV cercado', El Universal, 9 May 2004.

⁶¹³ 'Sudeban reclama al BCV utilidades cambiarias del oro', El Universal, 9 November 2004.

In the meantime, the tenures of the president of the Central Bank and of another director were to come to an end in January 2005. The requirements for the appointment of the President of the Central Bank had been changed in 2001. Previously, according to the Central Bank Law enacted in 1992, the President of the Central Bank was nominated by the President of the Republic and ratified by two-thirds of the Senate (when the legislative body was bicameral). In 2001, the law was amended to reduce that requirement. The new law stated that the ratification by the legislative body required only a bare majority of votes in the National Assembly.

President Chávez made public his intention to nominate a different candidate to the sitting President for the new term. He even called on BCV's President Diego Castellanos to resign along with the BCV's board, because, according to Chávez, the Central Bank had continued to refuse to alter its calculations regarding the profits from the exchange market. President Chávez said, rather harshly, "Castellanos has reached the age of retirement, in the event a judge ordered his imprisonment he would be at home. He can resign and give way to someone who wants to serve the country because the Central Bank does not belong to its President."⁶¹⁴ A new Central Bank President was ratified by the National Assembly on 27 January 2005 by a simple majority.⁶¹⁵ The BCV's board, with its new members, approved a rectified transfer to the Treasury on 17 February 2005. The calculation for this transfer was extended to the previous legal economic term and also included a modified transfer from previous miscalculated profits.⁶¹⁶

*The 'US\$ billion of the International Reserves' case*⁶¹⁷

President Chávez requested that the Central Bank allocate US\$ 1 billion of the international reserves for financing the agriculture sector. On 8 November 2003 he stated, "We are reaching the level of US\$ 21 billion in international reserves. For what purpose do we have to hold deposits for US\$ 21 billion in American and

⁶¹⁴ 'Chavez insto a renunciar al presidente del BCV', *El Universal*, 21 December 2004.

⁶¹⁵ National Assembly. Minutes Ord-07-05 of the session held on the 27 January 2005.

⁶¹⁶ 'BCV entregara Bs.3,2 billones', *El Universal*, 17 February 2005.

⁶¹⁷ This case was known in Venezuela as the 'millardo' case. 'Millardo' is the term used in Spanish for billion.

European banks of money that belongs to all Venezuelans? What do we get from having those deposits? Why can't we use one billion? That it is what I am asking. This money does not belong to the government. This money belongs to the country. This money does not belong to the Central Bank either."⁶¹⁸ He added that he had been discussing the matter unsuccessfully with the Central Bank for three months and now wanted to introduce that discussion in public and hinted he could call a 'consultative' referendum on the decision.

The Central Bank initially opposed that petition on technical grounds. The technical case was based on the fact that it was impossible for the bank to convert the money, held in foreign currency, into local currency twice. The international reserves accumulation process is normally as follows (see also Figure 7.2):

- 1) The oil company PDVSA receive foreign currency as payment for oil exports.
- 2) PDVSA is mandated to sell that foreign currency to the Central Bank.
- 3) The Central Bank gives PDVSA the equivalent in Bolívar.

The Central Bank argued to the government officials that when the Bank holds international reserves, the oil company had already received the equivalent amount in Bolívar. Those resources in Bolívar were used mainly to pay for PDVSA domestic expenditures and paying taxes to the government. Returning those international reserves to the government was comparable to providing the government with inflationary financing. Since the constitutional mandate to the Central Bank prevents such transfer of funds the Bank was unable to consent to the President's demands.⁶¹⁹

Government civil servants and Central Bank officials met several times to discuss this issue. Although the Central Bank's communiqués were discreet, the dispute was bitter. Two directors, Domingo Maza-Zavala and Armando León, went public to defend the Central Bank's autonomy.⁶²⁰ Rafael Quiróz, an advisor to the President of the Central Bank, recounted, "Tension with the government was high. There was no way that government officials could understand our arguments. In a heated

⁶¹⁸ Hugo Chavez, Alo Presidente 171, 9 November 2003, (Transcript by Ministry of Communications).

⁶¹⁹ Central Bank of Venezuela, Communiqué, 7 January 2004.

⁶²⁰ 'Ataque al BCV es desestabilizador', El Universal, 10 January 2004; 'Maza: BCV solo puede apoyar al agro con redescuento', El Universal, 7 January 2004.

discussion, Central Bank director Maza-Zavala called President Chávez an orphan of financial expertise.”⁶²¹

President Chávez publicly rebuffed those arguments accusing the Central Bank of pursuing ‘neo-liberal’ policies promoted by the International Monetary Fund (IMF) against the public interest. He threatened to intervene with the Bank, as he had done with the oil company PDVSA, if the Bank refused to consent to his requirements, or to challenge them in the Supreme Court of Justice (TSJ).⁶²² Additionally, the legislative faction that supported the government in the National Assembly swiftly introduced the issue in the legislative body. The Permanent Committee of Finance exhorted the Central Bank to consent to the presidential request.⁶²³

The National Assembly in its session of 8 January 2004 approved (by 85 votes to 37) an ‘exhortation’ to the BCV to facilitate US\$ 1 billion to finance agricultural programmes.⁶²⁴ The National Assembly’s President, Francisco Ameliach publicly announced that he intended to introduce, in an extraordinary legislative procedure, a reform of the Central Bank Law in order to accommodate the President’s request.⁶²⁵ Finally, orchestrated street protests added to the pressure on the Central Bank. Supporters of the government descended upon the Central Bank headquarters in Caracas twice in early January and to the Central Bank Office in Maracaibo on the 15 January 2004 to protest against the its refusal to grant the US\$ 1 billion.

The dispute between the government and the Central Bank, however, did not escalate. The Ministry of Finance intervened to reassure the public that the government and the Central Bank were negotiating a financing mechanism that would fulfil President Chávez’s request for the agricultural sector. The Central Bank offered a compromise solution by using monetary regulations to facilitate private and public financing of the agricultural sector. On 22 January the Central Bank officially eased the discount

⁶²¹ Rafael Quiróz, interview by author, Caracas, 5 September 2005.

⁶²² Hugo Chavez, Alo Presidente 176, 28 December 2003 (Transcript by Ministry of Communications).

⁶²³ ‘Asamblea Nacional gestionara ante el BCV millardo solicitado por el ejecutivo’, El Universal, 5 January 2004.

⁶²⁴ National Assembly, Ordinary Session; Minutes of session held on 8 January 2004.

⁶²⁵ ‘Ameliach garantiza a Chávez reforma de Ley del BCV’, El Universal, 10 January 2004.

requirement for banks lending to agricultural businesses.⁶²⁶ This solution helped avoid a public dispute between the Chávez administration and the Central Bank, but only temporarily. As the oil price continued to be high, Venezuela continued to obtain significant additional revenues for its oil exports. The next section discusses how the government modified institutional arrangements to allow it to use its newly acquired revenues in its preferred way.

7.4 The first Development Fund (Fondespa)

President Chávez insisted on the urgent need to use some of the international reserves held by the Central Bank. The Central Bank's initial solution of facilitating resources, by relaxing its monetary regulations, had managed only to partly meet Chávez's demands.

During the conflict between the Central Bank and the government for the use of international reserves, however, the Central Bank had relaxed the rules forcing PDVSA to sell all its income in foreign currency to the Bank. The 1982 rules allowed PDVSA to keep some funds abroad, but only when the Central Bank authorised it. Since this regulation was enacted in 1982, PDVSA had maintained such a fund, of up to US\$ 600 million, for its operating needs. However, the Central Bank Board at its meeting held on 29 January 2004, in a split decision authorised PDVSA to set up other funds.⁶²⁷

The option of setting up a new fund in US dollars was not adopted until May 2004. The Central Bank also suggested an option of modifying the existing Macroeconomic Fund. This option, however, was not adopted and the Central Bank opted to ratify the option of a PDVSA fund abroad that the oil company could use for investment in

⁶²⁶ Official Gazette 37,864, 23 January 2004.

⁶²⁷ Public records do not show evidence of that decision. There is a letter sent on 12 February 2004 to the Select Committee of Finance of the National Assembly by Central Bank President Diego Castellanos reported in 'Maza Zavala solicita regal legal para fondo especial', El Universal, 15 June 2004. Comments on the decision are reported in an interview with Rafael Quiróz in 'Tension en el Directorio del BCV', El Universal, 16 June 2004.

social programmes. Central Bank President, Diego Castellanos, sent another letter to the National Assembly with that suggestion.⁶²⁸

The suggested modification allowed PDVSA to hold resources of up to US\$ 2 billion to create a special fund for social development. This decision was not intended to give further independence to the oil company, but specifically to allow it to set a fund apart from its regular operational fund to allow for the swift financing of government projects. When the Central Bank Board first discussed the authorisation, some members of the Board proposed that it wait for a feasibility study by the Bank's technical experts. The Minister of Planning, Jorge Giordani, a member of that Board, opposed the referral to the Banks technocrats on the grounds that the resources were urgently needed. The Central Bank's president Diego Castellanos supported Giordani's position and the authorisation was passed.⁶²⁹

The government, however, had anticipated the Central Bank's position. The Central Bank's decision regarding the character of the Fund was stated in loose terms. The decision was not clear about whether or not the Fund was to be topped up regularly or if it was a one-off authorisation. Later, another member of the Central Bank Board, Domingo Maza-Zavala, also made public his disagreement with how the Fund was implemented. He said, "Although the creation of the fund is a positive thing, rules are needed for how it is going to be administered, who is going to administer it and how is going to be supervised. After the Central Bank had deposited US\$ 1.1 billion, PDVSA has not responded to date to the Bank's demands."⁶³⁰

On 14 May 2004, PDVSA's assembly of shareholders, the main decision making authority of the organisation, approved the creation of that Fund, named, 'Fondo para el Desarrollo Económico y Social del País' (Fondespa).⁶³¹ President Chávez announced on 23 May that the Fund had been created, and was under his direct control. He publicly said to his Minister of Planning, Jorge Giordani, that, "This fund was born; I had approved it, Jorge. I have my controls that never fail. You know they

⁶²⁸ 'El directorio del BCV propuso un mecanismo con legalidad opaca', Victor Salieron, El Universal, 10 June 2004.

⁶²⁹ 'Tension en Directorio del BCV', El Universal, 16 June 2004.

⁶³⁰ 'Maza Zavala solicita regal para fondo especial', El Universal, 15 June 2004.

⁶³¹ PDVSA website.

never fail. We have approved this fund to accelerate several programmes that were progressing at a pace that we are now redoubling.”⁶³² PDVSA, now authorised by the Central Bank, initially set aside US\$ 2 billion for Fondespa during the fiscal year of 2004.

Originally, PDVSA did not set up an internal structure to administer the Fund as the immediate use of the Fund was to finance the ‘missions’. Minister Rafael Ramírez first announcement regarding the Fondespa was that the Fund was to allocate directly US\$ 600 million for funding the ‘missions’.⁶³³

Six months later it transformed its existing social development subsidiary, Palmaven, into a full ‘social development’ subsidiary.⁶³⁴ It used another existing subsidiary, Corporación Venezolana del Petróleo (CVP), to administer the rest of the Fund. This division complied with the way in which PDVSA treated Fondespa in its balance sheet. Part of the resource was treated as expenditures to be administered by Palmaven. The other part was assigned to subsidiary CVP and treated as ‘returnable investment’.

Palmaven, the social development subsidiary, had originated at a time when foreign companies were operating in Venezuela. When oil wells were drilled, the affected areas, mainly agricultural areas, received assistance from the foreign companies to compensate them for the damage caused by the establishment of oil facilities. Those activities carried out by various oil foreign firms were grouped in the Palmaven subsidiary after nationalisation in 1975. Palmaven was charged with mitigating environmental impact and ensuring technical assistance was provided to the agricultural sector.

After the 2002-2003 strike, the corporate objectives of Palmaven were changed, as it was reported in PDVSA’s annual report of 2003. Its Annual Report stated, “This affiliate has been completely transformed. Its new role is to promote national social

⁶³² Hugo Chavez, Alo Presidente, 192, 23 May 2004 (Transcript by Ministry of Communications).

⁶³³ ‘Hay \$1,2 Millardos en el Fondo’, El Universal, 4 July 2004.

⁶³⁴ ‘PDVSA anuncia creacion de filial de desarrollo social’, El Universal, 12 November 2005.

development through educational, health and job creating initiatives, directed to the poorest sectors of Venezuelan society. Its previous activities related to environmental services were transferred to the HSE (health, safety and environment) organisations of other operating affiliates and the participation of Palmaven in 14 agricultural joint ventures are being evaluated in order to be sold or transferred.”⁶³⁵

Palmaven’s new organisational framework was structured to address the needs of the missions. The main divisions of Palmaven were:

- Planning
- Control of the regions
- Control of Capital Region
- Agricultural and energy projects
- Socio-Educational projects
- Infrastructure projects
- Endogenous development projects

Palmaven set an allocation of approximately 40% of Fondespa to fund the missions.

Table 7.10 shows the 2004 and 2005 allocation of resources.

Table 7.10 Fondespa allocation to the missions (US\$ million)

Mission	2004	2005	Total
Misión Ribas	227	213	440
Misión Vuelvan Caras	157	154	311
Misión Barrio Adentro	23	173	196
Misión Identidad	60	0	60
Misión Sucre	64	0	64
Misión Mercal	93	295	388
Misión Núcleos de Desarrollo Endógeno	29	8	37
Misión Guaicaipuro	0	11	11
National Asphalt Plan	74	62	136
Technology resources to Missions	15	0	15
Other donations (1)	73	6	79
Total	815	922	1737

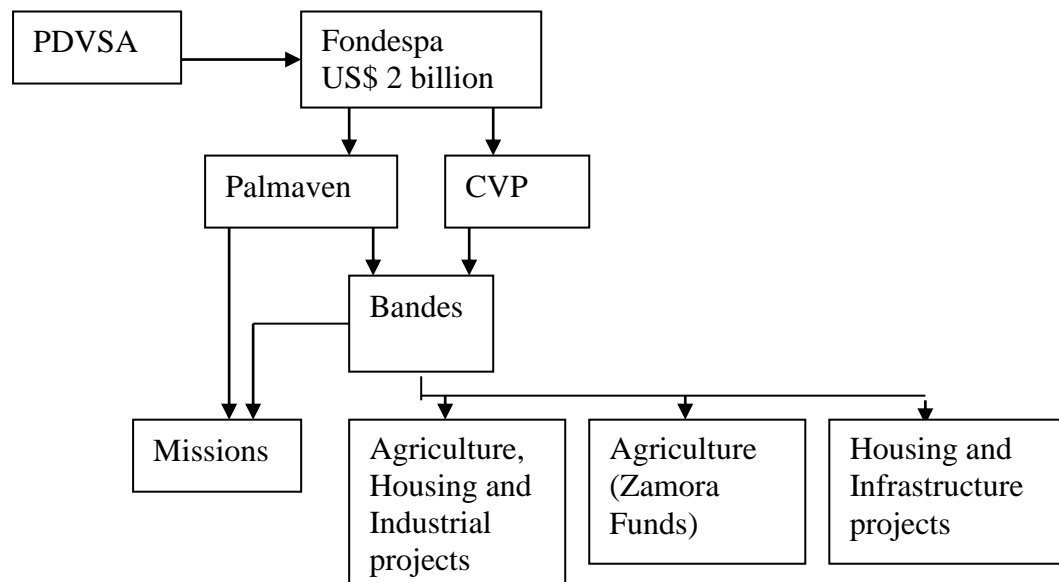
(1) Including funding a programme called Mission Milagro that covered Cataract surgery in Cuba for Venezuelan patients

Source: Palmaven

⁶³⁵ PDVSA Annual Report 2003. Form 20F presented to US Security Exchange Commission.

Carlos Mujica, a member of Palmaven's staff, explained how the funding flowed: "Palmaven normally opens a trust in a public bank, typically Bandes [Banco Nacional de Desarrollo] to make payments to the Foundations responsible for each mission. Each mission is independent on how to spend the money transferred to them. Monitoring the execution of each mission's activities is very complicated. Other programmes, however, such as the Asphalt Plan which made asphalt available to governors and municipalities free of charge is controlled directly by Palmaven. The other direct involvement of Palmaven is with the programme for endogenous development centres. Palmaven implements them as the President of the Republic designates where they are to be built. That is why we created a special division for those centres."⁶³⁶ Figure 7.3 shows the financing scheme adopted by Palmaven to support the missions.

Figure 7.3 Flow 'Fondespa's funds -> Missions and other projects'



Source: Palmaven and CVP

⁶³⁶ Carlos Mujica, interview by author, Caracas, 13 September 2005.

Corporación Venezolana del Petróleo (CVP), the PDVSA subsidiary responsible for investments and association with third parties, was assigned a new responsibility regarding the administration of Fondespa. Specifically, CVP was responsible for providing a vehicle to finance social projects other than the ‘missions’. Similarly to Palmaven, CVP delivered this financing through Bandes. On 19 May 2004 CVP signed a contract with this public bank to act as trustee. Bandes would use CVP’s resources to pay for the cost of social programmes and other projects in the area of transportation, road infrastructure, agriculture, health and education.⁶³⁷

CVP authorised which programmes or projects are to be financed through Fondespa. The decision of which projects receive funding, however, was generally made by the President of the Republic directly. The President normally instructed PDVSA which projects were eligible. The Ministry of Planning coordinated the evaluation of those projects. Table 7.11 shows the distribution of CVP projects, by economic area. Other ministries, regional development corporations and governmental agencies acted as executing bodies. Franklin Méndez, member of the CVP’s board and Vice President of Bandes, commented, “Bandes is responsible for monitoring the execution of the projects and to ensure transparency in the use of Fondespa’s resources by the executing bodies. CVP, however, makes only selective physical inspections to check the advancement of the projects. CVP do not have enough staff to inspect all the financed projects.”⁶³⁸

The Chávez administration insisted on allocating Fondespa resources directly, to spend the oil windfall. How the fund would be replenished was yet to be defined. In August 2004, Chávez announced that Fondespa was to be replenished, as long as the resources were used. The Central Bank’s initial authorisation, however, did not specify that the fund could be replenished on an ongoing basis.⁶³⁹ BCV’s board member, Domingo Maza-Zavala, stated that the authorisation was for only the original US\$ 2 billion.⁶⁴⁰

⁶³⁷ PDVSA, Fondo para el Desarrollo Económico y Social del País (Fondespa), Report, 31 August 2005.

⁶³⁸ Franklin Mendez, interview by author, Caracas, 16 September 2005.

⁶³⁹ By rotational it was understood that the Fund was going to be replenished on a regular basis.

⁶⁴⁰ ‘Fondo Social: se repondrá cuando se agote’, El Universal, 14 August 2004.

Table 7.11 CVP financing for 2004-2005 (US\$ million)

Area	CVP funding
Electrical generation and distribution	759
Transport and road construction	731
Public Transportation (includes a new national airline)	647
Endogenous Development, agriculture and medium enterprises (includes refurbishing a military fort and a cement plant in association with an Iranian company)	586
Communications, environment and studies (includes a new public TV channel, and mining exploration)	93
Total	2,816

Source: CVP

The controversy about the character of the Fund lingered for some months. On 23 November 2004 President Chávez insisted that another US\$ 2 billion were to be made available to the Fund for the following year.⁶⁴¹ In his annual address to the National Assembly, Chávez insisted that Fondespa was a ‘rotating’ fund.⁶⁴² The Central Bank never modified its first authorisation or issued a new one. PDVSA, however, proceeded to make resources available to the Fund for another US\$ 2 billion in 2005 by loosely interpreting the original authorisation. Fondespa, as a permanent mechanism to channel extra oil revenues, was, however, bound to be modified by a new institutional arrangement.

7.5 The second Development Fund (Fonden)

Since late 2003 President Chávez’s administration had tried to modify the institutional arrangement regulating the conversion of oil revenues to public spending. Chávez’s demands, however, had been only partially met. As the National Assembly had agreed to Chávez’s request, the main institutional obstacle had been the Central Bank. Previous regulations gave the Central Bank an institutional shield to prevent the

⁶⁴¹ ‘Chávez insiste en que Petróleos de Venezuela aportara otros \$2 millardos’, *El Universal*, 23 November 2004.

⁶⁴² Hugo Chavez’s annual salutation to the National Assembly. National Assembly website (www.asambleanacional.gov.ve).

implementation of different mechanisms for using oil export generated income. Tax and budget regulations forced the channelling oil revenues through bureaucratic procedures that obstructed the immediate use of oil revenues. The government and the Central Bank had been at odds over how to implement a more expeditious mechanism for using oil revenues. Both, the so-called 'Millardo' case and Fondespa combined to heighten the government-BCV tensions.

In both cases, however, an ad hoc solution had been introduced to solve the needs for government financing. Chávez and his supporters in the National Assembly, however, wanted a more structural change. Discussions over the creation of a new institutional arrangement continued alongside the partial implementations of the transferring of the Central Bank's international reserves and Fondespa. This new initiative led to the creation of the Fondo Nacional de Desarrollo (Fonden).

The introduction of 'Excess International Reserves'

The National Assembly intervened in the conflict between the Central Bank and the government as early as January 2004. Chávez's supporters urged the Central Bank to facilitate the partial use of the international reserves, based on the concept of 'excess international reserves'. The discussion about what 'excess international reserves' meant dominated elite public opinion at a time of extreme political polarisation. The opposition to Chávez deemed his proposal unconstitutional, a threat to healthy monetary policy and Central Bank independence.⁶⁴³ Chávez and his supporters accused opponents of the proposed move as followers of neo-liberal policies, of being insensitive to social needs and said that their opinions were lacking technical rigour and were politically motivated.⁶⁴⁴

⁶⁴³ See for example Orlando Ochoa, Jose Guerra and Jesus Rojas in 'Proyecto de Reforma de Ley del BCV viola la Constitución', El Universal, 19 June 2005; AD Party's president Jesus Mendez-Quijada in 'AD alerta que reforma de Ley del BCV afectara el Situado', El Universal, 21 June 2005; Pedro Palma in 'Jugando con fuego', El Universal, 15 November 2003.

⁶⁴⁴ Hugo Chavez, Alo Presidente 176, 28 December 2003 (Transcript by Ministry of Communications and Rodrigo Cabezas and Tobias Nobrega in Conference 'Reservas Excedentarias en Venezuela: Una propuesta' held in the National Assembly, 21 April 2004.

The main technical objection regarded the mechanism which allowed Venezuela to convert its oil revenue in dollars to Bolívar, as discussed earlier (see Figure 7.2). By reducing reserves denominated in strong currencies from the Central Bank balance sheet, support of the Bolívar was weakened. In defence of the Chávez proposal, the President of the Finance Permanent Committee of the National Assembly, Rodrigo Cabezas, presented international cases in which an optimal level of reserves could be calculated for a specific economy. The main thrust of Cabezas's thinking was that Venezuela had reached the optimal level of reserves, and therefore using that surplus would cause no harm to the Central Bank position. Similarly, the Minister of Finance Tobias Nobrega defended the introduction of rules defining an 'optimal level' of international reserves.⁶⁴⁵

This legislative initiative, however, was put on hold whilst political life focused on the recall referendum. Fondespa had provided the government with an express mechanism to address its financial needs during 2004.

The creation of a legal device for setting a certain level of international reserves was resumed in May 2005. The Solicitor General Marisol Parra proposed a reform to the law regulating the Central Bank to limit the constitutional mandate that granted the Bank a monopoly in the administration of the international reserves.⁶⁴⁶ In fact, Article 318 of the National Constitution states, "...the Central Bank of Venezuela must, among others, formulate and execute monetary policy, participate in the design and execution of foreign exchange policy, regulate the local currency, credit and interest rates, administer international reserves, and any other responsibility established by law."⁶⁴⁷ Solicitor General Parra suggested that by putting a cap on the level of international reserves held by the Central Bank, the constitutional principles were preserved.⁶⁴⁸ This interpretation of the constitutional text assured that the use, for other purposes, of the international reserves above that set level was legally feasible.

⁶⁴⁵ Asamblea Nacional, Reservas excedentarias en Venezuela: una propuesta, Proceedings of Conference held on 21 April 2004 (Caracas, Asamblea Nacional, 2005).

⁶⁴⁶ Marisol Parra, interview in 'Procuradora propone reformar Ley del BCV', El Universal, 28 May 2005.

⁶⁴⁷ Official Gazette 5,453, 24 March 2000.

⁶⁴⁸ Marisol Parra, *ibid.*

Chávez's supporters in the National Assembly introduced a Bill in June 2005 to regulate 'excess international reserves. On 21 June 2005 the Assembly approved the first reading of the reform of the Central Bank of Venezuela law for "the legal order in the management of excess international reserves". The justification for the Bill given by the Deputies was that the prevailing system limited the government's capabilities to use the oil rents to boost economic growth.⁶⁴⁹

The Deputies' arguments referred to the limits imposed by the Central Bank's demands for a counter value in Bolívar if the government wanted to buy US dollars for further use in public spending. This has to be authorised by the annual budget law previously passed each fiscal year. This annual budget set a reference price for oil exports in which the oil taxes are calculated. When fiscal revenues are positively impacted by unexpectedly high prices, prevailing institutional arrangements forced the government to wait for the taxation cycle to take place.

Additionally, although this is not mentioned in the Deputies' proposal, established budget procedures also implied automatic transfers to governments at sub-national levels (governors and mayors). Keeping oil income out of the normal budgetary process implied that sub-national levels do not share that extra income.

The reform of the Central Bank Law

There are three mandatory budget allocations that are proportional to the size of the budget. First, a constitutional grant to sub-national governments (both states and municipalities) called 'Situado Constitucional'. In fact, Article 162 of the Constitution states, "The constitutional grant will be equivalent to a maximum of 20% of total ordinary fiscal revenues as estimated annually. This allocation is automatically calculated as a fixed percentage of the fiscal incomes. It would be distributed between the states and the Capital District as follows: 30% of the total grant divided equally between each entity and 70% proportionally to the population of each entity. The

⁶⁴⁹ This is similar to British 'White papers'; See Asamblea Nacional, 'Exposición de Motivo de la reforma de la ley del BCV para el arreglo jurídico en el manejo de las reservas internacionales excedentarias', 2005.

states will allocate at least 50% of the received amount to investment. The municipalities within each state will receive at least 20% of the constitutional grant and other ordinary income of that state. In case of variations in fiscal revenues that impose modifications to the national budget, the constitutional grant will be proportionally readjusted.”⁶⁵⁰

Second, a fund called the ‘Decentralisation Fund’ (Fondo Intergubernamental para la Descentralización, or Fides) is automatically allocated among states and municipalities. This transfer had been established in the early 1990s, when the administrative decentralisation of the State was decreed by law.⁶⁵¹ Third, a special budget appropriation resulted from the application of a law passed in 1996 that directly provided for an allocation of part of the taxation to mines and hydrocarbons activities. This law, referred to as the ‘special economic allocations to the states’ derived from Mines and Hydrocarbons (Ley de asignaciones económicas especiales para los Estados derivadas de minas e hidrocarburos, or Laee) was passed on 18 December 1996.⁶⁵² This law established a special privilege for those states in which oil activities are developed. The so called ‘special allocation’ was a share (30%) of the direct taxes generated by mining and oil (hydrocarbons) exploitation as are stipulated in the Hydrocarbons and Mines laws. The allocation is in two parts. First, 70% is assigned to those states with mines and oil facilities (including refineries) and secondly, 30% to the remaining states. The two largest oil states are Zulia and Monagas. From 2000 to 2004 both states were governed by opponents to the Chávez regime.

Table 7.12 shows the significance of the transfers in relation to the national budget. Approximately a quarter of ordinary taxes are to be directly transferred to sub-national governments. When governors and the President belong to the same political party or governing coalition the political relevance of those transfers is minor. However, when those automatic transfers favour governorships in the hands of

⁶⁵⁰ Official Gazette 5,453 Extraordinary, 24 March 2000.

⁶⁵¹ See Official Gazette Extraordinary 4,153, 28 December 1989 for ‘Ley Organica de Descentralizacion, delimitacion y transferencia de competencias del poder publico’. The Decentralization Fund was decreed by the President on the 25 November 1993 and lately modified twice (Official Gazette 5,132 Extraordinary, 3 May 1997 and Official Gazette 37,066, 30 October 2000).

⁶⁵² Official Gazette 36,110, 18 December 1996.

opponents to the President, the latter has an incentive to limit those transfers. Although the ‘Chávez coalition’ controlled, from 2000-2004, 15 out of 24 states, the opposition controlled some of the most populous ones.⁶⁵³ Table 7.13 shows that the mandatory transfers to those nine states controlled by Chávez’s opponents accounted for almost 50% of total transfers during the period of 1998-2005.

Establishing funds such as Fondespa, which takes resources away from PDVSA before they enter normal budgetary channels, has important implications for sub-national levels of government. These implications, however, were largely ignored by regional political forces. Only opposition parties, such as the AD party, with extended regional representation, raised concerns about it.⁶⁵⁴

Table 7.12 Legal transfers as % of fiscal revenues (1998-2005)

Year	%
1998	29
1999	25
2000	24
2001	22
2002	26
2003	28
2004	32
2005	23
Average	26.13

Source: Onapre

Table 7.13 Distribution of legal transfer by the states (1998-2005)

States according to political affiliation of Governor	Share of all Legal Transferred (%)
States governed by opponents to Chávez (9 out of 24)	49.64
States governed by Chávez’ coalition	51.36

Sources: Ministry of Finance, CNE, Carter Center

⁶⁵³ States include the Capital District.

⁶⁵⁴ Jesus Mendez-Quijada in ‘AD alerta que reforma de Ley del BCV afectara el Situado’, El Universal, 21 June 2005.

Ricardo Sanguino, who was one of the deputies that introduced the reform to the Central Bank Law commented, “We wanted to promote efficiency in public spending. If you wait for the budget system to work you would always be delayed in implementing public programmes. The State bureaucracy is elephantine and it is extremely inefficient, especially to implement programmes targeted to people that have been excluded in the past by traditional public spending programmes.”⁶⁵⁵ Dester Rodríguez, the PDVSA board member in charge of the social programmes referred in a similar way to the normal public bureaucracy: “We need to drive a tractor over it and demolish it.” He also suggests that for each Bolívar of nominal public spending through budgetary channels only ten cents reach the targeted beneficiary of each programme.⁶⁵⁶

Moreover, Sanguino defended the idea of the Fund for extraordinary oil revenues as a mechanism to facilitate the use of those resources for high priority issues such as health, education, infrastructure and servicing public debt. He adds, “We are not subtracting fiscal income such royalties or other normal taxes. We are not diminishing the regions’ share of fiscal revenues. The normal budget is calculated in line with past patterns. We are using only the extra oil income to fund productive investment separated from the normal bureaucracy.”⁶⁵⁷

The Central Bank privately raised objections to the transfer of international reserves to a special fund.⁶⁵⁸ The Bank, however, publicly agreed with the creation of a fund. Rodrigo Cabezas, President of the Finance Select Committee of the National Assembly, said, “The Central Bank has not given its opinion about the transfer to the international reserves. We know some of the members of the Board do not agree with that because of concerns about monetary policy. The bank suggested a draft for a law creating the development fund to the executive branch and to the Assembly. That suggestion will be used for drafting the presidential decree creating such a fund.”⁶⁵⁹

⁶⁵⁵ Ricardo Sanguino, interview by author, Caracas, 6 September 2005.

⁶⁵⁶ Dester Rodríguez, interview by author, Caracas, 12 September 2005.

⁶⁵⁷ Ricardo Sanguino, *ibid.*

⁶⁵⁸ Rafael Quiróz, interview by author, Caracas, 5 September 2005.

⁶⁵⁹ Rodrigo Cabezas in ‘BCV solo propuso el Fonden’, El Universal, 24 June 2005 and in ‘BCV critico traslado de reservas que ordena el Parlamento’, El Nacional, 8 July 2005.

The President of BCV, Gastón Parra, publicly pledged support for the creation of special development funds, financed by the extraordinary oil revenues. Parra defended the constitutional mandate as stipulated in Articles 311 and 314 of the National Constitution. He said, “I personally wrote those articles in 1999. Using oil revenues for productive spending is compliant with the Constitution.”⁶⁶⁰

In fact Article 311 of the Constitution states, “Revenues from the exploitation of minerals and subsoil wealth will be primarily used to finance productive real investment, education and health.” Similarly, Article 314 stipulates that extra-budgetary spending is allowed only when the Treasury obtains sufficient resources to finance that extra spending.⁶⁶¹

Opponents of the law in the National Assembly, however, deemed the reform unconstitutional because it contradicted the constitutional mandate that confers the Central Bank the exclusive administration of the international reserves (Article 318 of the National Constitution).⁶⁶² The proposed reform specifically changed the mechanism through which the Central Bank converted oil revenues in US dollars to the international reserves. The proposed modification overcame the constitutional limitation by considering part of the international reserves as ‘excess’ reserves. In fact, the thrust of the reform was the introduction of a legal category called the ‘adequate level of international reserves’.

On 19 July 2005 the National Assembly passed the reform of the Central Bank law by a simple majority vote. Specifically, the ‘adequate level of international reserves’ was regulated by four articles:

Article 7: The Central Bank must estimate an adequate level of international reserves.

⁶⁶⁰ Gaston Parra, in a congressional hearing reported in ‘Gaston Parra confía en buena utilización de los recursos’, El Nacional, 13 July 2005.

⁶⁶¹ Official Gazette 5,453 Extraordinary, 24 March 2000.

⁶⁶² Other deputies from the opposition alleged unconstitutionality on the grounds of not compliance with constitutional requirements to pass a law, as reported in ‘Asamblea aprobo reforma de la Ley del Banco Central’, El Nacional, 20 July 2005.

Article 21: The board of the Central Bank must carry out a study to estimate that level of reserves.

Article 75: The Central Bank must inform the executive branch the level of international reserves that is deemed adequate. The Central Bank must include the study in which it sets that level as part of the input for the elaboration, each year, of the national budget and in the annual accord on economic policy stipulated in the Article 320 of the National Constitution.

Article 114: The Central Bank must establish a unique methodology based on the structural characteristics of the Venezuelan economy. In the event of the Central Bank not agreeing to that unique method, it must submit the analysed proposals to the Finance Select Committee of the National Assembly to adjudicate.

Similarly, the previous obligation of PDVSA to sell all dollar income obtained from crude oil and other hydrocarbon exports to the Central Bank was relaxed. Before this relaxation, PDVSA was required to maintain reserves in foreign currency only for operational needs, and up to a maximum established by the Central Bank. That limit had been set at US\$ 600 million until 2004, when the Central Bank had authorised the creation of Fondespa, as discussed earlier.

The reformed law established a new regime. First, PDVSA was to be forced to sell to the Central Bank only the equivalent in US dollars of the operating budget in Venezuela and the fiscal commitments fixed for PDVSA in the annual budget. Second, similarly to the previous regime, PDVSA could hold foreign reserves to a maximum authorised by the Central Bank for its operating needs abroad. Third, the remaining foreign reserves obtained from PDVSA exports would be transferred to the Fund that was to be established by the executive branch.

The reformed Central Bank law mandated that the fund could provide financing only for, “Investment in the real economy, in education and health, in the enhancement of the public debt and attending special and strategic situations.”⁶⁶³ Finally, the law also

⁶⁶³ Official Gazette 38,232, 20 July 2005.

set up a unique transfer of foreign reserves for US\$ 6 billion. Additionally, Article 8 of the reform stipulated that the transferred resources could “be held by the Fund only in foreign currency”.⁶⁶⁴

The fund received, therefore, an initial endowment that corresponded to the controversial use of the Central Bank’s international reserves, much debated since President Chávez asked the Bank for such a transfer in November 2003. President Chávez expressed his satisfaction: “We finally won this battle,” he said, referring to the long controversy between the executive branch and the Central Bank, finally resolved by the intervention of the legislative branch.⁶⁶⁵ Chávez promptly proceeded to implement the so-called National Development Fund.

The National Development Fund (Fonden)

On 29 August 2005, Presidential Decree 3,854 created the National Development Fund, Fonden, and provided an initial endowment of US\$ 6 billion.⁶⁶⁶ The fund was created as a public company under the administrative direction of the Ministry of Finance. The company’s objectives largely reflected the legal mandate outlined in the Central Bank Law which addressed the purpose of the fund (Article 1). The governance structure of Fonden consisted of an Executive Board and an Operating Committee (Article 4). The whole Board was appointed by the President of the Republic. It included as members the Ministry of Finance, the Ministry of Energy and Petroleum, the Ministry of Planning and two other directors (Article 5). The Operating Committee is a three-member body responsible for its operations. Its members included an Executive Secretary and two specialised managers (Article 6).

The Fund was authorised to pay sovereign public debt but was prevented from issuing debt instruments (Articles 7 and 9). Article 8 authorised the Fund to allocate resources to solve “extraordinary situations arising from natural catastrophes or public disasters”. The reformed Central Bank law imposed a constraint that could conflict

⁶⁶⁴ Official Gazette, *ibid*.

⁶⁶⁵ Hugo Chavez, ‘Chavez: ganamos la batalla del BCV’, El Nacional, 21 July 2005.

⁶⁶⁶ Official Gazette 38,261, 30 August 2005.

with the new regulation. That law demanded that spending could be only in foreign currency, at least for the initial endowment as originated in the transfer of international reserves. The mandate to allocate resources, “in investment in the real economy, in education and health, in the enhancement of the public debt and attending special and strategic situations” was not further regulated.

Similarly, the replenishment mechanism was not clear in the reformed law. It was not explicitly set and rather depends on interpretation. It depends upon the Central Bank’s definition of a methodology to set the level of international reserves beyond which foreign reserves are transferred to Fonden. Enid Blanco, staff member of the Central Bank, commented, “Some of the regulations regarding Fonden are not yet clear, especially the replenishment of the fund. The Bank’s board is just discussing the methodology to set the optimal level of reserves. It is all uncertain at the moment.”⁶⁶⁷

The fund began its formal operations in September 2005. The Central Bank transferred the approved US\$ 6 billion in various instalments. President Chávez officially launched Fonden on 23 September 2005, approving the first allocation of approximately US\$ 400 million for various infrastructure projects shown in Table 7.14.

Table 7.14 Fonden’s initial allocation

Allocated to project	US\$ million
Greater Caracas transport system (including subway)	196.90
City of Valencia subway system	6.45
National rail network	192.59
Electricity generation plant	8.13
Total	404.07

Source: Ministry of Finance

Fonden’s initial rules, as set out in the Presidential Decree, did not address a suggestion made by the Finance Select Committee of the National Assembly when the Central Bank reform was passed. The Committee suggested, in its report, “To

⁶⁶⁷ Enid Blanco, interview by author, Caracas, 6 September 2005.

incorporate in the decree creating Fonden a mechanism that allows federal entities participation in the financing programmes of the fund, through proposing strategic investment projects for the regions.”⁶⁶⁸

Similarly, the presidential decree ignored another of the Committee’s recommendations, of forcing Fonden to report its activities quarterly to the National Assembly. No reporting obligations were set in the decree. The functioning of Fonden since decreed in September 2005 has not been formally regulated by either Presidential decree or legislative measures.

Summary of operations of the Development Funds

Both the first development fund (Fondespa) and its replacement (Fonden) have, together, managed a significant portion of the extraordinary oil revenues obtained from the high prices of oil during 2003-2005.⁶⁶⁹ Deposits to both funds have not been regulated by any pre-established mechanism. The executive branch has exerted its discretion in calculating deposits to the Funds, including the determination of the excess international reserves of the Central Bank that have been transferred to these two funds. Table 7.15 shows deposits to both funds.

Similarly, the allocation of the resources in both funds has obeyed completely the discretion of the President. Allocation corresponding to the first development fund was discussed earlier. Regarding the second fund (Fonden), allocation is determined by President Chávez. In his weekly TV programme, President Chávez, addressing members of his cabinet, said, “I want to receive a list of projects, Ministry by Ministry, that are in the budget. If a Minister considers that a project that is in the budget already does not have sufficient resources, you have to tell me to create a first list of projects. A second list, I would say, would be of short term projects. I mean projects that can begin soon. This, in order for me to make, with my team, a list of

⁶⁶⁸ Asamblea Nacional, Finance Select Committee Report, 2005.

⁶⁶⁹ US led invasion of Iraq in 2003 marked a cycle of high prices in the international oil market that have lasted until the second quarter of 2006, when this chapter was written.

projects, to estimate up to what limit we can support those projects.”⁶⁷⁰ Table 7.16 shows how resources in Fonden have been allocated since the initial allocation, shown in Table 7.14, in September 2005.

Table 7.15 Deposits to the development funds 2004-2006 (US\$ million)

Fund/source	Source	Deposit
Fondespa (2004)	PDVSA	2,000
Fondespa (2005)	PDVSA	2,000
Fonden (initial endowment in September 2005)	Central Bank (international reserves)	6,000
Fonden (oil exports September 2005-May 2006)	PDVSA	7,175
Fonden (oil exports and excess international reserves) estimated for May-December 2006	PDVSA and Central Bank	5,000
Total Deposits to the development funds		22,175
Comparison to:		
As % of Average Annual National Budget (2004-2006):	63%	
As % of Total Value of Oil Exports (2004-2006*):	18.4%	

(*) Oil Exports for 2006 are an estimated based on production level and prices as for May 2006 reported in Opec Bulletin May/June 2006.

Source: Palmaven, CVP, BCV, Ministry of Finance, Opec.

Table 7.16 Fonden’s allocation (September 2005-June 2006)

Allocated to project	Us\$ million
Environment	34.12
Defence	200.00
Energy and Oil	1,685.60
Mining	131.43
Infrastructure	1,820.72
Reduction of Public Debt	1,000.00
Agriculture and land reform	218.00
Public housing	226.00
Steel mill	1,837.00
Aluminium plant	210.00
Timber	687.00
Mission Barrio Adentro (phase III)	449.00
Cement Plant (joint venture with Iran)	221.00
Social security Fund	1,000.00
Total	9,719.87

Source: Ministry of Finance (Annual Report 2005); Transcripts of ‘Alo Presidente’ by Minci; Deputy Rodrigo Cabezas (President of Finance Select Committee of the National Assembly).

⁶⁷⁰ Hugo Chavez, Alo Presidente, 2 October 2005 (transcript by Ministry of Communications).

From an accumulated total in the Fund by May 2006 of US\$ 13,175 million, US\$ 10,123 million have been allocated to diverse projects, including funds for reducing the total public debt in foreign currency and the seed capital for a new fund for social security. Together with the Fondespa's allocations and the initial Fonden's allocation, the Developments Funds have assigned 85% of the US\$ 17,175 million collected by those funds from 2004 to May 2006. These collected revenues have represented 63% of the average annual national budget (for those years) and 18.4% of the value of oil exports for the same period.

The allocation of the Development Funds resources seems to respond to varied policy goals. Some of the allocation (23.03%) is reminiscent of past policies of promoting State-led industrial development, as is the case of the steel, aluminium and other mining projects. The energy and oil sector obtained 16.71% as well. Another important area is infrastructure, receiving 24.72% of the allocated resources. Redistribution policies obtained a significant portion of the Funds (21.71%). The remnant (13.83%) went to various projects including public debt reduction, defence, a TV station, land reform and public housing.⁶⁷¹

Conclusions

This chapter has shown how the Chávez's administration reacted to a new oil prices boom. This reaction resembles previous experiences. It responded by establishing new rules, new organisations and new procedures to suit the President's preferred policies. Extra oil revenues were handled by a combination of ad hoc mechanisms and modified institutions to allow highly centralised decision making, and in this case, rapid access to extra revenues. By altering pre-existing rules that required those resources be shared with sub-national levels of government and to avoid budgetary procedures, new rules were passed to allow President Chávez to dispose of those resources without any legal or procedural constraints.

⁶⁷¹ These calculations are based on public announcements, mainly by President Chavez, and not on audited or official reports.

Chávez's administration seems to have responded to three considerations. First, an ideological stance that saw matters such as Central Bank independence and conservative monetary policy as neo-liberal approaches that were contrary to its perception of the public interest. Second, the government was under immediate pressure to legitimise itself among its main political constituencies in a time of severe political polarisation and electoral challenge. Finally, the government recognised the limitations of the public bureaucracy, and deemed these inefficient structures limiting effective governmental action and public service delivery.

The new institutions, however, did not address weaknesses in public delivery mechanisms. They merely allowed established procedures to be circumvented. They did not replace established procedures and practices. Existing bureaucratic 'habits' had been, previously, obstacles to the State 'profiting' from extraordinary oil revenues. The creation of parallel structures, even if they were well targeted to the government's most urgent needs, risked obscuring public policy setting, decision making and, even if weak, the institutionalisation of public finance procedures. The conflict, discussed in this chapter, between the Central Bank and the government shows that Venezuelan Presidents tend to prevail even over relatively well established institutions. The events discussed in this chapter demonstrate how the 'checks and balances' – the constitutional mechanisms and other State entities – could not constrain the dominance of the executive branch in its determination to administer, in the short run, the country's rich endowment of oil rents.

Chapter 8

Institutional façade, back-door politicisation

In 1974, when the international price of oil jumped to an unprecedented level and Venezuelans were planning to nationalise their oil industry, there was little basis for doubting a favourable road to development. A rich endowment and a relatively stable institutional platform at the political level certainly supported such an expectation. Three decades later, Venezuela's underachievement invites reflection about possible explanations for that unfulfilled promise. The point of departure of this research has been oil institutions. The primary objective of the research has been to revisit those 'rules of the game' directly affecting the relationship between the Venezuelan State and its oil wealth. By examining oil, the thesis has focused on the core of the Venezuelan economy, the main source of fiscal revenues and the single most determining variable of Venezuelan political economy.

At a macro level, the observable facts are that institutional arrangements have continuously failed to fulfil their intended purposes. This first hypothesis was that oil institutions were worthy of scrutiny. The purpose of the research has been to identify possible explanations for their malfunctioning, and therefore to identify the nature and extent of their contribution to the whole story of failure. The findings of the seven preceding chapters, however, point in a slightly different direction. Rules of the game as they were designed and formalised in each period and in each matter under scrutiny did not exhibit any inherently unworkable feature that could not have been put right by relatively competent management and committed policy makers.

This thesis reveals, instead, an entrenched pattern of politicisation in each matter and in each period under scrutiny that prevented the institutionalisation of all arrangements attempted along the way. The story revealed across this research is

analogous to that of the alcoholic who keeps on trying new therapies but ends up on each occasion visiting the pub again. Different institutional arrangements end up being distorted, ignored or simply replaced. Venezuelan policy makers, the evidence of this thesis confirms, constantly solve policy issues by enacting new laws, new regulations and new procedures but not tackling the underlying problems.

Moreover, in the case of oil management (both the state-owned oil company and oil revenues), policy makers seem to maintain a double stance. On the one hand, they produce an institutional framework that reveals their understanding of what needs to be done to manage the oil wealth, to avoid collateral negative effects and to curtail threats that could diminish the positive effects of oil to the economy. On the other hand, once an ‘institutional façade’ has been built they proceed to deform that arrangement. They usually obtained that outcome by means of three avenues: first, by a highly discretionary interpretation of its regulations but still within the limits of the law; or second, by simply ignoring its mandates and usually getting away with it in the absence of effective mechanisms of enforcement; or third, by replacing the established arrangements by ones that suit the needs of the moment. A further cycle of maintaining an ‘institutional façade’ with back-door politicisation is then initiated for another round.

Politicisation ‘à la Chalmers’ and more

When Chalmers refers to the politicised state he asserts that “effective influence will bypass rules and procedures and they will be altered frequently to accommodate new patterns of power”.⁶⁷² In the cases studied in this research, bypassing and alteration of rules did not necessarily respond to changes in power, although they frequently did so, but they also responded to changes in conditions within one administration. President Perez’s administration created the Investment Fund in 1974 and as early as 1976 they ignored some of its regulations. President Chavez’s new Constitution in 1999 elevated the Stabilisation Fund to constitutional status only to overlook it two

⁶⁷² Douglas Chalmers, ‘The Politicized State in Latin America’ in J. M. Malloy, Authoritarianism and Corporatism in Latin America (Pittsburgh, University of Pittsburgh Press, 1977), p.25.

years later. On both occasions, the original measure was taken free from pressing circumstances such as conditionality from a multinational financial organisation or any other imposed conditions. In both cases the initial measure adopted seemed to indicate a genuine belief in its pertinence.

Chalmers alerted that “the action that is finally taken must be justified in terms of its political consequences for shaping society and the political process itself”.⁶⁷³ The Venezuelan cases show, again, that actions taken were not necessarily even justified on the grounds of a grand and larger goal. Although sometimes this was the case, such as President Chavez’s justification for depleting the Stabilisation Fund in 2003 or the implicit acceptance by President Caldera of the PDVSA technocracy’s actions in the mid-1990s, it was, by no means, the rule. ‘Rules of the game’ were so frequently bypassed and altered that it is difficult to argue that larger stability or system-survival objectives were always in place across three decades.

Chalmers’s politicisation model can be developed in the Venezuelan case here. Chalmers’s notion of a constant influx of different actors, arenas and decision-rules at the policy level is certainly observed in the conduct of oil policy across the span of time studied. An influential Minister could skew policy to his preferences, as the cases of Minister of Energy Calderón-Berti or Minister (and also President of the Central Bank) Díaz-Bruzual illustrate. On other occasions, two strong and well positioned bureaucrats either within the technocracy or within the governing party clashed with each other and required the President to arbitrate between them. This was the case with both Ministers Hernández and Armas and also with PDVSA’s Presidents Alfonzo-Ravard and Sosa-Pietri. In certain instances, a politically proactive and determined PDVSA President could bypass the influence of a weak Minister as the case of Luis Giusti and Edwin Arrieta exemplifies. Chalmers’s claim of ‘everything is possible’ is completely justified in these cases. Any pattern of policy making influence was possible.⁶⁷⁴ What was constant was the deinstitutionalisation of the PDVSA-government relationship despite the numerous exercises of specifying each actor’s role.

⁶⁷³ Chalmers, *ibid.*, p.25.

⁶⁷⁴ Chalmers, *ibid.*, p.26.

Similar varied patterns are shown with respect to the use of oil revenues. Different forms of institutionalising the oil money funds were attempted. The Investment Fund in the 1970s was equipped with a bureaucracy anew, well trained personnel, imported know-how from renowned technical organisations and well established procedures. The Stabilisation Fund in the 1990s was established with a neutral formula, attached to the well respected Central Bank bureaucracy and finally, elevated to the highest possible legal order (i.e. the Constitution). Decentralisation in the late 1980s made States and Municipalities direct stakeholders in fiscal revenues such as those provided by oil income. Chavez's development funds first used PDVSA as the delivery agency and later created an autonomous, highly centralised body. Save the latest incarnation of the Development Fund created only in 2005, therefore too early to judge, all institutional forms did not survive long. They failed to collect oil revenues in a systematic way and, when they managed to collect a certain amount of revenues, they did not succeed in redirecting them to their purposes.

Various enforcers, the technically-minded bureaucracy, the autonomous Central Bank, the States and Municipalities and the usual constitutional enforcers (i.e. the legislative branch, the judiciary and Comptroller General), all failed to ensure the survival of many of the rules. Moreover, the legislature often coalesced with the executive branch to modify or ultimately eliminate unwanted and restraining rules. On the few occasions when the legislature stood for the existing rules, there was an opposition-controlled Congress obstructing the government during election time, only to make a U-turn when they returned to power.

The only pattern that emerged from the different attempts at institutionalisation is that the President wielded exceptional power to influence the outcome of those arrangements. Not surprisingly, when Presidents were in a precarious situation during 1992-1998, the oil policy making role, the arena and the decision making shifted to the technocrats in PDVSA. In the absence of broader institutionalised channels less dependent on the fortune of one actor, the shifting of power was a likely outcome. PDVSA, at that juncture, assumed an unprecedented policy and political role.

Politicisation *a la* Chalmers can even be developed further. Not only could rules and procedures be accommodated at any time or in any arena, and actors and decision

making shifted with similar ease, but the Venezuelan case shows that PDVSA could also play a plainly political role, as was first demonstrated with the incipient signs of PDVSA meddling in the electoral campaign in 1998 and secondly, and more significantly, with the top managers' rebellion in 2002-2004.

The latter case also reveals how widespread politicisation had pervaded Venezuelan society. It was a well trained technocracy, brought up in the highly institutionalised corporate environment (to a large extent inherited from the Anglo-Saxon corporate mentality during the oil exploitation by foreign companies) that did not hesitate to use the company for purely political aims. The 'meritocratic' state (PDVSA) that had been living within the 'politicised' State for decades became equally politicised after a conflict that, ironically, began when the oil technocracy protested the interference of politicians with the meritocratic system of the company.

Yet it can also be argued that it was the absence of legitimised institutional channels in which to resolve a broader political conflict that led a large group within Venezuelan society, represented by the oil technocracy, to improvise a political arena and to assume an improvised political role to force a political outcome. Whatever calculations, however, prevailed in the managing of the oil conflicts in 2002-2003, the engulfing of the oil company in the political arena only amounted to new precedents in the politicisation of the Venezuelan State.

Another facet of politicisation revealed in this study of Venezuela's post-oil nationalisation is the role of the legislative branch. Chalmers refers to the idea that in an institutionalised regime public policy is more of a 'post-political' process derived from a "formally constituted authority".⁶⁷⁵ As the Venezuelan constitutional order is theoretically built upon the traditional principle of the 'separation of powers' it was to be expected that the legislative branch would have played a significant role in policy making. The legislative arena had therefore to be the place where different interests in society, in this case oil, could 'institutionally' be aggregated. The empirical evidence shown in this research reveals that this was seldom the case.

⁶⁷⁵ Chalmers, *ibid.*, p.25.

The legislative branch, in many instances, just delegated its constitutional prerogatives to the Executive. The mechanism of ‘enabling laws’ served to grant legality to the fact that the President was often in a position where he could give himself a blank cheque. Many rules of the game for the State-oil wealth relationship were written by an ‘enabled’ President profiting from that delegated freedom and prioritising his short term interests. The rewriting of rules was continuously facilitated by this expeditious legal process because all presidents, except Luis Herrera, enjoyed such a prerogative.

Politicisation and lack of regulative capacity

Politicisation often resulted from a dynamic consistently revealed by this research. The State neglected the Weberian character of the bureaucracy or simply did not build a regulative capacity that could deal with problems in a merit-based fashion. When the State tried to implement certain policies, or simply correct certain courses of action, it had to resort to the enactment of administrative orders as the only tool that could stimulate bureaucratic performance.

Orphaned of technical expertise, successive governments persisted in rewriting rules in the expectation that this hierarchical mechanism was sufficient for achieving the objective. The case of the Ministry of Energy illustrates this dynamic. As its regulative capacities swiftly faded after nationalisation in 1975, the Ministry, therefore the Executive, was left with only its legal prerogative of writing rules, demanding routinised paperwork, or simply resorting to the ‘reward or punish’ mechanism of appointing top officials to fulfil its regulatory role. The latter mechanism contributed to further politicisation since appointments became based more on personal loyalties and less on technical abilities.⁶⁷⁶

⁶⁷⁶ A consensual view on this emerged from all my interviews with PDVSA officials and other policy makers. They seem to agree that the turning point of this practice was as early as the tenure of Humberto Calderon Berti in the Ministry during the Herrera’s administration (1979-1984). They also agree that this politicisation of appointments was gradual. Before the conflicts of 2002, it seems that the government was cautious not to exacerbate that practice. PDVSA’s boards were filled by a quota of political appointees but with enough technocrats to reach a sort of unspoken balance between the two.

The neglect of the regulative capacities of the Ministry of Energy left the State in a weak position to deal with the principal-agent problem. As Bernard Mommer, long standing observer of Venezuelan oil and one of the most influential policy makers in the *Chavista* regime, reflected, the fact that the State held 100% ownership in PDVSA did not guarantee its control of the company.⁶⁷⁷ To compensate for this weak position the State had to resort to, in addition to the mechanisms already described, ad hoc procedures, temporary external consultative commissions and other parallel instruments. These unstructured mechanisms generated, again, more politicisation as they were only loosely, at best, regulated by any formal procedure.

On the other hand, having some regulative capacity, however, did not guarantee the institutionalisation of oil policy matters either. The effort of building a technically minded and Weberian-like bureaucracy, as was the case with the Investment Fund in the 1970s, did not prevent the bypassing of the agency and the uncontrolled competition for influence over its decisions between other ministers and governmental officials. The creation, during President Herrera's administration (1979-1984) of an 'ad hoc' group chaired by the Minister of Interior deciding over a steel mill project is a case in point.

President Chavez showed similar disregard for existing, well established bureaucracies. His handling of a dispute with the Central Bank over the use of international reserves and the establishing of a Fund with PDVSA's foreign reserves held by the Bank in 2003 is again a case in point. The Central Bank, supposedly independent, was overruled by the Executive after a ferocious campaign initiated by the President himself. These cases reinforce the notion that 'everything was possible'. Having relatively well established bureaucracies or lacking them led equally to politicisation.

⁶⁷⁷ Bernard Mommer in a talk in the Bolivar Hall in London, 10 April 2006.

Politicisation: is it necessarily a bad thing?

It is pertinent at this point to ask two questions. First, did this ingrained process of politicisation in the conduct of the State-oil wealth relationship as above imply a negative outcome? Second, if that was the case, why not before nationalisation?

The continuous process of ‘back-door politicisation’ overwhelmed the institutionalisation that was sought. It is necessary here to maintain the definition of institutions as the codified rules constructed by society to govern actors’ behaviour, and reject the loose notion that institutions are, at the end of the day, the observable regularities in such behaviour. This later notion would suggest, in this case, that ‘everything is possible’ would have been the ultimate ‘rule of the game’. Adopting such a notion would render any institutional analysis futile. It would also overlook the lessons that the Venezuelan case studied here offers. Assuming that institutions are the ‘natural’ course of action adopted by actors would preclude from policy makers the tools that institutional design, reform and other forms of statecraft entail.

The constant attempt to adopt an institutionalised framework to regulate the Venezuelan State’s relationship with its oil wealth responded not only to the mandate of providing a legal structure, ingrained in Venezuela’s Roman law tradition, but also to real problems that adopting an ‘everything is possible’ stance would not have resolved. As was pointed out earlier, Venezuelan policy makers had a good understanding of the collateral effects that oil wealth confers. The need to tackle those effects was continuously manifested in their search for the ‘codified rules’ that would correct them.

Two new major problems have threatened the relationship between the Venezuelan State and its oil wealth since 1974. Nationalisation of the oil company brought the principal-agent problem to the core of oil policy. Before nationalisation, oil policy needed mainly to seek the best distribution of rents for the Venezuelan State. Obtaining the largest possible share of the rents from the foreign operators required dealing with the oil business only after organisational, technical and financial decisions had been taken. The State then simply collected its share of the surplus created in that process. The profit-maximising motif of the foreign firms assured that

that surplus was the best that could be obtained from the business. The problem for the Venezuelan State was to assure it had access to that surplus.

Oil nationalisation, instead, translated this whole set of decisions to within the State. In this business-like setting, owners delegate such decisions to managers. This delegation meant, in this case for the Venezuelan State, the need to align its perceived 'public interest' to the interests of the PDVSA technocracy.

The solution of this principal-agent problem required a new institutional framework. Leaving the relation of the State (the principal) with the technocracy (the agent) unattended was obviously not a policy option. The evidence of this research, however, suggests that this framework was never institutionalised. The uncertainty brought about by this disinstitutionalised relationship has had a demonstrable effect on business performance.⁶⁷⁸

Secondly, 1973 marked a turning point in the behaviour of oil prices in the international market. Prices have followed a more volatile pattern since then. Increased volatility has also been accompanied by the occurrence of accentuated peaks such as the one observed in 1973-1974, 1980-1981 and more recently in 2003-2005. These uncontrolled events intensified in the Venezuelan economy a tendency to experience boom and bust cycles. Volatility in fiscal income was, however, not a new phenomenon for the Venezuelan State, and is not even oil-specific,⁶⁷⁹ but it has certainly been exacerbated since the gigantic leap in oil prices in the early 1970s. Tackling irresponsible spending behaviour during booms and instability in oil fiscal income required, once more, the imposition of some rules to curb the common tendency of rulers for short sighted spending and to minimise the effects of the random-like behaviour of oil prices. Yet again, the option of leaving these aspects of the State-oil wealth relationship to their own devices was not a policy option.

⁶⁷⁸ There is a vast literature on the 'principal-agent' problem in the Management, Corporate Finance, Microeconomic literatures among other.

⁶⁷⁹ During the dictatorship of General Gomez (1908-1935), one of his Ministers of Finance, Roman Cardenas, implemented a short-lived 'stabilisation fund'. Prior to the discovery of oil, the Venezuelan economy was highly dependant on commodities exports such as coffee and cocoa.

Institutions, such as those discussed in this thesis, were intended to induce behaviour unlikely to emanate from a rules-free approach. Politicisation, as it has been manifested throughout the cases studied here, has meant that the ills associated with oil wealth could not be prevented or ameliorated through the institutions designed for that purpose. Successive ‘rules of the game’ introduced throughout these decades, taken individually, were not intrinsically flawed or unfeasible. It was, however, the reluctance to conform to them that explains its inefficacy. Rules, in the end, cannot make themselves be obeyed. Moreover, the delusion caused by the continuous rewriting of rules, what I have called here the ‘institutional façade’, has helped to perpetuate the neglect of those collateral negative effects that prevent Venezuelans from fully profiting from oil wealth.

Lessons for institutional designers

The empirical evidence here casts some significant clouds over institutional designers, reformers and the like. As enforcement of rules is the clear prerequisite of any effective set of institutions, institutional designers seek to create mechanisms that improve the likelihood of compliance by actors, if not of self enforcement. Elevating a norm to the constitutional level; involving a bureaucratic, Weberian-like body which makes actions difficult to overrule; providing a form of exact calculation that narrows the discretion in applying a certain rule, are all tools that institutional designers resort to for maximising the likelihood of compliance. These tools, when used in the Venezuelan case, all failed to produce such effects.

The recurring pattern of politicisation rivalled and thwarted any attempt at institutionalising certain desirable behaviours, be it saving oil money, preventing oil technocracy pursuing private interests or preventing the government drying out PDVSA for short run gains at the expense of long term growth. An institutional blueprint based on mechanisms for correcting oil-related problems was clearly not enough. A deep rooted tendency for failing to notice the very same rules that had been agreed suggests that there is a broader dimension that needs to be taken into account for creating more efficient institutions.

The rather optimistic view of rational-choice institutionalists (i.e. that in the long run institutions are chosen favouring efficiency gains for a society) would suggest that Venezuelans would learn from experiences such as those described in this research. There is a vast literature on the beneficial effect of institutions on growth.⁶⁸⁰ Although there is not complete agreement on which precise type of institutional settings are functional for growth, few would dispute that the ‘rule of law’ as a meta-institution is of critical importance. However, the ‘rule of law’ understood, following the cases analysed here, as having an ‘institutional façade’ that is continuously refashioned to suit ‘temporary situations or individual interests’ is not a sufficient condition to guarantee long term growth.

On the other hand, historical institutionalism, would suggest that patterns of behaviour, such as those observed in this research, respond to long accumulated qualities ingrained in society and difficult to modify in the short run (i.e. the ‘path dependency’ argument). Moreover, such qualities commonly respond to historical factors sometimes labelled as ‘cultural beliefs or values’, which are not only beyond the scope of this research, but are extremely difficult to connect empirically to any particular form of aggregated behaviour. The latter limitation, however, should not obscure the fact that such factors are certainly worth exploring given their high potential for explanatory power.

Notwithstanding this caveat, the evidence of this thesis reveals an across-regime pattern of politicisation that, in this particular case, limits the way in which Venezuelans might benefit from their oil wealth. As long as the experience of oil management can be extrapolated from broader characteristics of Venezuelan political economy, the same lessons could be linked to broader issues such as development or democratic consolidation. The aim of this research is to facilitate a deeper understanding of the politicisation that has occurred in Venezuelan political economy at critical points in the relationship between the State and the oil sector across three

⁶⁸⁰ See for example Dani Rodrik’s work, including: ‘Institutions for High-Quality Growth: What they are and How to Acquire them’ in Studies in comparative international development, Vol. 35,3, Fall 2000; ‘Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development’ (with A.Subramanian and F.Trebbi), Journal of Economic Growth, Vol. 9, no.2, June 2004. See also Daron Acemoglu in the Lionel Robbins 2002 lectures at the London School of Economics (www.lse.ac.uk).

decades. These insights contribute, in turn, to a better understanding of contemporary Venezuelan problems.

Appendix A

Methodology

This research was originally conceived as an exercise in institutional analysis. It set out to investigate the origin, implementation and performance of formal rules developed by the Venezuelan State to deal with its oil wealth. The initial hypothesis was that these ‘oil institutions’ have failed to fulfil their purposes. This argument was derived from two sources. First, from the general observation of the collapse of several institutional forms established for different aspects of the relationship between the State and the oil sector. Secondly, from the abundant analysis by Venezuelan scholars and local commentators of the systemic failures of both the political and the economic systems.

This ‘institutional analysis’ approach required a research method that would enable an inquiry on those lines. ‘Institutional analysis’ as such is a rather broad field. Research under the loose label of ‘institutional analysis’ or the so-called ‘new intuitionism’ in its rational-choice, historical, and sociological variants have not followed a unique method of inquiry. Moreover, there are two distinct variants in the type of analysis conducted under that label. First, some studies, typically in the comparative politics or rational-choice school, take institutions as a given and seek to analyse the effect of a particular institution or set of institutions in particular outcomes of interest for each study. Second, the most ‘historical’ variant treats institutions within a broader context in which their relationship to outcomes is more complex. Institutions in this context, shape behaviour but at the same time are shaped by the broader circumstances present in the context in which they operate.

The first approach can usually be undertaken by quantitative methods or by tools such as game theory. These studies work well in such settings where sufficient statistical data is available or where the conduct of political and economic affairs is highly

structured and abundant information can be collected in a systematic way. The second approach tends to rely on more varied sources of data. It requires the exploration of detailed factual information and, crucially, an examination of the historical context, the surrounding circumstances and the micro motives in which choices are made by relevant actors. This line of inquiry needs to extract important information beyond the usual data available in public statistics and records. This is normally achieved by methods such as elite interviewing.

In the context of Venezuela and in the cases of interest for this research, elite interviewing was deemed particularly appropriate because statistics and public records are notably of poor quality. Elite interviewing, nonetheless, has been complemented by document and statistical analysis and surveying of the secondary literature available for all relevant matters related to the cases researched here. These combined methods have helped to build what Bates et al. called ‘analytic narrative’.⁶⁸¹ This approach has allowed me to take advantage of, using their words, the “rich, qualitative, and descriptive materials that narratives offer”,⁶⁸² and, from a focus on various theoretical constructs such as Chalmers’s actors, arenas and decision-rules or Ostrom’s action arena, action situation and actors⁶⁸³, to account for particular events. In addition, the built narrative was supplemented by quantitative information to help qualify outcomes, therefore assessing the performance of the analysed ‘rules of the game’.

Fieldwork

Fieldwork was spread over three years. Although some interviews were made in London, as some former senior officials became available for interviewing, the main thrust of the fieldwork was conducted in Caracas in six parts. First, I conducted some exploratory interviews while I was visiting the Instituto de Estudios Superiores de

⁶⁸¹ R.H.Bates et al., Analytic narratives (Princeton, Princeton University Press, 1998).

⁶⁸² R.H.Bates et al., *ibid.*, p.12.

⁶⁸³ Elinor Ostrom, ‘In A method of Institutional analysis’, in F.Kaufmann (ed.) Guidance, Control and Evaluation in the Public Sector (Berlin, Walter de Gruyter, 1985); Elinor Ostrom, ‘An agenda for the study of institutions’, Public Choice 48, 1986; Elinor Ostrom, Roy Gardner and James Walker, Institutional Analysis and Common-Pool resources in Rules, Games and Common-Pool resources (Ann Arbor, The University of Michigan Press, 1994).

Administración (IESA) in the first semester of 2002. In this phase of the research I made use of two cases (the stabilisation fund and the new hydrocarbon law) to explore what depth of information might be obtained. This initial effort was followed by four fieldtrips, organised and distributed across two years:

- February-March 2003 dealing with the case of the Investment Fund (FIV).
- July-August 2003 dealing mainly with PDVSA-government relationships in the 1990s and supplementing the research on the Stabilisation Fund conducted in 2002.
- February-March 2004 dealing with the case of the Ministry of Energy.
- July-August 2004 dealing with the case of the PDVSA strikes of 2002 and 2003.

Finally, in July 2005, my supervisor, George Philip, and I agreed that including recent events related to the handling by the Chavez administration of the oil prices boom in 2003-2004 would benefit the research. Accordingly, an extra field trip was undertaken in August-September 2005 for research into this latter topic.

Interviews

The first batch of interviews (during the exploratory period in the first semester 2002) followed a semi-structured approach. I prepared a guide for each interview based on pre-prepared questions that I had drawn from preliminary research on each topic to be addressed. I soon learnt that former senior Venezuelan officials were very open to discuss issues as long as they felt relatively free from a strict format. The semi-structured approach enabled them to elaborate on their answers in a way that solicited additional information. When they answered the question loosely posed following the prepared guide they tended to answer shortly and then expanding on issues they brought up by themselves.

This first experience led me to organise the following rounds of interviews as follows: First, I conducted documentary research on each case or topic based on available episodic and running records such as annual reports, the official record held in Venezuela (Official Gazette), pamphlets or other written material and, crucially, mass media material. This latter research was mainly conducted through the internet in

three main sources: websites of El Universal and El Nacional and the site called Venezuela Analítica. This preparation allowed me to lay down the main facts related to each topic. I then prepared a guide for interviewing rather based on events I wanted to cover than on specific questions.

Second, once this advance preparation was made I contacted the potential interviewees to request an interview. Initial contacts were made either by telephone calls or, at the request of the interviewee (or, usually, his/her secretary) through a formal letter or electronic mail. In both cases I emphasised the fact I was visiting the country for a short period (generally, a month) and that the research was solely for academic purposes. In a great majority of cases the response was supportive and interviews were fixed in either their offices or their homes.

Third, interviews were conducted following the prepared guide. I particularly made a point of not asking for their opinions either in general or about the events covered, although many interviewees offered them voluntarily. In each interview, I initially talked about the ground rules such as emphasising the strict academic nature of my interest, his/her agreement to be recorded and/or cited in the text and the time available for the interview (in all previous communication I asked for 30 to 45 minutes). I only briefly introduced my own research, always in very broad terms and never advancing any particular hypothesis. I emphasised, however, my interest in the particular case or events intended to be covered during the interview.

In the great majority of the cases, interviews extended for longer than the time I had asked for. Almost all interviews lasted between one and two hours, except for few interviews that were conducted via telephone. The guide was used only to assure covering all the events and main issues related to each case. I initiated each block of the conversation within the interview by bringing a particular fact or an open ended question. Two examples illustrate this approach:

1. To Luis Hinestrosa, General Manager of FIV in the early 1980s.

Could you describe for me the decision making process when you decided to allocate funds for a particular project?

2. To Deputy Ricardo Sanguino, member of the Permanent Finance Committee of the National Assembly in 2005.

How were the deliberations of the Committee when you approved the Central Bank Reform in June 2005?

The open ended questions enabled interviewees to expand on their answers. I probed responses further around issues I had previously researched and which I felt needed to be clarified. For example:

To Alvaro Silva-Calderón, after he referred to the consensual nature of the debate of the Hydrocarbon Law.

Guicaipuro Lamedá had made public a rather different view based on his participation in the Commission that prepared the Hydrocarbon Law in 2002. What is your view of that?

In general, interviews were left uninterrupted to allow interviewees to expand on their answers. For most interviews this tactic worked well as respondents usually gave abundant details about the events being discussed. I discouraged them, though, to give their personal opinions about general matters such as economic crises, the collapse of old political elites, politics in Chávez's times. In such cases, I immediately raised another issues related to the events in which I was interested.

Some general trends emerged:

First, the older the issue being discussed, the franker and longer were the responses. Similarly, some interviews were turned down in the more recent issues (i.e. officials in the Chavista regime were not available). This latter case was, however, relatively minor and the information was collected through alternative sources.

Second, after an initial relatively formal or aloof start many interviewees became very friendly and relaxed in their responses (I noticed the turning point when, for example,

they turned to address me in a more colloquial way that generally included a switch from using the ‘usted’-form of address to the ‘tu’one).⁶⁸⁴

Third, in many cases they were willing to help me through either providing written material not generally publicly available or, significantly, by contacting colleagues or fellow ex-senior officials to arrange an interview for me. In one case, ex-President of the Republic Luis Herrera, although very cordially, refused to answer specific questions and rather referred me to one of his former cabinet ministers.

Four, interviewees were in general not opposed to being cited, but on many occasions during the course of the interview they asked not to be quoted on a particular comment. A majority of interviews were recorded, again following the trend that the older the issue, the more open to talk they were.

Sample

The sampling followed a straightforward procedure. I listed all the main actors such as the ministers and other top officials (such as deputy ministers) responsible for the issues covered in each particular case, Presidents or influential members of Congressional committees. In the case of the Ministry of Energy and the National Tax Agency (Seniat), they requested interviews be directed to the section dealing with public affairs. They subsequently suggested which officials were available for interview.

In the case of the oil company PDVSA, I selected at least one President and one member of the Board in each of the periods into which I divided my research on the company. Mid-ranked company officials were selected following personal contacts that could help to get access to them as the company had a well known unspoken rule of not being very accessible to the public. The sample corresponding to the last fieldtrip (August-September 2005) related to the Development Fund (Fondespa) all

⁶⁸⁴ Unlike in English, for example, in Spanish you can use two verbal forms to refer to the other person. First, the rather formal ‘Usted’ as in ‘Usted podrá ver esto en...’ or second, the more informal ‘tu’ as in ‘Tu podrás ver esto en...’.

interviews were agreed through direct contact with the offices responsible for ‘Social Programmes’ within the company.

The Investment Fund (FIV)

Aquiles Vilorio – Deputy Minister (General Manager FIV)

Carmelo Lauria – Minister of Industry, Presidency’s Chief Staff

Carlos Rafael Silva – Minister-President FIV

Constantino Quero-Morales – Minister-President of FIV

Gumersindo Rodriguez – Minister of Planning

Heberto Urdaneta – Minister-President FIV

Hernan Luis Soriano – Minister-President FIV

Julian Villalba – Minister-President FIV

Leopoldo Díaz-Bruzual – Minister- President FIV

Luis Hinestrosa – Deputy Minister (General Manager FIV)

Stabilisation Fund (FIEM)

Antonio Casas-González – President of Central Bank

Carlos Hernández-Delfino – Staff Central Bank

Francisco Rodriguez – Director OAEF, National Assembly (former Congress)

Gustavo García – Director OAEF, National Congress

Miguel Rodríguez – Minister of Planning

Pedro Rosas-Bravo – Minister of Finance

Ricardo Hausmann – Minister of Planning

Teodoro Petkoff – Minister of Planning

Development Funds (Fondespa and Fonden)

Carlos Mujica – Staff PDVSA (Palmaven)

Dester Rodríguez – Board of PDVSA

Enid Blanco – Staff Central Bank

Frank Salcedo – Staff PDVSA (CVP)

Franklin Méndez – Staff PDVSA (CVP)

Rafael Quiroz – Staff Central Bank

Ricardo Sanguino – Deputy, National Assembly

PDVSA

Alberto Quiros-Corradi – Member of the Board
Ali Rodríguez – President
Alonso Guerrero – Oil opening (Pérez Companc)
Arévalo Guzman-Reyes – Member of the Board
Andrés Sosa-Pietri – President
Bernard Mommer – Member of the Board
Edelmira Duran – Seniat
Elio Contreras – Staff
Federico Araujo – External legal advisor
Francisco Monaldi – Oil finance expert
Guaicaipuro Lameda – President
Hugo Hernández-Rafalli – Member of the Board
Jorge Baralt – Information Technology Staff
Jose Gregorio Morales – Chief Financial Officer
Juan C. Garanton – External legal advisor
Liliana Blanco – Staff
Luis Giusti – President
Mercedes Navarro – Staff
Oscar Veracoechea – Staff
Oscar Murillo – Chief Legal Officer
Pablo Reimpell – Member of the Board
Rafael Garrido – Staff
Ramon Espinasa – Chief Economist
Victor Ramos – Staff

Ministry of Energy

Alirio Parra – Minister
Alvaro Silva-Calderón – Minister
Bernardo Alvarez – Deputy Minister
Celestino Armas – Minister
Heliodoro Quintero – Staff
Manuel Da Silva – Staff
Rafael Guevara – Deputy Minister

Rayza Pradet – Staff

Ricardo Corrie – Staff

General (across cases)

Alfredo Toro-Hardy – Ambassador to the United Kingdom

Janet Kelly – Academic and member of Presidential Commission for Dialogue

Jorge Olavarria – Historian and Congressman

José Andrés Octavio – Comptroller General

José Vicente Rangel – Vice-President of the Republic

Luis Herrera Campins – President of the Republic

Paulina Gamus – Congresswoman and leader of AD

Pedro Palma – Economist, Venezuelan-American Chamber of Commerce

Ramon J. Velásquez – President of the Republic

Tomas Carrillo-Batalla – Historian and Minister of Finance

All interviews were conducted in Spanish. I personally made the transcripts of all of the recorded interviews in English although not in full. I also translated into English all the quotes shown in the text.

Document research

Venezuelan public records are, to a large extent, not systematically kept except for the so-called ‘Official Gazette’ which is published regularly and available online since 2001 via the website of the Supreme Court (www.tsj.gov.ve). All laws and presidential decrees are published in the Official Gazette. Congress’s records are irregular although some were available, such as Minutes of Congressional debates and the legislative agenda accessible online (www.asambleanacional.gov.ve). Some documents, such as internal ‘white papers’ were provided by some of the interviewees out of their kindness. Transcripts of President Chavez’s weekly television programme ‘Alo, Presidente’ are available online (www.minci.gov.ve). They are a useful source of ‘official’ information normally not available through other governmental sources. I made extensive use of these sources.

Oil statistics were usually well-kept by the Ministry of Energy. They used to publish a statistical compendium entitled 'PODE' that contained detailed information about the oil sector. In recent years, the PODE has not been regularly published. The latest edition published in 2005 contains abundant information based on external sources such as Opec, an indication that this source is no longer kept as it was in the past. I relied enormously on a database kindly facilitated by Dr. Bernard Mommer in which he compiled PODE's data for about six decades.

The oil company PDVSA reports to the Securities Exchange Commission (SEC) annually. Although lately there have been delays in such reporting the SEC's reports were a useful source of information. I also have access to a statistical compendium that is circulated internally and was facilitated in 2004 by a PDVSA staff member, Elio Contreras. Mr Contreras pointed out that this information had been previously classified as 'confidential' but that this was no longer the case.

The other internal source of statistical information, well regarded by academics and analysts, is the statistical series of the Central Bank. Most of this information is available online (www.bcv.org.ve). I made extensive use of this source. The National Budget Office (Onapre) provided some information regarding the national budget, partially available online (www.onapre.gov.ve). The Electoral National Council (CNE) provided information about election results and the composition of Congress. Both PDVSA and FIV's annual reports provide financial information about these two bodies. Statistics compiled by Asdrúbal Baptista in his book ("Bases Cuantitativas de la Economía Venezolana 1830-1995") supplemented my statistical research.

International sources complement the lack of internal information in many cases. Oil statistics contained in Opec's annual statistical bulletins were very useful. They were downloaded from its website (www.opec.org). The statistics on governments' finances kept by the International Monetary Fund were useful as well. Figures provided by the US Department of Labor regarding inflation were used to estimate real values in US\$.

Finally, I made extensive use of the running records provided by mass media, especially two nationwide and well known newspapers El Universal and El Nacional.

Most of the information from these two sources was gathered from their websites www.eud.com and www.el-nacional.com using their search engines. A third source of online information was the online journal entitled 'Venezuela Analítica' (www.analitica.com). These sources were particularly useful for compiling the events related to the topics researched in this thesis. Information from these websites was very useful regarding first, events such as the approval by Congress of a particular law or measure decreed by the President and, second, public announcements by government officials. Open-ed and other opinion pieces were discarded from the results of those online search engines.

Appendix B

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Appendix C

Major shifts in rules of the game since nationalisation in 1975

Date	Regulating...	Reverting/Eliminating
1976	Deposits rules to the Investment Fund were changed to reduce contributions to the Fund.	Original formula for deposits and permitted areas for investment were distorted.
1976	Taxation to PDVSA (stringent measures in matters such as liquidation, rates, prices).	Reinforcement of tax system applying to foreign firms.
December 1976	Delimitation of roles of the Ministry of Energy and PDVSA. Presidential Memorandum.	Although retained main roles of the Ministry, implicitly gave PDVSA an equal status vis-à-vis its watchdog & a pseudo-legal way to bypass the Ministry.
December 1976	Ministry of Energy was merged with Electrical area of Ministry of Industry.	Departments regulating the oil industry were reduced or diminished in the hierarchy.
August 1979	Reform of PDVSA's statutes. Financial and administrative independence dented. Board's appointment and duration was changed.	Increase power of the Ministry. Board's reforms deemed to follow 'entrepreneurial' interests of Ministry Calderón Berti. Rule of 'no political considerations' into PDVSA senior management was broken.
December 1980	Deposits rules to the Investment Fund were changed to further reduce contributions to the Fund.	Contributions to the Fund reduced to only 5% (originally 50%) of oil receipts.
September 1982	PDVSA's foreign reserves were translated to Central Bank.	Financial independence agreed in 1975 was broken.
1983	Congress (dominated by AD) objected to association with foreign capital firm 'Veba Oil' in Germany favoured by PDVSA and the government of President Herrera of Copei (who opposed Art.5 during the nationalisation debate).	Attempt to annul first-time application of Art.5 of nationalisation law (regulating private capital participation).
1984	Congress (still dominated by AD) passed a watered down resolution objecting to the way the deal with Veba Oil was made. The new government of President Lusinchi (AD) did not object to the deal.	Rule of keeping PDVSA issues out of electioneering was broken.
1991	Permanent Energy Committee of Senate (controlled by AD) authorised auctioning of some oil fields.	Application of Article 5 of Nationalisation Law is again subject to 'discretion'.
August 1991	Ministry of Energy produced a Directive with instructions to PDVSA on several administrative issues.	Attempt to improve the diminished role of the Ministry since modifications in 1976.

Date	Regulating...	Reverting/Eliminating
September 1991	President Perez modified the Ministry's directive of August 1991 conceding to PDVSA's pressures.	The attempt to improve role of the Ministry is watered down.
1991	President Perez's administration proposed to Congress a bill for a Stabilisation Fund. Congress did not approve it.	Attempt to separate oil revenues obtained in times of high prices for stabilisation purposes.
June 1993	Taxation to PDVSA is modified by eliminating the Fiscal Exports Values.	Eliminated a rule that traditionally granted the government a great deal of discretion in taxing PDVSA.
September 1993	Congress (votes of AD and Copei) approved strategic associations with private capital to exploit Orinoco Belt heavy oil, based on a Supreme Court ruling (1991) that re-interpreted Article 5 of Nationalisation Law.	Discretion in application of Article 5 of Nationalisation Law is extended.
July 1995	Congress (votes of AD and Copei) approved guidelines for associations with private capital to exploit conventional oil fields. Later, Congress also approved individual contracts.	Discretion in application of Article 5 of Nationalisation Law is further extended.
June 1996	Congress passed an 'accord' limiting the privatisation drive of PDVSA. Similarly, Congress approved a watered down privatisation law regulating retail petrol distribution.	Attempt to limit the participation of private capital allowed since 1993.
November 1998	President Caldera (enabled by Congress) passed a law establishing the Stabilisation Fund.	Mandatory separation of oil revenues in times of high oil prices into a fund for later use in times of low prices.
May 1999	President Chavez modified Stabilisation Fund Law. Rules for deposits were modified and use of withdrawals was also made more specific but withdrawals were made more discretionary (by President).	Regulation of deposits in the Fund were weakened (i.e. less money was to be saved). Fund's rules were made more subject to discretion.
December 1999	The new Constitution (Article 321) ordered the establishment of a stabilisation fund.	Reinforce the legal status of the Stabilisation Fund.
December 1999	The new Constitution (Article 303) mandated that the State not sell shares in PDVSA.	Reverted any privatisation attempt of PDVSA.
October 2001	President Chavez (enabled by National Assembly) decreed a modification of Stabilisation Fund's Law establishing a special regime (with immediate effect) annulling deposit's requirements and easing withdrawals requirements.	Special regime for 2001 to 2007. In particular, no deposits were required until 2003.
November 2001	President Chavez (enabled by National Assembly) decreed a new Hydrocarbon Law.	New law reinforced role of the Ministry, reverted PDVSA's low fiscal contribution by modifying tax regime, and reverted 1990's oil opening although allowed private participation in the business on better terms than the Nationalisation Law.

Date	Regulating...	Reverting/Eliminating
October 2002	National Assembly extended special regime for the Stabilisation Fund to 2008.	Immediate effects of the Stabilisation Fund Law again postponed.
December 2002	National Assembly modified Stabilisation Fund Law to ease requirement for withdrawals.	Withdrawals requirements removed in practice.
March 2003	National Assembly modified Stabilisation Fund Law to eliminate requirement for withdrawals.	Last requirements for withdrawals were eliminated.
2001-2003	Funds were depleted. Some withdrawals were challenged but Supreme Court dismissed the legal challenge.	Rules (even those that permitted discretionary interpretation) were ignored.
November 2003	National Assembly created a new Stabilisation Fund replacing the old one.	Requirements for deposit and withdrawals were weakened in comparison with original law (1998).
January 2004	National Assembly exhorted the Central Bank to facilitate resources to the government.	Central Bank independence rule is dented.
January 2004	Central Bank eased regulations (dated from 1982) regarding PDVSA reserves in US\$ held in the Bank. This allowed the creation of Fondespa within PDVSA.	Rules requiring that Funds be used for PDVSA operating needs are weakened facilitating the use for different purposes. PDVSA later used this discretion to set up the first development fund.
December 2004	President Chavez decreed the fusion of roles of Minister of Energy and President of PDVSA.	Reverted old separation of roles.
January 2005	President Chavez decreed the de-merger of the Ministry of Energy.	Mining sector is passed to Ministry of Industry (it does not affect PDVSA).
July 2005	National Assembly modified Central Bank Law introducing a new concept of 'Excess international reserves'.	Excess reserves not to be held by Central Bank but transferred to the Development Funds.
August 2005	President Chavez decreed a new Development Fund to be formed from excess international reserves held by Central Bank and regular PDVSA contributions.	The new Fund allowed the Executive to dispose oil revenues directly outside budget procedures (including mandatory sharing of part of those resources with States and Municipalities).
October 2005	National Assembly modified the Stabilisation Fund Law created in 2003.	Formula for accumulation in the fund was totally modified. The new formula completely distorted concept of stabilisation. Central Bank was removed from any involvement with the Fund.
March 2006	National Assembly approved new guidelines for associations (mixed enterprises or joint ventures) to replace 1990s oil opening contracts.	Modified the contractual regime granted to private capital associations during oil opening in the 1990s.