

# HOW TO RECONSTRUCT VENEZUELA: POLITICAL CONFLICT, WEAK STATE CAPACITIES, AND SOCIAL VIOLENCE

Latin American Program

**Working Paper**

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January 23, 2019: People rally in support of Venezuelan National  
Assembly President Juan Guaidó  
Photo Credit: shutterstock.com/ Daniel Ruben Alfonzo



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## INTRODUCTION

Just how did Venezuela, once a beacon of modernity and Latin America's most stable and prosperous democracy, become instead the worst-performing economy in the region, with the worst humanitarian crisis the Western Hemisphere has seen?<sup>1</sup> How did this sad state of affairs occur amid the largest windfall from record-high oil prices?

Two decades ago, as the 20th century drew to a close, Hugo Chávez, a charismatic former military leader democratically swept into power in Venezuela. He promised the people of this oil-rich nation that he would usher in a new era of prosperity. His government, he vowed, would be free from the corrupt practices that had squandered the country's resources for the sole benefit of those belonging to the traditional political elite in power.

The reality, however, is that today, Venezuela is the worst it has ever been. Its citizens are so desperate and hopeless that more than 15 percent of its population have left. The magnitude of the country's crisis means that rebuilding Venezuela has become a challenge for the whole region. How can we best reconstruct this country, which has the highest proven reserves of oil in the world?

Venezuela is still a resource-rich nation that could, in theory, bounce back rather easily. But rebuilding Venezuela will require much more than an economic road map. Decades of misrule have dismantled all its democratic institutions, destroyed the rule of law, caused the collapse of its oil industry, and increased the potential for armed conflict. It is by understanding not only the country's fragile state but also its particular strengths that we can increase our chances of success. How do we rebuild Venezuela in the face of weak state capacities and in the context of a complex humanitarian crisis?

Understanding the legacy of chavismo is a key aspect of any reconstruction effort. In an effort to prolong their rule, Hugo Chávez—and, subsequently, Nicolás Maduro—created chavismo, a series of structures and incentives that, by their very nature, could render traditional reconstruction efforts insufficient. For instance, an economic plan that ignores the power wielded by the military or even colectivos (irregular, leftist community organizations) is likely to backfire. This report sets forth an assessment of Venezuela's weak points in hopes of answering these questions. It also identifies key areas that, if well managed, could aid in the country's reconstruction.

Because of the complexity of the situation in Venezuela and the country's overlapping crises, it is important to understand how the Venezuelan state was been weakened over the last two decades. Explaining how the unraveling of state institutions occurred is vital to identify both the root causes of the country's collapse and the risks of attempting to reconstruct these institutions. Additionally, this report seeks to understand the reasons that, despite confronting one of the world's worst economic crises and humanitarian



disasters, Chávez's political heir, Nicolás Maduro, has managed to cling to power. Three waves of deadly protests, accusations of a rigged election, and widespread international condemnation have failed to topple the chavista regime.

In the final section of this report, I propose a sequence of measures that could increase the chances of successfully reconstructing Venezuela. Past experiences teach us that when power groups feel that their existence is under threat, the risk of further instability and violence grows. By identifying a series of quick wins that can help gain the public's trust and goodwill, it is possible to increase the likelihood of a successful reconstruction. Sequencing reforms appropriately, and understanding the limitations and legacy of the collapse, involve a delicate balance. Failure to account for these issues could result in unforeseen consequences that become more serious than the problem they set out to solve.

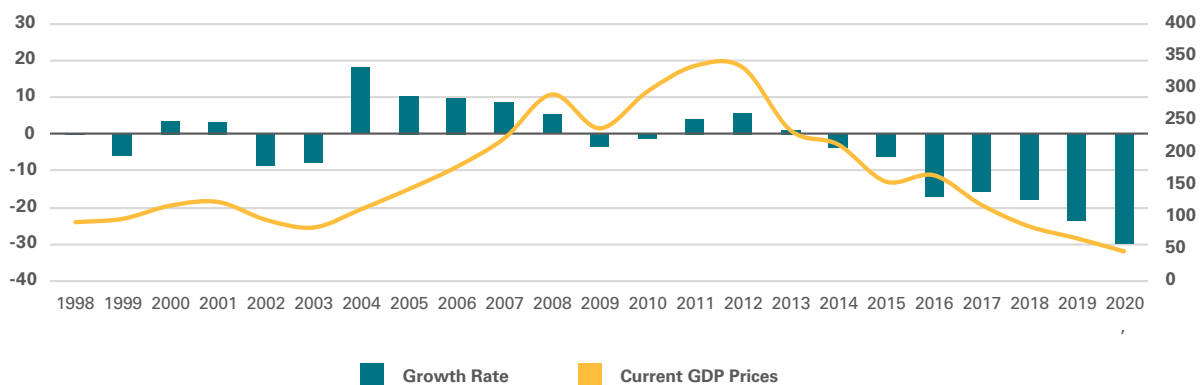


Venezuelan Refugee family asking for money in an Ecuadorian city, February 02 2019.  
Photo Credit: shutterstock.com/ Glenn R. Specht-grs photo

## VENEZUELA'S COMPLEX GOVERNANCE AND HUMANITARIAN CRISIS

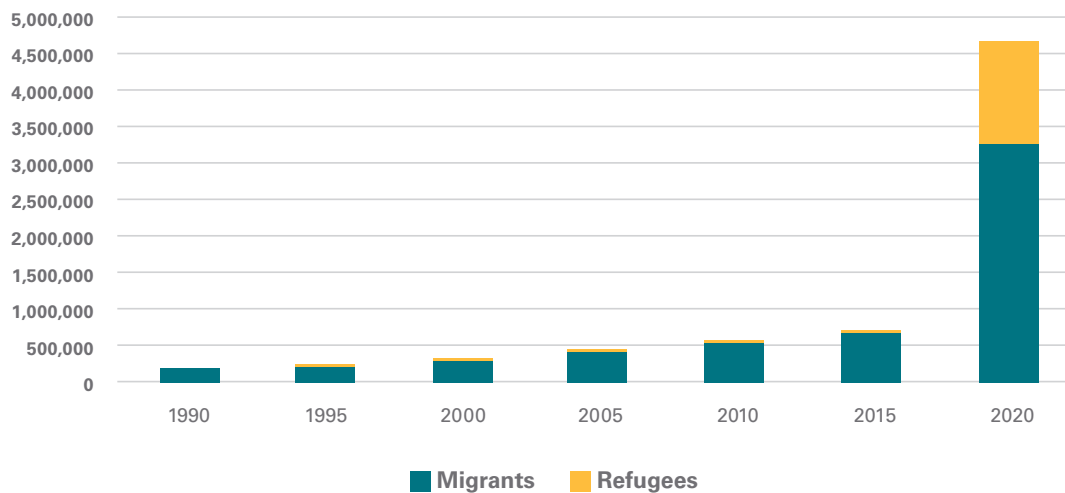
Venezuela is experiencing the worst recorded economic collapse in Latin America and one of the largest migration crises in the world, despite the absence of war.<sup>2</sup> In under six years, the country's gross domestic product (GDP) contracted by over two-thirds and, according to the United Nations, more than 5 million people fled to neighboring nations.

**GDP Growth Rate (%) and GDP at Current Prices**



IMF - World Economic Outlook 2020

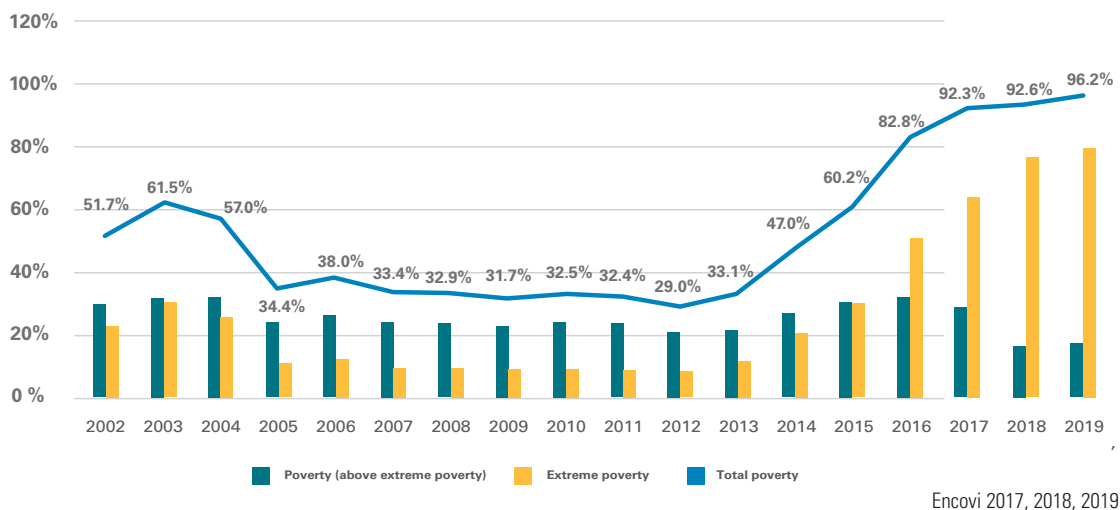
**Migrants and Refugees leaving Venezuela**



UN

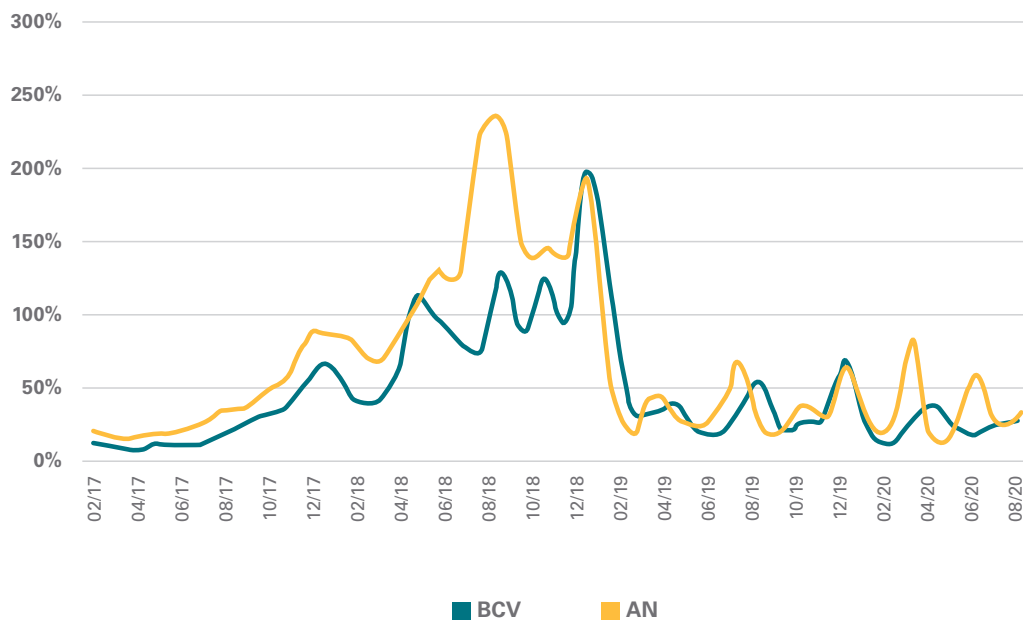
Over 95 percent of the population live in poverty, of which almost 80 percent live in conditions of extreme poverty, and close to 34 percent of children are vulnerable to serious malnutrition.<sup>3</sup>

### Migrants and Refugees leaving Venezuela



To make matters worse, the country continues to be enmeshed in a hyperinflationary process that has averaged over 73 percent inflation each month for the past three consecutive years.

### Monthly Inflation

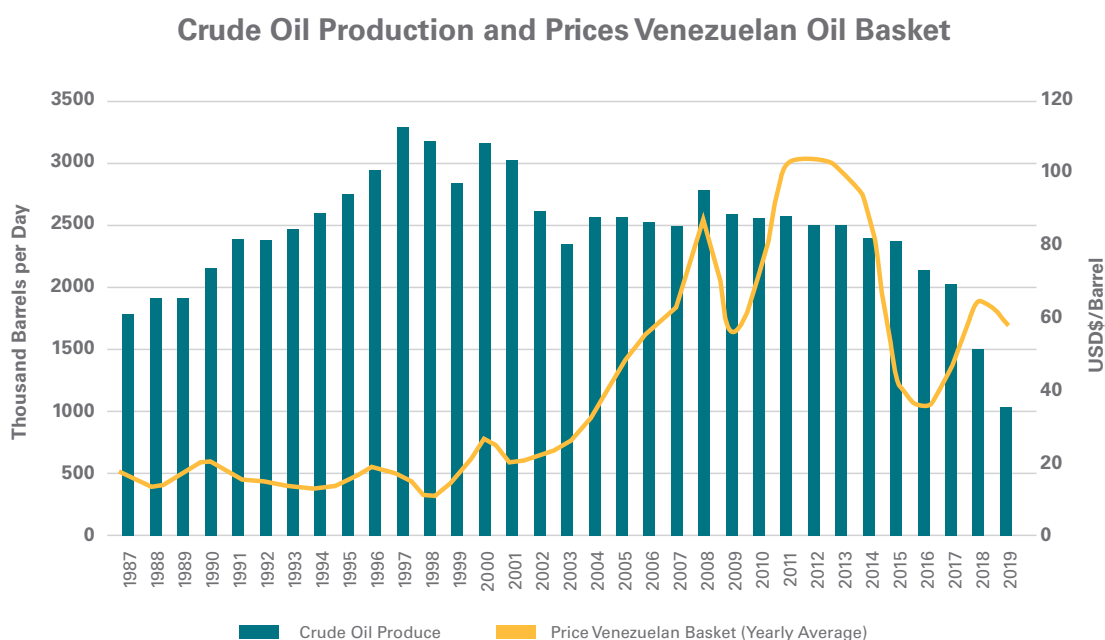


Venezuelan Central Bank (BCV), National Assembly, Econométrica, Ecoanalítica

To add insult to injury, the country's basic infrastructure is deteriorating at dizzying speed, as power outages become increasingly common. Water and gasoline are also in short supply, leaving many provinces virtually isolated and—without a functional banking system and cell phone system—cut off from the formal economic sector.<sup>4</sup>

As in any economy that is highly dependent on a single commodity, the most relevant factors that help explain the economic collapse of Venezuela are the rapid decline in crude oil production and exports, exposure to oil price changes, economic mismanagement, and rampant corruption. Once an important global energy player, Venezuela now produces less oil than Mexico and Colombia, and even less than Ecuador, Argentina, and Brazil. In 2013, after Nicolás Maduro was elected to substitute for Hugo Chávez (who died unexpectedly that same year), Venezuela extracted almost 2.5 million barrels per day (bpd)—a substantial drop from the 3.2 million bpd the state-owned oil company, PDVSA, produced when Chávez was first democratically elected in 1998.

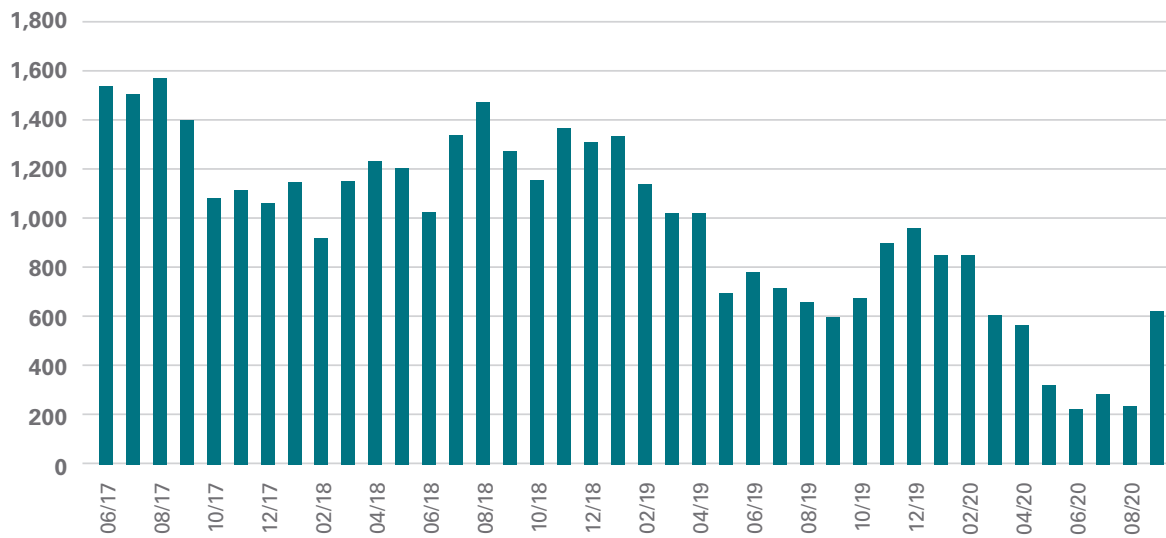
By mid-2020, the country exported less than 420 thousand bpd.



PDVSA, OPEC, EIA



## Crude Oil Monthly Exports ('000 bpd)



EIA, ITC-TradeMap, TankTracker

Due to the dramatic decline in production, Venezuela has experienced a full-blown economic and social crisis, which, unlike in the past, cannot be exclusively explained by the decline in oil prices. The country's current crisis results from the decline in oil prices coupled with the way its crude production rapidly caved in. The dramatic decline in oil exports, stemming from a rapid fall in production in tandem with an unsustainable fiscal policy and a poorly managed state-led economy—characterized by overvalued controlled exchange rates, pervasive price controls, and arbitrary regulatory barriers aimed at fencing in the private sector—created the perfect storm to breed such a sizable economic depression.

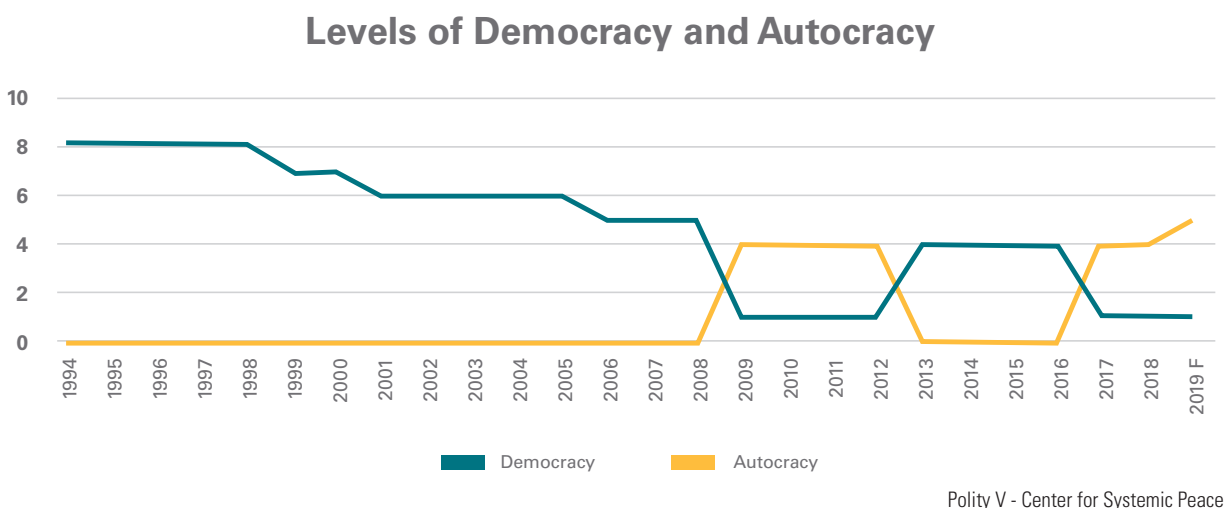
However, as in the case of many other rentier states, social collapses are not just the outcome of ill-designed economic policies but are also a reflection of weak political and economic institutions.<sup>5</sup> For the last three decades, Venezuela has struggled to implement substantive structural reforms. Additionally, the country's state capacity to manage the population's demands has been seriously undermined, as objective material conditions have continued to deteriorate and political and social conflicts have become more prevalent.

The consolidation of the Bolivarian Revolution in the early 2000s, with the charismatic Hugo Chávez at its helm, concentrated political power in the presidency; Chávez openly used the state as a discretionary political tool to cement political support.<sup>6</sup> This transformation included constitutional changes that empowered the executive branch; dismantled checks and balances; banned term limits to reduce democratic alternation; increased the opaqueness of fiscal expenditures; allowed the Armed Forces to govern directly by taking control of key areas of public administration; weakened or even eliminated state or security agencies that were perceived as too independent politically;

and used oil income as a tool to widen patronage networks that helped appease low-income sectors.

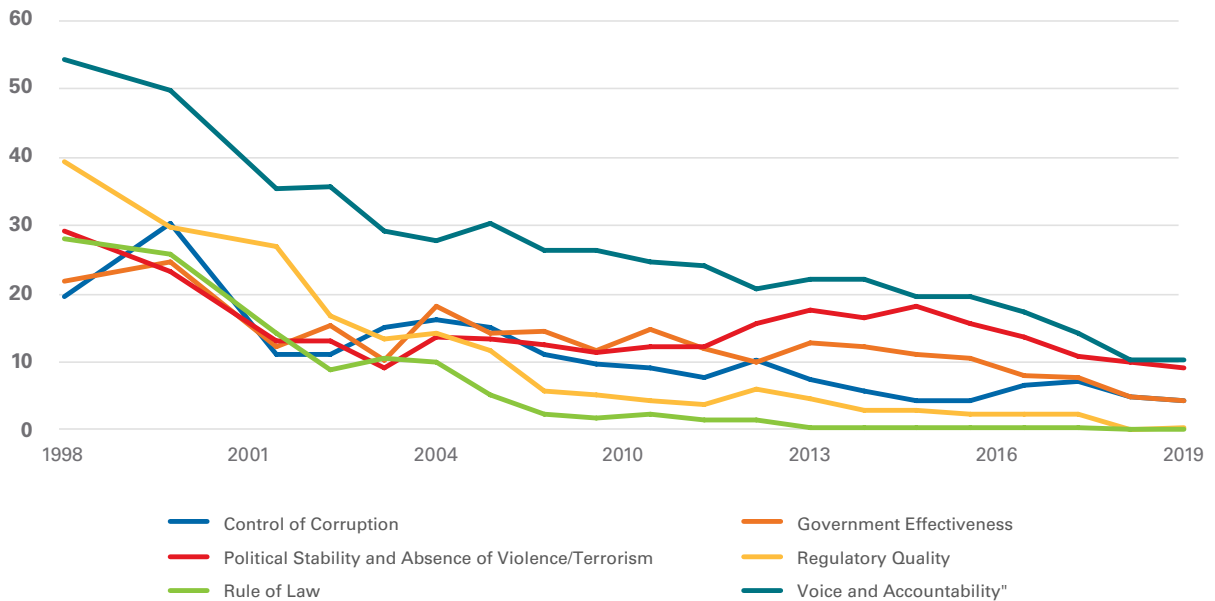
The wide array of poor institutional decisions and the fact that chavismo has consistently raised the stakes of holding executive power has led the political opposition to challenge the presidency through both electoral and nonelectoral means. Both types of efforts have failed to unseat Chávez, and later Maduro, and have instead led to different cycles of political violence, instability, and a deep legitimacy crisis.<sup>7</sup> These repeated cycles of political conflict have, in turn, caused a gradual but definitive erosion of democratic governance and the rule of law. They have also led to the evaporation of property rights and, perhaps more gravely, to a severe deinstitutionalization of state capacities.

As Chávez's political heir, Maduro deepened these traits to such a degree that the country is now considered a full-blown authoritarian regime running a dysfunctional state. According to Polity IV, which codes governance and authority characteristics of states in the world system, Venezuela has moved to a high 6-point score (out of 10) in its authoritarian index, while the democracy dimension has fallen to 0.7 point.



During Maduro's presidential tenure, the government has further destroyed its institutional capacities. Venezuela's public sector is quickly becoming that of a failing state with these key characteristics: crumbling infrastructure, rampant corruption, regular food shortages, rapidly declining educational and health indicators, a complete politicization of the bureaucracy, a surge in criminal violence, and very low rates of state legitimacy.<sup>8</sup> According to the Worldwide Governance Indicators, Venezuela consistently performs under the 10th percentile across all the relevant dimensions when compared with other Latin American countries, with particularly poor results in government effectiveness, the quality of regulation, and corruption.

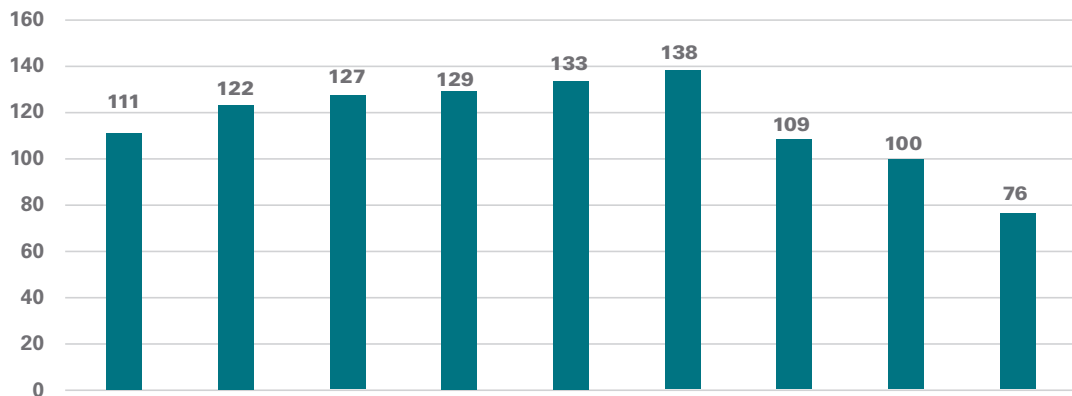
## Worldwide Governance Indicators - Percentile Rank



World Bank - Worldwide Governance Indicators

As the state's presence throughout the territory weakens, street violence and organized crime continue to grow. Before the economic depression, Venezuela's violent crime and homicides were already among the highest in the world.

## Metropolitan District Violent Crimes Rate per 100,000 people



Venezuelan Observatory of Violence



The hike in violence in the states of Apure, Bolívar, Zulia, and Táchira, which share a border with Colombia, is of particular interest. Most of this violence relates to the growing presence of illegal markets, such as cocaine trafficking, and is being exacerbated by weak policing and easy access to illegal arms, gasoline smuggling, and informal gold mining across the border.<sup>9</sup> The Venezuelan Armed Forces are allegedly directly involved in all these illicit activities, especially in trading and logistics, or “transshipment” processes.<sup>10</sup> Profits are also shared with Colombian paramilitary and guerrilla groups that operate in the south of Venezuela.

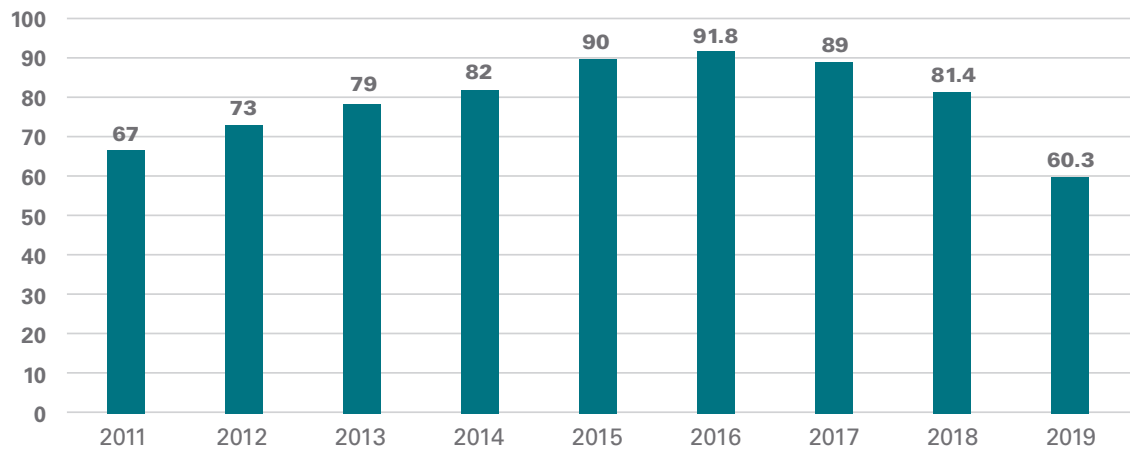
In fact, the combination of all these factors has created a permissive ecosystem for illicit drug production and other larger illegal activities,

such as informal gold mining. It is safe to say that the recent rise in cocaine production in Colombia can be partially explained by the presence of irregular forces (guerrillas and paramilitaries) and the rather low logistical transaction costs for the transportation of cocaine throughout Venezuela.<sup>11</sup> The exacerbating factors are, to varying degrees, possible thanks to the lawlessness in the border areas.

Venezuela’s national security and citizen’s protection efforts are also under threat from other worrisome emerging trends. In particular, Venezuela is experiencing an increasing presence of urban criminal gangs, known as *megabandas*, that control limited, albeit relevant, northern territories.<sup>12</sup> The heads of these *megabandas* tend to operate from jails as they bribe security officials in exchange for protection, in order to safely engage in crimes such as kidnapping and racketeering. Other types of irregular groups, known as the *colectivos*, have also been forming.<sup>13</sup> The state delegates food and security services to these groups, which are often disguised as social grassroots initiatives sponsored by the revolutionary party, especially in shantytowns in large cities like Caracas. Some of these informal groups have occasionally shown strong links to criminal, armed organizations. The outcome of these new social developments is worrisome: the state continues to deepen and reinforce a perverse cycle of violence. In 2018, Venezuela’s Violence Observatory estimated that the country experienced 81.4 violent crimes per 100,000 people, which is among the highest rates in Latin America.



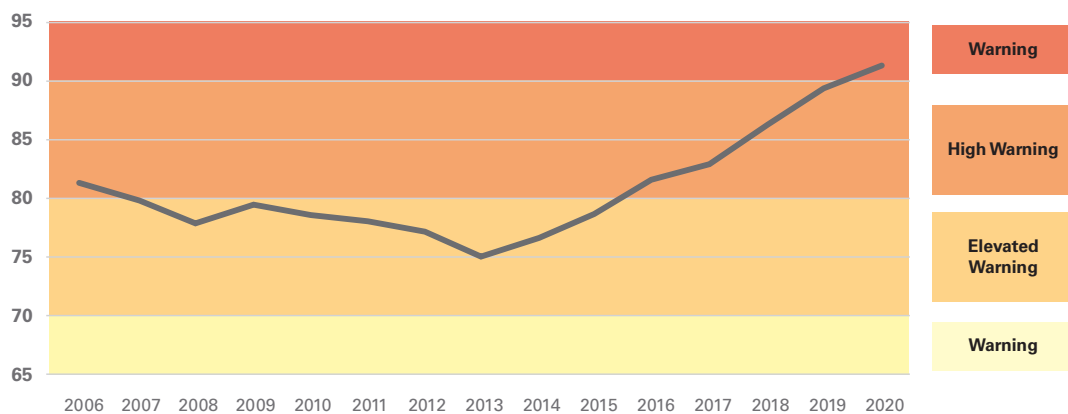
### Venezuela's Violent Crimes Rate per 100,000 people



Venezuelan Observatory of Violence

In 2019, the Fragile State Index, which measures how prone different states are to violence and conflict, gave Venezuela an “alert” status.

### Fragile State Index - Venezuela



Fund for Peace - Fragile State Index

This multifaceted collapse has already translated itself politically into a deep crisis of governance and legitimacy. Since early 2019, after Maduro rigged the presidential elections in mid-2018 and failed to obtain sufficient international recognition, the National Assembly opted to block Maduro’s attempt to initiate his second presidential period. Before then, he had long resisted calls to stand down through a democratic referendum, and he had systematically repressed large street demonstrations. He sidelined the opposition-led National Assembly in 2017, replacing it with an unconstitutional Constituent Assembly, which was labeled as fraudulent by all the opposition parties. As a result of the political crisis, Juan Guaidó, the leader of the opposition-held National

Assembly, declared himself ready to assume the presidency in late January 2019 until open elections could be held.<sup>14</sup> More than 60 countries formally recognized Guaidó as Venezuela's interim president.

Nonetheless, Maduro has been able to cling to power due to his political support from the military's high echelon. What has ensued is a dangerous and conflict-ridden stalemate that has more than two years, between de jure and de facto presidential figures that remain at odds with each other within the same territory. According to public opinion polls, in August 2019 more than 84 percent of Venezuelans believed that Maduro should resign, but 27 percent thought that this outcome was very unlikely.<sup>15</sup> In other words, people's expectation is that the stalemate will continue to linger even if they accept that the de facto government is illegitimate.

This situation of conflict has been compounded by U.S. sanctions, which now entail financial, oil, and secondary sanctions.<sup>16</sup> These measures also include broad individual sanctions against key figures of the regime enacted both by U.S. and European authorities.<sup>17</sup> In practice, this means that, without solving the governance crisis, the international community will be unwilling to remove the sanctions and the Venezuelan people will need to continue waiting in order to attempt, with appropriate support from multilateral organizations, to stabilize the economy and rebuild the oil sector.

Given the depth of Venezuela's humanitarian crisis, even if these international constraints are removed, any attempt to stabilize the macroeconomy, assist low-income sectors, and restore the country's infrastructure will need to address these underlying institutional problems. Only a program with a holistic approach that considers significant initiatives for state building holds some hope of success. Exclusively relying on strong international financing would compromise the rare chance for institutional, social, and economic change that might emerge.



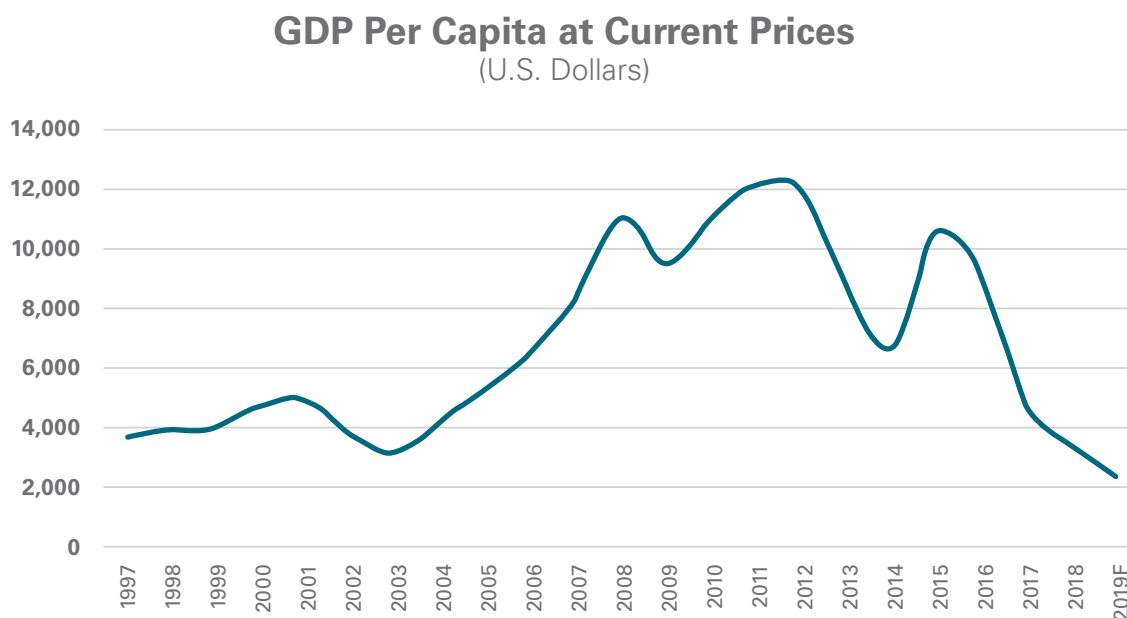
Caracas. February 1, 2017. President of Venezuela, Nicolás Maduro (center) with First Lady Cilia Flores (left) and Defense Minister Vladimir Padrino López (right), in a militar parade. Photo Credit: shutterstock.com/ StringerAL

## From Boom to Bust to Collapse

The most surprising aspect of Venezuela's economic and social tragedy is that it took place immediately after the largest oil windfall in the country's history.<sup>18</sup> This backdrop of abundance has made the nation's collapse even more spectacular.

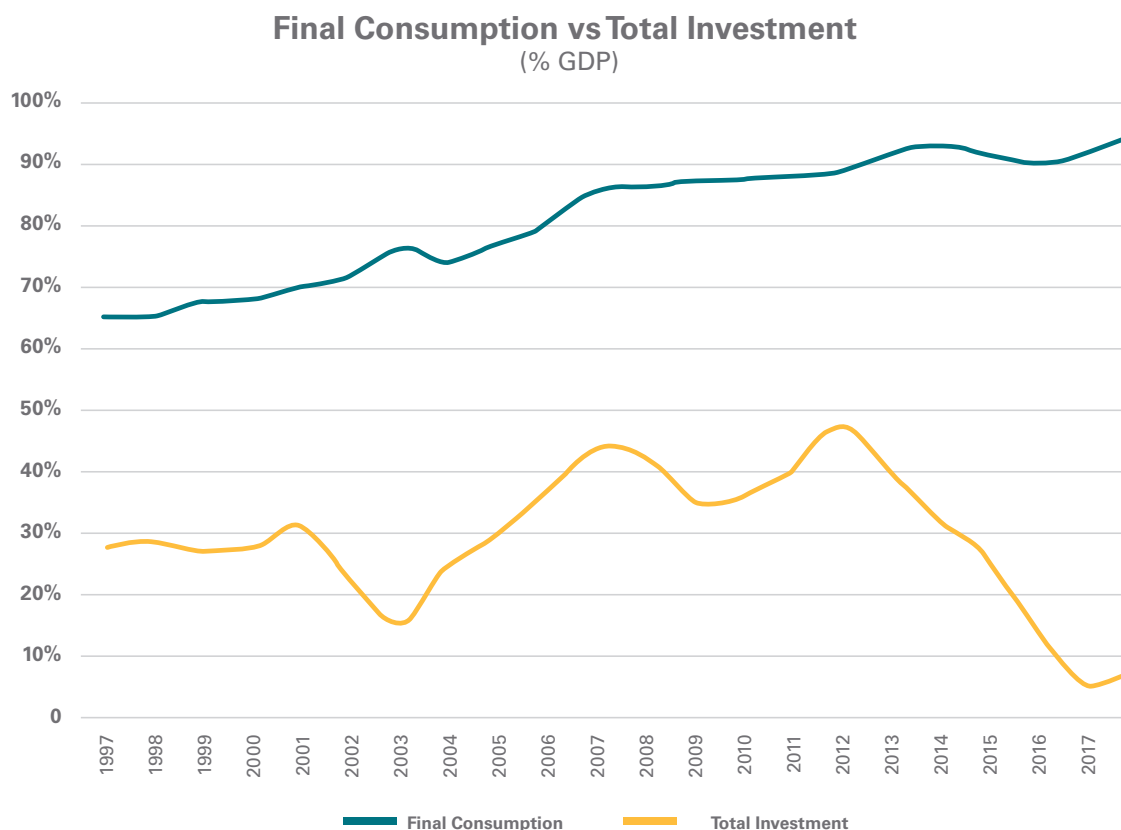
Hugo Chávez was elected in 1998 after organizing a failed coup d'état in 1992, by promising a radical overhaul of Venezuela's political system.<sup>19</sup> During the 1990s, Venezuela was already struggling with political instability, inequality, extreme poverty, fiscal deficits, low growth, corruption, high crime rates, a weak rule of law, and a strong perception that democracy was not working due to the lack of institutional accountability.<sup>20</sup> In a desperate move to overthrow traditional political parties, voters opted to support a political agenda aimed at rewriting the Constitution and empowering the executive branch, undermining the separation of powers, and allowing the Armed Forces to play a more prominent role in Venezuelan politics.<sup>21</sup> This process reinforced many of the previous negative development trends in the country, especially the weakening of institutions and the lack of accountability, thus fostering even more political instability. However, Chávez took advantage of the spectacular global recovery of oil prices in the early 2000s to compensate for some of these problems, remain popular, and ensure his reelection on two different occasions until his death from cancer in 2013.

During the 2004–10 period, Venezuela experienced the best terms of trade of any Latin American country, due exclusively to high oil prices.<sup>22</sup> Global tailwinds were so benign toward Venezuela that oil exports surpassed \$400 billion, despite a significant drop in the energy sector's productivity. Growth rates for that period averaged 5 percent of GDP, and per capita income grew by more than 40 percent during the same period.



IMF - World Economic Outlook 2020

However, most of this growth was driven by consumption financed by the oil boom, not by investment.



During these years, poverty rates and other social development indicators also improved, though not as much as they should have, given the size of the bonanza.<sup>23</sup> *So why did the country waste, yet again, another golden opportunity—but one that this time fell apart so rapidly? What causes account for this dramatic failure? Unlike in the past, what explains why this oil boom not only turned into another oil bust but also morphed into something even worse: a full-fledged humanitarian crisis?*

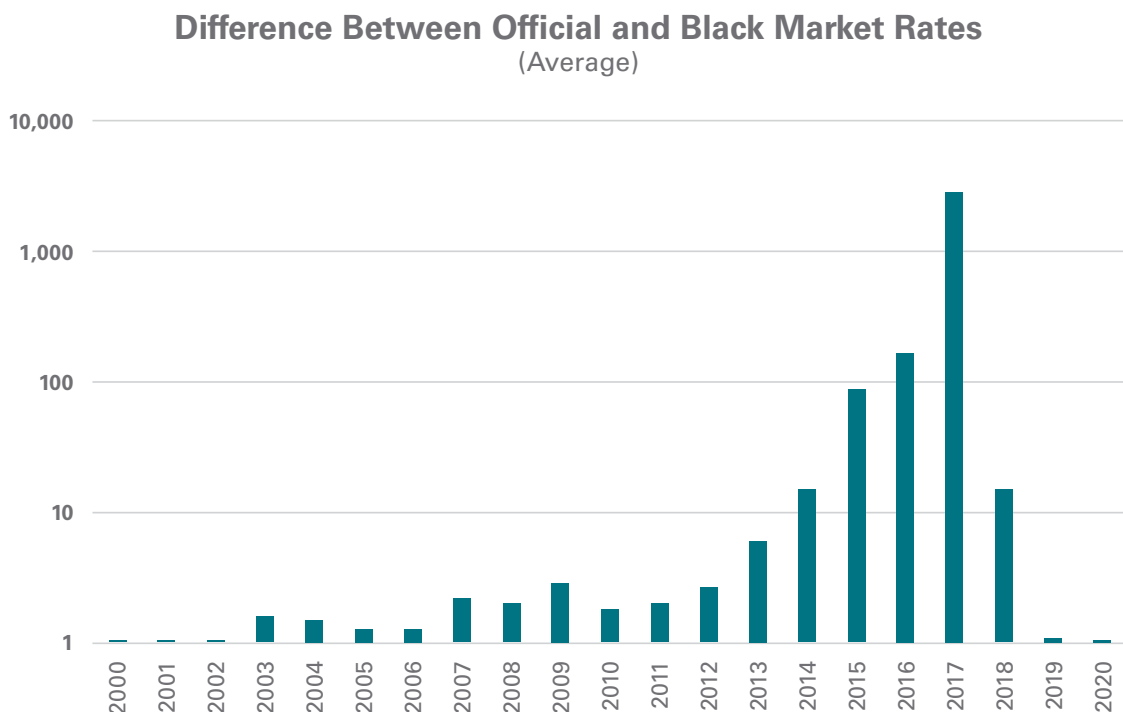
**The size of macroeconomic imbalances and lack of reform.** Oil has been viewed as a resource curse for economic growth and political development. Economies dependent on natural resources suffer chronic problems in economic performance, altering their capacity for long-term growth. According to Abuelafia and Saboin, Venezuela’s economic collapse resulted from three primary causes that were largely undergirded by the resource curse: blatant state interventionism in the economy; changing the oil sector’s operational and financial rules of the game; and irresponsible macroeconomic management.<sup>24</sup> The ways in which this curse has manifested itself are numerous: exchange rate appreciation, high levels of indebtedness, overspecialized production, eroding state capacities, and widespread corruption.<sup>25</sup> Venezuela fits this



portrayal to perfection. Public policies aimed at fixing these problems are varied but, largely for political reasons, have been difficult to implement. The measures include macroeconomic stabilization funds, fiscal responsibility rules, ensuring transparency in oil contracts, strengthening accountability, and enhancing state capacity.

When examining Venezuela's most recent experience with the resource curse, the corrosive temptation created by the oil windfall can explain political leaders' willingness to adopt an overvalued multiple exchange rate control system, expand fiscal expenditures, introduce price controls, nationalize productive sectors, dismantle the country's macroeconomic stabilization fund, and undermine the autonomy of the Central Bank or become overindebted. However, what stands out are the size of the macroeconomic imbalances that both Chávez and Maduro decided to accumulate over time and the lack of political interest in reversing, at least partially, some of the problems by introducing minimum reforms.<sup>26</sup> In other words, predatory policies remained in place for a very long time, without substantial change, due to the size of the oil windfall. By the time it became evident that these policies required a complete overhaul, it was too late. The development impact was already too negative.

For example, the overvalued controlled exchange rates that have persisted in Venezuela for more than 15 years have created such a distortion that, at its peak, the black-market rate was 1,000 times less than the official rate.



BCV

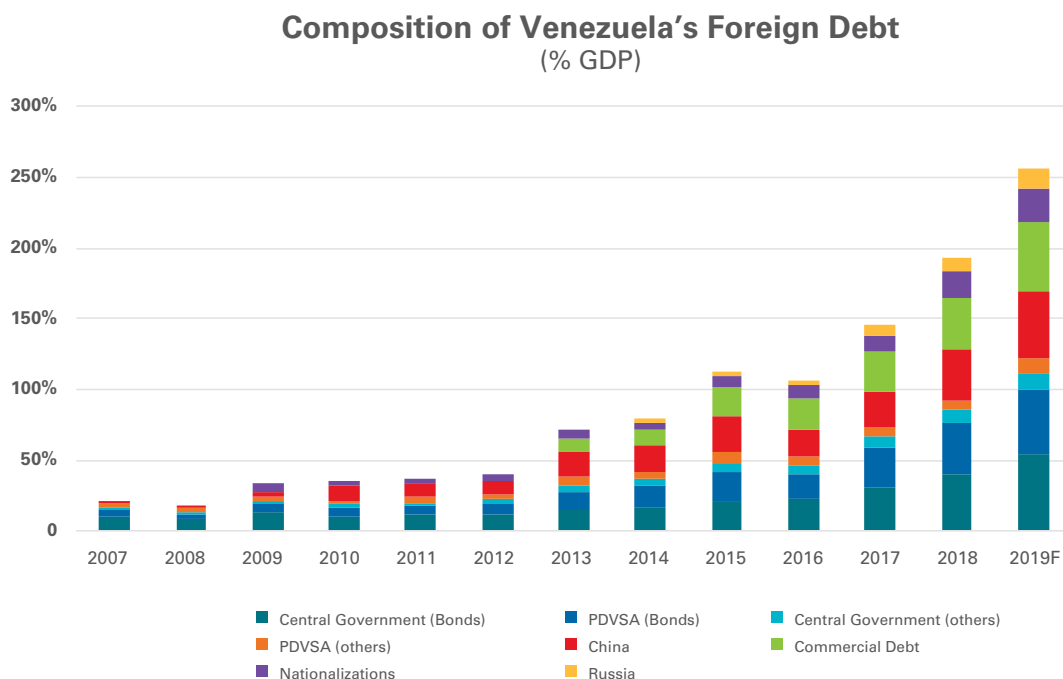
The result was a huge shadow market in which the government, according to certain estimates, traded over \$200 billion worth of imports between 2003 and 2012, at a significant fiscal cost. This nontraditional subsidy mostly ended up in the pockets of importing elites connected to public officials, although consumers also benefited indirectly through lower retail prices for these imported products.

On one hand, the system placated certain groups within the private sector that had access to unprecedented rents (at the expense of local producers); on the other hand, the system satisfied low-income sectors, in that it led to their higher consumption levels.<sup>27</sup> *The political economy of this scheme was so powerful that the government decided to issue foreign debt, deplete its international reserves, and even access parallel fiscal funds hidden abroad to finance the system.*<sup>28</sup> By the time the arrangement needed to be dismantled, its negative effects—in terms of corruption of state capacities, fiscal sustainability, private-sector development, and private consumption—were so large that changing the scheme appeared difficult and costly.

**The dismantling of PDVSA.** Before Chávez, PDVSA was autonomously run by a board of directors led by an executive branch appointee. However, through gradual changes to its structure, particularly after the 2002–3 oil strike, PDVSA lost its operational autonomy and became the state’s “most important welfare agency.”<sup>29</sup> In order for Chávez to strip PDVSA’s institutional accountability and succeed in gaining full operational control of the sector, he engaged in several maneuvers. First, he appointed loyal followers rather than industry professionals to PDVSA’s board of directors and merged the Ministry of Oil and Mines and PDVSA under a single leadership. Second, after the oil strike, Chávez fired 18,000 PDVSA workers in total, and 80 percent of the company’s exploration and well engineers.<sup>30</sup> Third, Chávez altered the exchange covenant between the Central Bank and PDVSA.<sup>31</sup> And fourth, he expanded PDVSA’s activities beyond oil and energy, converting PDVSA into the state’s primary provider of welfare assistance, through PDVSA’s Social Development Fund (Fondespa).<sup>32</sup> As a result of these changes, PDVSA became a hub for political affiliates to manage the state’s primary source of patronage. In less than a decade, Venezuela’s state-owned oil company increased its payroll from over 30,000 employees to more than 80,000.<sup>33</sup>

Under Chávez, PDVSA’s transparency vanished, as did foreign investment.<sup>34</sup> Before the oil strike, PDVSA’s operations were supervised by the Ministry of Oil, an internal comptroller general, the U.S. Securities and Exchange Commission (when the oil giant issued debt in New York), and the Central Bank; they respectively supervised PDVSA’s budgets, transparency, bond creditworthiness, and foreign hard currency assets for foreign debt payments. However, with Chávez, checks and balances disappeared, and PDVSA’s covenant terms with the Central Bank changed, thus allowing PDVSA to expand its hard currency fund to several billion dollars and finance social, agricultural, and infrastructure projects locally and abroad through its newly expanded Fondespa. Through this new mechanism, PDVSA could distribute funds both locally and internationally, without

reporting to the Central Bank or the National Assembly. In essence, PDVSA became the key source of direct spending for the central government, issuing new debt in international capital markets and acquiring large sums of financing (over \$50 billion) from nontraditional sources, including the China Development Bank.



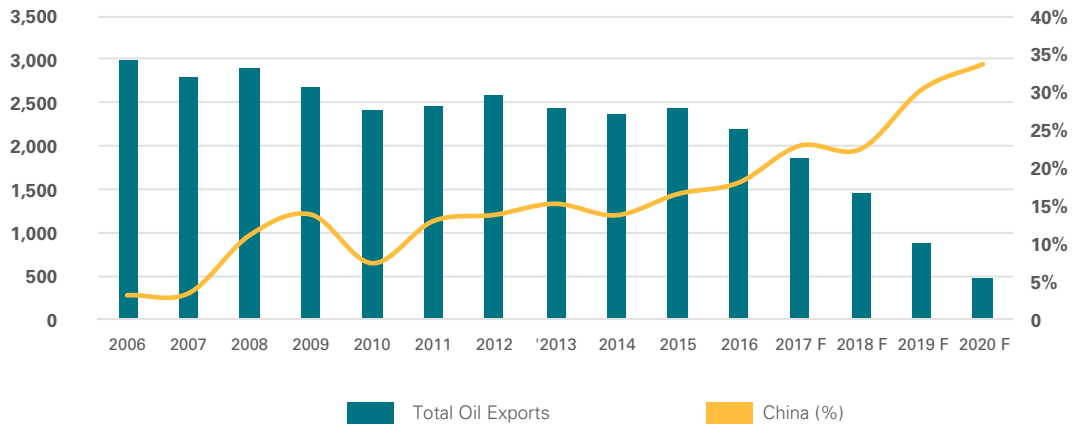
Source: *The Dialogue*, BCV, ONCP, IMF

Russia also entered the financial scene in 2014 and 2016, providing \$6.5 billion to PDVSA in short-term financing.<sup>35</sup>

In theory, such an influx of funds from U.S. capital markets, China, and Russia should have granted Venezuela some economic relief. Instead, the new funds were used by the presidency to finance non-oil expenditures, further distancing PDVSA from its core business focus.<sup>36</sup> Some of these loans, particularly those from China, created a financial quandary because they were collateralized with PDVSA's daily income. In other words, the central government used PDVSA's future export sales to pay its debt to China. This meant that, rather than being reinvested in PDVSA's operations, export revenue would go directly to China. However, the problem for China would be that the viability of the oil-for-loan deals was contingent on PDVSA's cash flow and the company's ability to sustain consistent oil production and ensure future export sales.<sup>37</sup>

On one hand, PDVSA's deteriorating output has increasingly gone to China and Russia for debt repayment—from 3 percent of output in 2006 to 18 percent in 2016.<sup>38</sup>

## Total Oil Exports ('000 bpd) and China Share of exports

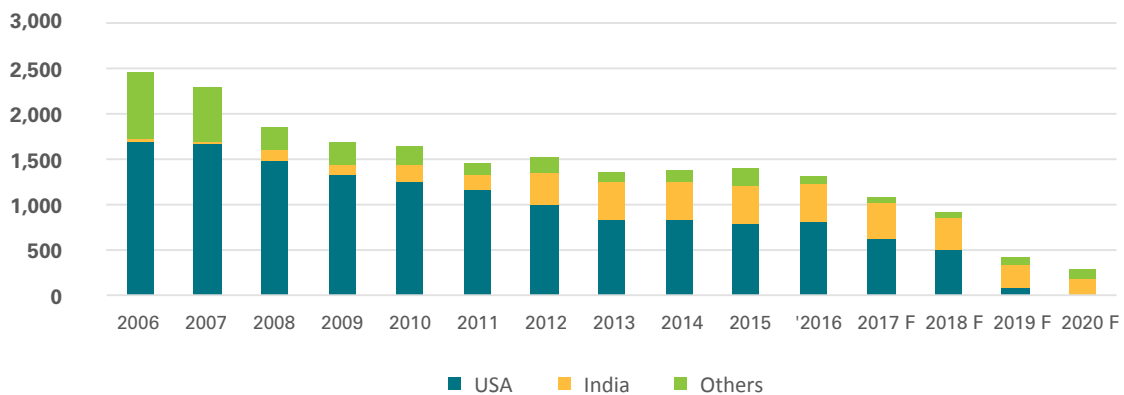


Source: PDVSA, EIA, ITC-TradeMap, TankTracker.

On the other hand, sales revenue from the United States and India, which are not in oil-for-loan deals with Venezuela, generated a positive cash flow before the imposition of U.S. sanctions. Oil-for-loan deals have made investing in operations and boosting oil production increasingly challenging for PDVSA. In contrast to today, in 2006, PDVSA supported its cash flow with over 2.5 million bpd exported. By 2018, less than 600,000 bpd generated cash—that is, less than a fourth of PDVSA's 2006 production. Productivity rapidly declined as a result.

After first losing access to global capital markets in 2013, Venezuela's ability to issue,

## Cash Generating Barrels ('000 bpd)

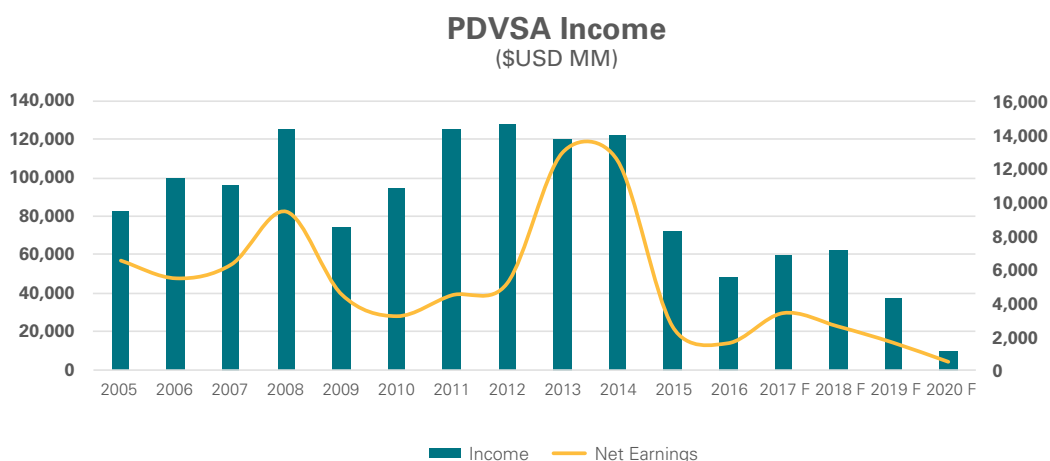


Source: PDVSA, EIA, ITC-TradeMap, TankTracker



refinance, and restructure its foreign debt was further limited by the 2017 oil sanctions imposed by the United States.

As a result, PDVSA had to choose between debt repayment and oil production



Source: PDVSA, EIA, OPEC, TankTracker

investment. PDVSA chose repayment, thereby sacrificing the possibility of stabilizing oil production. Even after choosing repayment, Venezuela nonetheless feared creditors' litigation and overseas asset seizures stemming from its poor delivery of oil output. Drowning in overdue debt to its international bondholders, Venezuela asked China for a debt moratorium; China agreed by offering an interest-only grace period on Venezuela's repayment.<sup>39</sup> Notwithstanding this arrangement, PDVSA was selectively defaulting on its foreign debt in capital markets by late 2017.

*Making things worse for PDVSA, the 2017 U.S. sanctions also prohibited Venezuela from importing products such as diluents, and banned Citgo and other companies from engaging in oil-for-loan deals with Venezuela.<sup>40</sup> As a consequence, PDVSA stopped exporting to the United States and faced major difficulties in finding new markets for its heavy crude.<sup>41</sup> To make matters even more difficult for Venezuela, the U.S. Treasury announced additional sanctions in August 2019. These included secondary sanctions, which served as a disincentive to Russian, Indian, and Chinese brokers from doing business with PDVSA.<sup>42</sup> These international restrictions exacerbated the financial pressure on the already stressed and deteriorating oil company.*

**The centralization and nationalization of public services.** Both Chávez and Maduro nationalized key public services and created new, national state-owned enterprises to deliver these services. The nationalizations affected multiple sectors, including telecommunications, electricity, and water supply. As a result of this process, several inefficient and very large state-owned enterprises were created, and they

were marred by poor management and widespread corruption.<sup>43</sup> As a result of highly subsidized tariffs and scarce managerial capabilities, few operational and maintenance investments were made. Additionally, personal interests were often prioritized in the procurement of new capital investments. Hence, public services began to collapse across the country as the enterprises failed to stabilize the coverage and quality of service delivery to the population.

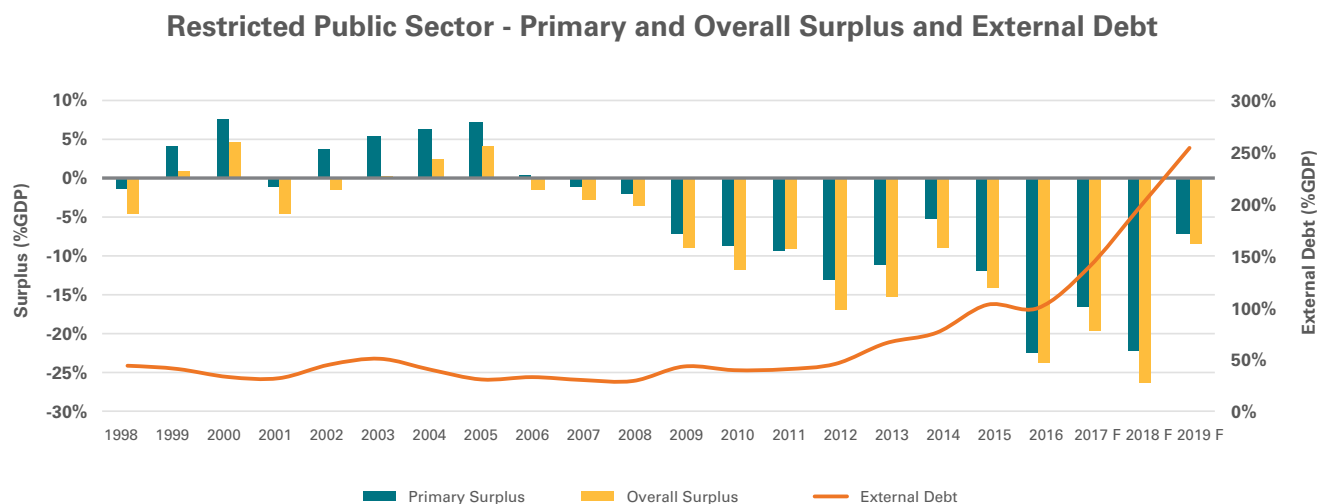
A good example of this phenomenon is the electricity sector. Between 2014 and 2019, electricity generation declined from 18,000 megawatts per day to less than 9,000 megawatts. This sharp decline took place despite massive public investments by the national energy corporation, CORPOELEC, most of which were wasted and siphoned off. The distribution network also experienced significant failures, due to inadequate maintenance and investment decisions by CORPOELEC. By 2019, when the country faced recurring national blackouts, CORPOELEC had already lost over 45 percent of its employees, including its best engineers. Most of these employees reported that low salaries and extensive corruption were the main reasons for their departure.

Other public services such as health care and education also underwent complete administrative centralization. During the 1990s, Venezuela initiated an important decentralization process in order to innovate and improve the quality of public services at the regional and local levels. After 1998, this process was completely reversed and the national ministries once again assumed total control over administrative responsibilities. This led to a drastic decline in most educational and public health care indicators. The ministries managing the health care and education public services favored *misiones*, informal programs guided by political considerations, to fund and deliver a variety of public services. This weakened the formal structures for service delivery.<sup>44</sup> Overall, public services, regardless of their nature, operated in adverse social and budgetary conditions, leading to the massive desertion of teachers and the migration of doctors to other countries. Thus, the centralization and informalization of key public services seriously limited the capacities of local governments and communities to adapt and retain human capital in public hospitals and schools, or to invest in their infrastructure in the midst of a complex humanitarian crisis.

**The fiscal collapse of the state.** Venezuela's fiscal spending has traditionally been pro-cyclical, with expansions taking place during oil booms and significant adjustments during oil busts.<sup>45</sup> These adjustments commonly involved drastically cutting expenditures and refocusing the functions of the state to increase the effectiveness of social programs; and they have usually been adopted together with a large devaluation of the exchange rate, to boost the private sector's competitiveness. However, these adjustments were historically short-lived once oil prices started to rise; fiscal spending expanded and the exchange rate was artificially allowed to be overvalued. This cycle, which was typical of any oil economy, fed social and political instability, and is one of the most important causes underlying the country's development problems.<sup>46</sup>

However, under Chávez and Maduro, this pro-cyclical pattern changed significantly. Fiscal policy remained pro-cyclical, as in the past; but unlike previous periods, it was more expansive and adjustments were systematically avoided by increasing the size of the foreign debt and monetizing the fiscal deficit.<sup>47</sup> The outcome of this myopic behavior created the basis for Venezuela to default on its foreign debt, as the country lost access to capital markets and the cost of debt service payments increased. This approach to fiscal policy also created the conditions for monetizing the fiscal deficit by printing money, something that fed a hyperinflationary process. When Chávez came to power in 1998, the size of the state was slightly larger than 23 percent of GDP. By the time he died in 2013, public expenditures were nearly 50 percent of GDP, the highest in the region.<sup>48</sup> Fiscal deficits also grew during this same period, from 4.5 percent to 15.3 percent of GDP.

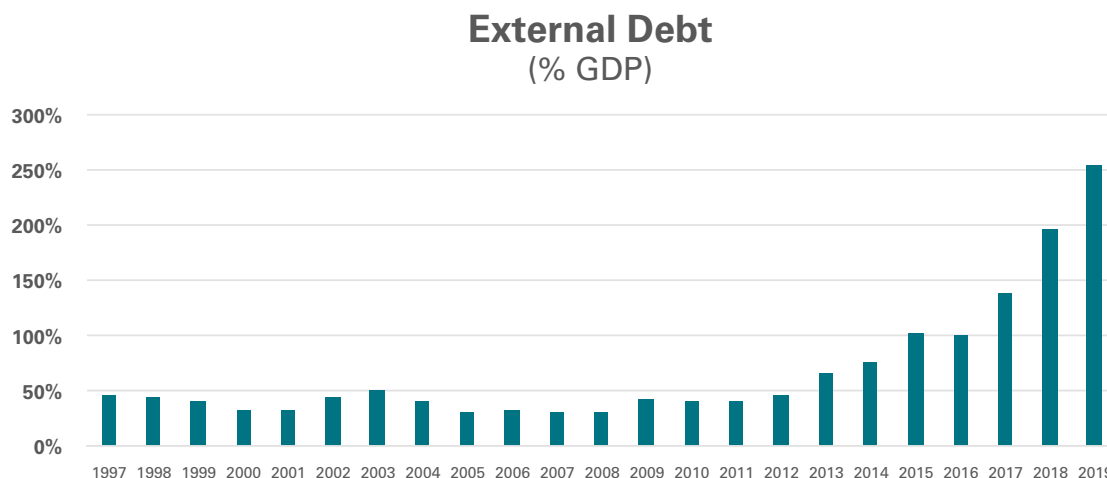
In addition to losing access to capital markets, Maduro could not access the same generous bilateral funding from other sources, such as Russia or China, as Chávez had done during his presidency.<sup>49</sup> In 2013, capital markets were basically closed for Venezuela, and China began slowly rolling back its debt exposure. Russia also moved away from state-to-state funding of military spending and moved toward short-term financing of PDVSA through its state-controlled company, Rosneft. In a very short period,



Source: Torino Economics, BCV, PDVSA, SEC, Bloomberg

due to the high stock of debt and the contraction of the economy, by the end of 2019 Venezuela's foreign debt had reached more than 250 percent of GDP.

Rather than pursuing fiscal adjustment, restructuring Venezuela’s debt, or opening up to the private sector and accessing multilateral funding, Maduro opted to keep paying foreign creditors, maintain a controlled and overvalued exchange rate, curtail imports from more than \$50 billion a year to less than \$14 billion, continue to nationalize private-sector enterprises, and rapidly monetize the fiscal deficit.<sup>50</sup> By October 2017, Venezuela



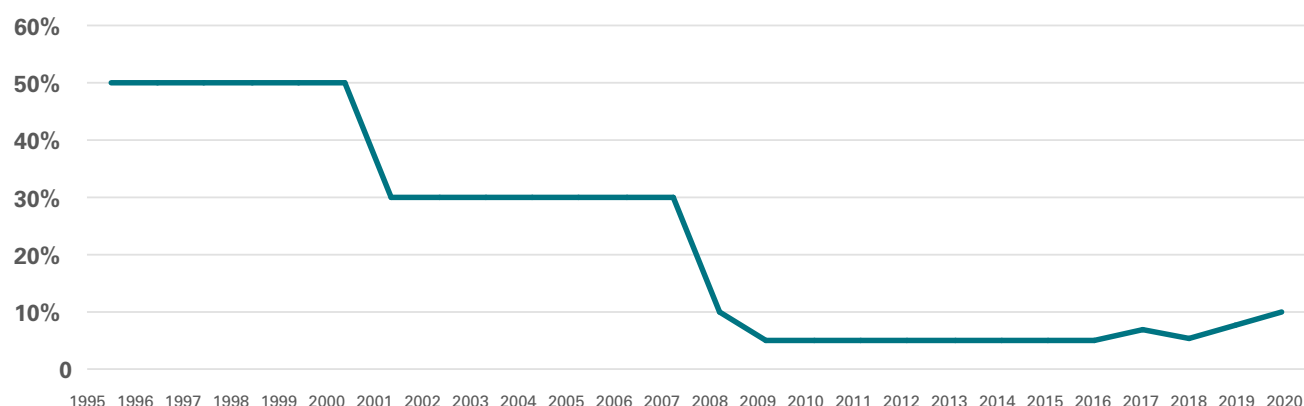
*Source: Torino Economics, BCV, MF, PDVSA, WB, Bloomberg*

entered a period of unbridled hyperinflation, and the state rapidly experienced the “Tanzi effect”—named for former International Monetary Fund fiscal affairs director Vito Tanzi—who described how hyperinflation further weakens fiscal revenues and, in turn, reinforces the monetization of the fiscal deficit. By 2020, hyperinflation had continued for more than three years, with a monthly average inflation rate of over 70 per cent.

**Property rights.** The private sector in Venezuela has operated in the context of a state-controlled economy since 2004 with broad price controls, strict labor regulations, and a growing layer of administrative barriers to trade and investment.<sup>51</sup> In addition, private property rights have been seriously eroded due to massive expropriations, nationalizations, and confiscations in almost every sector of the economy.<sup>52</sup>

State-owned enterprises expanded in all areas, sometimes by heavy-handed means.<sup>53</sup> Some of these confiscations involving property that was illegally expropriated and not compensated for by the state are now being challenged by domestic and foreign investors in international arbitration processes, generating potential fiscal liabilities of

### Index of Economic Freedom - Property Rights

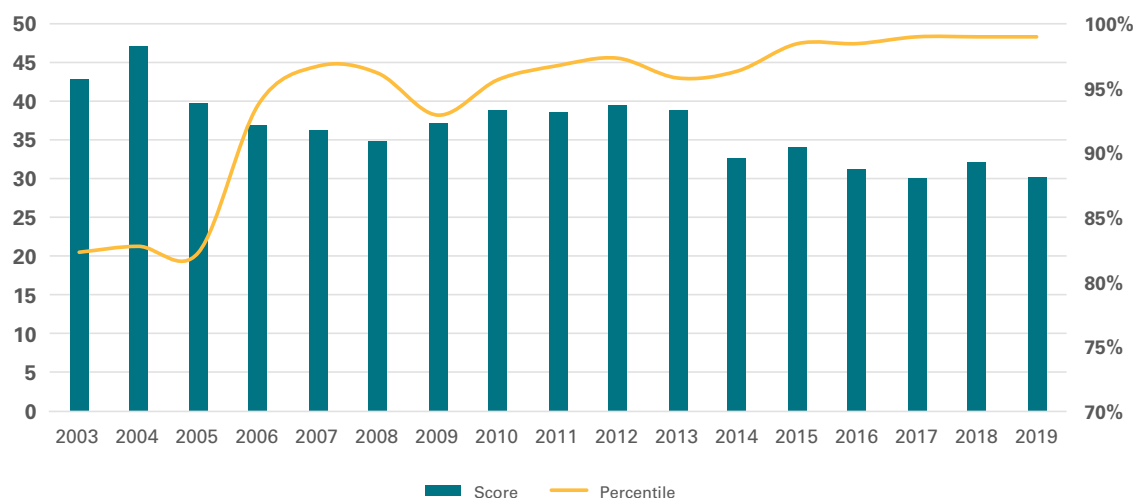


Source: The Heritage Foundation

more than \$15 billion.<sup>54</sup> Currently, sectors in which the direct presence of the state is dominant go beyond oil and mining to include telecommunications, electricity, agroindustry, forestry, financial services, petrochemicals, cement, and even retail. By 2012, the central government ran over 2,000 state-owned enterprises of all sizes. In 2018, less than 600 of them still operated, most of them requiring fiscal transfers to stay afloat.<sup>55</sup>

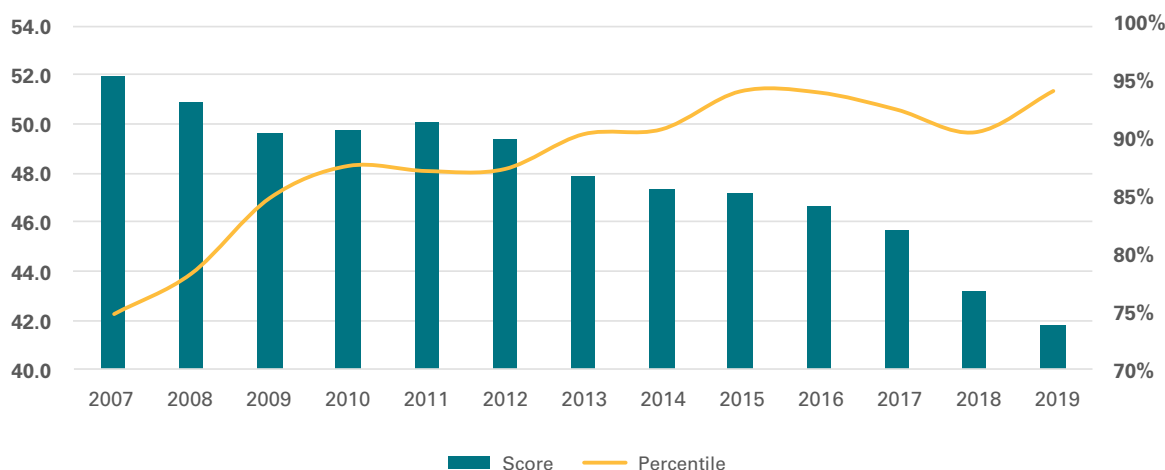
The World Bank's Doing Business and the World Forum Competitiveness indexes, which rank countries in terms of domestic investment climate, placed Venezuela near the very bottom of the list by 2018.

### World Bank Doing Business - Venezuela



Source: World Bank Doing Business

## Competitiveness Index - Venezuela



Source: World Economic Forum - Competitiveness Index

According to an annual survey conducted by Venezuela's National Industrial Confederation, the private sector had lost 80 percent of the firms participating in the manufacturing sector since 1999.<sup>56</sup> Thus, any recovery plan for the private sector will require restoring property rights, improving the business climate, promoting investment, promoting entrepreneurship, and privatizing or adopting public-private partnerships to manage most of these state-owned enterprises.

**Rent seeking.** The combination of oil income, heavy state regulation, exchange rate controls, and predatory policies, together with a highly politicized and ineffective judiciary and high crime rates, created the perfect ecosystem to incentivize and institutionalize rent seeking, graft, and corruption. Rent seeking in Venezuela is linked to state policies that create arbitrage opportunities, such as an artificially controlled and overvalued currency or heavily subsidized tradable products such as gasoline or food imports.<sup>57</sup> Other rents are linked to the state's failure to monitor illegal activities such as drug trafficking and informal gold mining. All these artificial and illegal markets represent billions of dollars in rents, with which different actors, including the military, have rapidly enriched themselves by controlling access to cheap dollars, overpricing imports, or smuggling these products to border nations. According to some estimates, by 2018 these rent-seeking activities were greater than \$8 billion a year; even after discounting the effects of the country's large economic contraction and the limitations created by international sanctions.<sup>58</sup> During the oil boom, in gasoline smuggling alone, rents easily represented more than \$2.7 billion a year.

Other more traditional forms of corruption, such as graft, have also become common practice, particularly in infrastructure investments, because personal interests are usually



avored by high public officials as well as by those managing state-owned enterprises. Most of these projects are difficult to justify in a cost-benefit analysis and end up overpriced and unfinished. For example, Odebrecht had its largest portfolio of public-sector projects in Latin America in Venezuela. Most of these projects were bloated, abandoned, and difficult to justify from a policy perspective. In addition, some of these projects involved massive bribes to politicians and public officials close to both the official party and opposition parties. Similar practices of graft and corruption were common in other megaprojects directly financed by the Chinese and the Russians in the electricity, oil, and defense sectors. The same was true for projects directed to the non-oil sector and financed with proceedings from the oil sector, managed by PDVSA, through the Social Development Fund.

Transparency International has estimated that the amount of money involved in international judicial cases against a group of former Venezuelan officials could surpass \$13 billion.<sup>59</sup> These cases involve 70 former public officials accused in 6 different countries of corruption and money laundering. This means that these former officials are involved in cases each amounting to more than \$185 million. This sad outcome can explain why Venezuela does so poorly in most corruption indexes. *According to the Corruption Perception Index, Venezuela ranks 168th out of 180 countries, clustered close to other oil-producing nations such as Angola, Libya, and Iraq. By this same measure, Venezuela is also considered the most corrupt nation in Latin America today.*



Construction in Venezuela. Photo Credit: shutterstock.com/ Another77

## Why has the regime remained resilient?

The factors that can explain the economic, institutional, and social collapse of Venezuela do not necessarily help explain why it has been so difficult to reverse politically. *In other words, why has neither regime change nor policy change occurred despite the size of the economic contraction and the rapid decline of most social indicators?* In Venezuela, political protests erupted in 2013, 2014, 2017, and 2019, yet political change has been systematically blocked by the ruling elite. Social protests have also emerged in different waves, especially by low-income sectors mobilizing against food shortages and the lack of access to public services; and despite the scale of some of these events, the regime has been able to coerce, appease, and control society.<sup>60</sup>

Throughout 2019 and 2020, Datanálisis public opinion surveys consistently registered that more than 90 percent of the population has a negative perception of their current individual situation.<sup>61</sup> Only 6.5 percent have a more positive outlook. Therefore, most individuals, independently of their political affiliation as well as income level, have a pessimistic assessment of their current personal welfare. A large proportion of the population considers inflation their biggest problem (38 percent), followed by economic recession (13 percent) and corruption (6 percent). When asked about the most pressing issues faced by the country as a whole, 65 percent mention economic issues first, 18 percent mention social issues, and only 16 percent mention the political dimensions of the crisis. A total of 60 percent of the respondents blame either Maduro or his government for these problems. More than 82 percent of the population would like to observe political change by having Maduro finish his rule, and more than 48 percent would like a negotiated settlement between the official party and the opposition as the best alternative to solving the political crisis. However, 27 percent believe that Maduro will stay in power and only 9 percent think that the military will intervene, even if negotiations fail or if Maduro decides to extend his rule. In addition, 62 percent of the population reports that, despite their desire for change, they are not willing to continue protesting, while only 35 percent are willing to continue participating in street protests.

If Maduro is so unpopular, due to the depth of the economic malaise and as reflected by his approval ratings being under 13 percent, why has he been able to postpone policy changes and at the same time avoid regime change? Several factors can help explain this paradox, and they are mostly related to the political nature of Venezuela's authoritarian regime. In the case of Venezuela, the long-lasting institutional effects of these factors are so important that even if political change is achieved, some of these legacies will continue to negatively influence political and policy outcomes in the country in the near future. *In other words, any future prospect for Venezuela's recovery will be shaped by the size of the previous economic and social collapse, but it will also be constrained by some of the same political factors that help explain why political change was been delayed for so long.*

**The Armed Forces.** Hegemonic authoritarian regimes, such as the one that rules and governs in Venezuela, are able to tighten their iron grip on power, not only by winning unfair elections or even rigging elections altogether when necessary but also by successfully co-opting the military into becoming their accomplice. In the case of Venezuela, unfair elections no longer serve to legitimize the hegemonic regime either domestically nor internationally because the ruling elite has lost their electoral appeal. As a result, the military has stepped up as an important political actor, especially in repressing dissent, coercing opposition and civil society actors, and holding over 15,250 “political detainees.”<sup>62</sup>

The professional role of the military in the country has been fully reversed.<sup>63</sup> It has gone from safeguarding peace and national sovereignty to one where the Armed Forces control and manage the country’s key industries, including its oil and mining industry. It also includes the illegal trade in fuel and its potential direct involvement in drug trafficking. In exchange for the access to these economic rents, the military has accepted the role of becoming “loyal to the revolution.” In other words, the Armed Forces have received direct administrative control over the largest legal and illegal extractive industries in the country in exchange for granting direct oversight to the ruling leader and its party of their operational autonomy.<sup>64</sup>

This process has been gradual and a source of conflict as factions within the Armed Forces have resisted or even attempted to overthrow the revolution in order to reverse the process. Nonetheless, thanks to the use of different strategies and tools, the ruling party has been able to abort these military rebellions and instead gain direct political control over the military institution, weaken its autonomy, and transform it into a body capable of deploying its repressive capacity against civil society and opposition movements if necessary.<sup>65</sup> The strategies and tactics used by the ruling party to achieve



Military Supporters of Interim President Juan Guaidó  
Photo courtesy of Shutterstock.com/ Julio Lovera



this outcome have included massive corruption, political profiling of its ranks, aggressive purging, and outsourcing the intelligence services to authoritarian foreign nations to allow the executive branch to independently monitor their behavior. As the Armed Forces have gradually lost their operational autonomy in exchange for direct administrative control over key industries, the ruling party has been able to promote paramilitary groups to counterbalance military power and further protect the regime's survival. In Venezuela, party and military institutions have closely interacted to assure the maintenance of unchecked presidential rule that keeps being elected in unfair elections.<sup>66</sup>

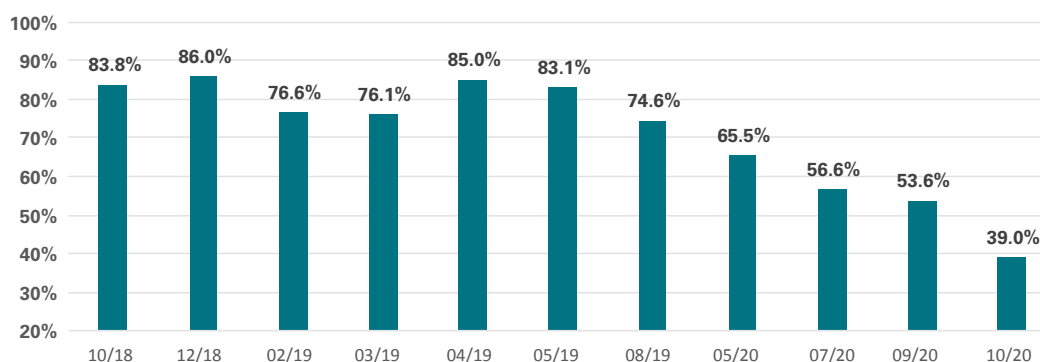
In addition, by granting the Armed Forces complete control over the oil and mining industries, Maduro has fully invested the military institution into the current status-quo. The military is perceived as increasingly corrupt and as an antidemocratic institution, according to public opinion. Only 12 percent of the population approves of the military's behavior.<sup>67</sup> However, the rents generated by these economic activities—in addition to the control of other key domestic industries and the direct control over key pockets within the state bureaucracy—are so important for the military, particularly for the higher echelon, that they are willing to resist any change in economic policy and ignore its social and political consequences.

Due to these “corporate” interests, their willingness to accept political change in order to reverse the economic and social collapse is also much lower; and even if they accept political change, they will do so without losing what they perceive as their prerogatives. *Like many other authoritarian experiences in developing countries where the military expanded its control over the economy—such as in Chile, Myanmar, Egypt, and Pakistan—any political transition in Venezuela will need to provide the military with ample guarantees and set up fiscal compensation rules or will need to continue to grant them economic domains where they can act autonomously, if necessary.*<sup>68</sup> Otherwise, it will be very difficult to politically change their role and restore civilian control over their administration.

**Social control.** The Venezuelan regime has also invested in setting up large social outlets on which low-income sectors have become more dependent as food shortages and hyperinflation have accelerated.<sup>69</sup> Though these poverty alleviation programs are important, as real wages have collapsed and access to food has become more difficult, they have been used as a political tool to guarantee social appeasement, and even as an instrument to condition political behavior in order to access larger social benefits.

The government's most relevant social program is currently named the Comité Local de Abastecimiento y Producción, or “CLAP,” as it is commonly known. CLAP provides individuals, rather than households, with access to a subsidized bag of food directly distributed by the state or grassroots movements linked to the ruling party. In August 2019, more than 74 percent of households declared that one or more members of the household received CLAP food bags.

### Households Receiving CLAP



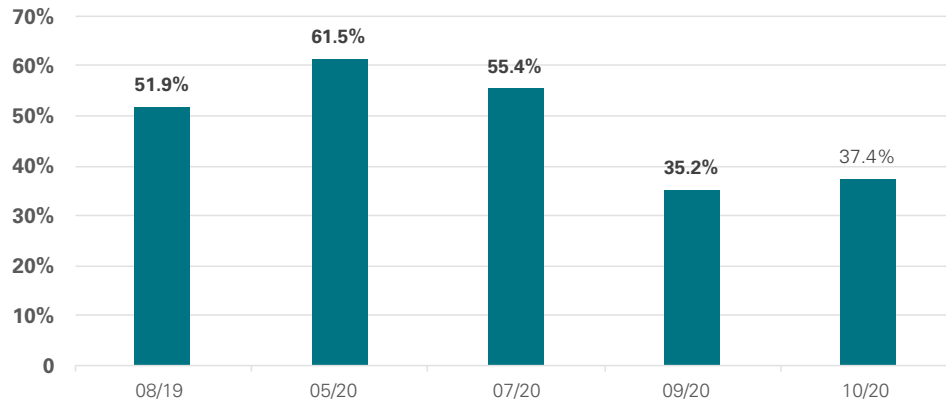
Source: Datanalisis Omnibus Poll May-20

Among low-income sectors, more than 81 percent of households have access to this bag of food. In theory, CLAP food bags should be handed out on a monthly basis to poor individuals. However, the distribution is irregular, and access is sometimes delayed for more than two months, especially in rural sectors.

In addition to CLAP, the regime has developed an electronic card, “Carnet de la Patria,” that holds the information of every single individual that has access to different cash transfer programs. Although it is not a prerequisite to access CLAP, it is mandatory for accessing other social benefits. Among the key information deposited in the electronic card is whether the individual is a public employee, their use of public services, if they live in public housing, banking information, and their political affiliation. This electronic card is a key instrument to “buy votes” during any electoral event, as they need to be renewed on a regular basis, and voters can be forced to renew them close to the voting booth on election day (in Venezuela, this process is known as Red Points, or Puntos Rojos), or otherwise they could run the risk of losing access to these benefits.<sup>70</sup> The electronic card is also demanded on occasions to access cooking gas in low-income sectors. In other words, the state in Venezuela does signal to poor communities, and more important to those dependent on state benefits, that big brother is watching; therefore, it has become a powerful psychological instrument of coercion to condition political behavior.<sup>71</sup>

In August 2019, more than 51 percent of the population declared that they have access to one or several of these cash transfer programs, and therefore they also hold an electronic card (Carnet de la Patria).

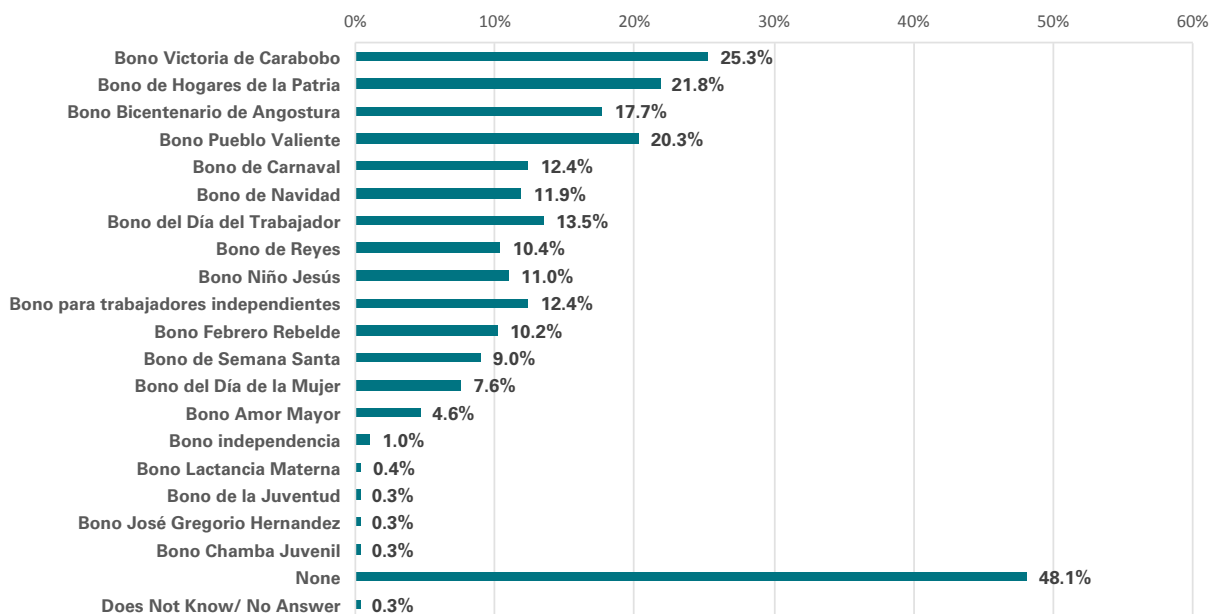
## Cash Transfer Program Reception



Source: Datanalisis Omnibus Poll Oct-20

There are more than 19 cash transfer programs, and it is unclear what their differences are in terms of their social goals. There is no public information on who their beneficiaries are or on their impact. The largest social outlet for the cash transfer program is Bono Victoria de Carabobo (which covers 25 percent of the population), followed by Bono Hogares de la Patria (22 percent), Bono Pueblo Valiente (20 percent), and Bono Bicentenario (18 percent).

## Cash Transfer Program Reception



Source: Datanalisis Omnibus Poll Oct-20.



**Autocratic legalism.** For the Maduro regime, fully dismantling the rule of law in Venezuela has become a key strategy for clinging to power and to use the judiciary branch to further empower the executive branch; bypass an opposition-controlled legislature through an unconstitutional National Constituent Assembly; exercise full control over the electoral authorities; ban political parties; and allow security agencies and the fiscal attorney to repress, jail, and prosecute social and political leaders when necessary. The use, abuse, and nonuse of the law—called by some authors like Javier Corrales “autocratic legalism”—refer to electoral and constitutional mandates cleverly manipulated by the president and his ruling party, with the support of the judiciary, to dissolve the division of powers.<sup>72</sup> Between 2005 and 2015, the Supreme Court issued 45,474 rulings, of which none have gone against the central government.<sup>73</sup>

According to the International Commission of Jurists and Foro Penal, 66 percent of judges and 90 percent of prosecutors were provisional in 2014; and according to the 2020 report of the Office of the UN High Commissioner for Human Rights (OHCHR), the Supreme Court has suspended elections of the Venezuelan Bar Association since 2015 and staff working in the justice system are discouraged by superiors from denouncing human rights violations.<sup>74</sup> Venezuela has ranked last in the Rule of Law Index since 2014.<sup>75</sup> Overall, this shows the complete lack of independence of the judiciary branch and its political objective of protecting the interests of the presidency and the official party.<sup>76</sup> According to several studies analyzing the causes behind the decay of the rule of law in the country, most judicial posts are temporal appointments that can be discretionally allocated and removed, and therefore are easily controlled politically.<sup>77</sup> Most cases are consequently politicized and subject to corruption. In order to guarantee complete control over the Supreme Court, and therefore over the whole judicial system, court sizes were expanded and appointments were conducted by exclusively favoring political affiliation—thus violating constitutional requirements.<sup>78</sup>

Overall, the negative outcome of dismantling the autonomy of the judicial branch has been dramatic. According to several human rights organizations operating in Venezuela (which has officially been ratified by the United Nations),<sup>79</sup> extrajudicial killings, torture and other cruel treatments, the trafficking of persons, the infrastructural deterioration of prison and detention centers, arbitrary arrests, political prisoners, and the denial of fair public trials have all grown exponentially in the past few years.<sup>80</sup> In addition, civil liberties, especially freedom of speech and the systematic protection of refugees and asylum seekers, have also been seriously restricted.

**State coercion.** The regime has also constructed a very specialized and centralized use of intelligence agencies and security forces in order to maintain social and political control over the population. First, in 2017, the regime created a specialized armed agency, under the Bolivarian National Police, theoretically dedicated to combating organized crime called the Fuerzas de Acciones Especiales (FAES).<sup>81</sup> This agency contains

social protests and dismantles dissenting social and paramilitary groups. According to several nongovernmental organizations (NGOs), the FAES directly conducts most of the extrajudicial killings in poor areas and urban centers and also on the border with Colombia.<sup>82</sup> According to OHCHR interviewees, as reported by the OHCHR's 2019 report, the FAES is referred to as a "death squad" and as an "extermination group," and in 2018 it killed over 7,500 people, as reported by the NGO Observatorio Venezolano de la Violencia.<sup>83</sup> The FAES is controlled by officials who informally also report to the party in power as well as the presidency. Though the military has very little influence over the operations of this agency, the agency manages operations in conflict-ridden states where paramilitary groups operate, such as in Barinas, Zulia, Apure, and Táchira.

Another specialized agency is the Dirección General de Contrainteligencia Militar (DGCIM), which is a sophisticated counterintelligence agency centered on keeping the military ranks under control and dismantling any potential rebellion within the Armed Forces. This agency directly reports to the Ministry of Defense. The DGCIM has been extremely successful at keeping several military insurgency movements at bay, although at a huge cost from a human rights perspective.<sup>84</sup> The agency has almost complete surveillance over key officials and their families.

A third powerful agency is the Servicio Bolivariano de Inteligencia Nacional (SEBIN), which specializes in keeping close surveillance of the opposition, the private sector, and even the military itself, repressing them when necessary. SEBIN operatives are trained and advised by Cuban intelligence, and they report directly to the vice presidency and the Ministry of Interior.<sup>85</sup> SEBIN has also shown highly repressive capabilities in dismantling and persecuting social movements and political parties. According to the NGO Foro Penal Venezuela, 15,045 people were detained between January 2014 and May 2019, most in political demonstrations.<sup>86</sup> Most political prisoners are held in custody by SEBIN, and, according to human rights organizations, prisoners are commonly subject to cruel treatments and different types of torture.<sup>87</sup>

**Paramilitary groups.** The regime has allowed by forfeit paramilitary groups, large gangs (megabandas), colectivos, and Colombian guerilla movements to operate in different areas across the national territory.<sup>88</sup> According to Paul Angelo, the regime's decentralized militia armed networks comprise over 1.6 million members, and as of February 2020, over 28 illegal groups operated along the Colombia-Venezuela border.<sup>89</sup> Some of these different types of groups, with exceptions, hold informal links to political actors in the regime. The megabandas and colectivos mainly operate in urban areas,<sup>90</sup> and they hold strong control over specific territories populated by low-income communities and supported by the FAES.<sup>91</sup>

More recent *colectivos* involve former police personnel and government bodyguards and sow fear through intimidation, extrajudicial killings, and a lack of identification (they wear masks and lack license plates).<sup>92</sup> By contrast, paramilitary groups and guerrilla movements operate in rural areas close to the border or in areas dominated by illegal activities, such as gold mining and drug trafficking. The Arco Minero del Orinoco region is especially controlled by organized criminal groups, locally known as the *sindicatos*. Their presence surged after the 2011 nationalization of all mining companies and the 2015 rise in gold prices.<sup>93</sup> The fact that the state allows them to operate does not mean that they can always go unchecked. When the regime or other special interests enter in conflict with these groups, due to political or economic reasons, the regime mobilizes one of its security agencies, especially the FAES, and even the military, to redress and rebalance the situation. These conflicts are sporadic and very violent and involve the use of heavy gun power. Simply put, the regime has relaxed the presence of the state in certain regions of the country, allowing different paramilitary groups to operate in exchange for holding the population socially and politically accountable, and informally sharing their economic rents from illicit activities with special interests with the regime.

**Opposition fragmentation.** Although the Venezuelan opposition has mostly remained united in their efforts to democratize the country and recover the rule of law, they are characterized by a large coalition of political parties with deep divisions between different factions.<sup>94</sup> This internal infighting is common, and on different occasions it has helped different parties or political leaders to justify breaking with the existing coalition, which in turn has allowed the regime to remain in power. Most of these divisions are grounded in different strategic views on how to dislodge the regime (whether by electoral means, international pressure, or street mobilizations) and personal and leadership rivalries between its members.



Protest in Caracas, Venezuela against the government of Nicolas Maduro. Demonstrators use shields to resist the repression of the national guard. Photo courtesy of Shutterstock.com/ Reynaldo Riobueno

## BARRIERS TO REFORMS

In Venezuela, many factors continue to be structural barriers to development that have been present beyond the almost two decades since the Bolivarian revolution. The problem is that many of these factors, which were in place before Hugo Chávez (1998–2013) and Nicolás Maduro (2013–), and which were already hurting growth and the quality of life, are now even larger barriers for the country's recovery. Among them are the country's dependence on the oil sector, fragile fiscal sustainability, low levels of private investment, pervasiveness of rent seeking, lack of accountability, weakness of the rule of law, growth of street violence, rampant corruption, large inequality, and high levels of poverty and social unrest.<sup>95</sup>

The country seems to have traveled, during the last three decades, in full circle without solving any of these structural problems. The issue is that now the reform list has become much larger, with new factors that include the collapse of public services, the depletion of key state capacities, the pervasive clientelistic use of social policy, the lack of protection over property rights, the presence of organized crime, the existence of large state-owned enterprises in almost every single sector of the economy, and the emergence of the Armed Forces as a powerful political actor with direct influence over strategic industries.<sup>96</sup>

Therefore, reinstitutionalizing the rule of law, modernizing the economy, and helping the country recover the provision of basic social services will require prioritizing reforms in the context of potential risks that could unexpectedly end up derailing these important efforts. For any future policymaker in Venezuela aiming at restoring growth and strengthening governance, the biggest challenge will be to design policies that are shielded from the inherent political, social, and institutional fragility underpinning these plans to transform the country. Identifying these spoilers and accounting for them without losing sight of long-term goals in the policy planning stage will be critical for Venezuela: What are the most important risk factors in these old and new structural barriers that might derail reforms? What elements might not only derail reform efforts but could also further deepen the political and social conflict in the country if they are not appropriately addressed?

**The mono-economy.** Oil dependence is a historical barrier that could continue creating many of the same problems as in the past. Reducing the dependency on the oil sector will require a large set of new public policies, in addition to massive private-sector investment in non-oil sectors, to help diversify exports, reduce the fiscal volatility linked to changes in oil prices, and promote a more aggressive trade integration strategy to open markets for potential exporters abroad.<sup>97</sup> These changes will involve passing key fiscal legislation to improve non-oil collection of taxes, introducing fiscal sustainability rules that could contribute to breaking with the procyclical nature of public expenditures,

strengthening private-sector development agencies for export promotion, implementing competitiveness policies to support the growth of new export-oriented non-oil sectors, and adopting a more aggressive trade policy through both bilateral and multilateral agreements.

**Preexisting legal frameworks.** Any economic change will require a political transition process to restore constitutional rule and democracy. These legal changes will entail major constitutional and electoral reforms. Some of these changes will also apply to many different policy areas, especially those dealing with the functioning of the rule of law, crime enforcement, defense, fiscal and monetary policy, the protection and restitution of property rights, and the reform of public services.<sup>98</sup>

In most of these policy areas, it will be necessary to develop a modern legal framework that can allow the implementation of needed reforms. Otherwise, the implementation process of any reform in these policy areas will be almost impossible to execute, given that most laws have been developed by the ruling party as a means to empower the presidency, reduce legislative or judicial oversight, undermine the autonomy of regulatory agencies, limit the participation of the private sector, minimize transparency, and restrict citizen rights. Without an adequate design and a consultation process that respects democratic institutions, many reforms will be significantly delayed, and thus the possibility to address some of these structural problems will be seriously limited.

**Low political cooperation.** Most of these changes require ample political cooperation across all political actors for their approval, including those powerful actors that benefited from the previous regime. Areas such as oil policy, social policy, fiscal reform, privatization, and public-private partnerships for public services, because of their very nature, will require even broader political support. However, political distrust, political polarization, political fragmentation, corruption, and a political culture that favors confrontation rather than consultation and coordination will provide a formidable risk for the design and implementation of key policies.<sup>99</sup> Therefore, any reform program should take into account the need to include, from the very beginning, those stakeholders that could potentially obstruct and benefit from these changes. In addition, consultation mechanisms should be developed to align these different groups. Providing the legislature's committees with the professional and technical support to discuss these reforms will prove essential for institutional strengthening. The same is true for professional, business, labor, and citizen associations, which could also become potential sources of support for many of these reforms.

**Weak state capacities.** In Venezuela, most key state capacities for policy design and implementation have been undermined by corruption, rent seeking, and clientelism.<sup>100</sup> This is the case across ministries at the national level, and also at the regional and local levels. Most regulatory agencies have been dismantled due to their weak legal

autonomy, scarce budgets, lack of human capital, and little investment in technology. Most policy areas do not have accurate statistics and information systems. Therefore, reforms should be focused not only on designing good policies but also on building the required state capacities to implement them.<sup>101</sup> If, for different reasons, among them corruption, building these capacities within the state seems intractable or involves a very long process, policymakers should consider options aimed at including civil society organizations, and even international organizations, in the delivery of some of these services or complementing the state with certain capacities that could be developed in cooperation with the nonprofit sector to enhance the transparency and implementation of these reforms.<sup>102</sup> Multilateral institutions will also need to play a critical role in financing the needed fiscal resources for the public sector to attract human capital. Without this talent, the reconstruction process might collapse altogether. In addition, weak state capacities might limit the ability of the country to adequately receive and execute money from internationally funded programs.

**Restoring basic infrastructure.** Venezuela's economic and social recovery will be contingent on its ability to restore basic infrastructure, such as electricity, cooking gas, water supply, and public transportation.<sup>103</sup> If this recovery is too slow, due to technical factors or conditions inherent to each of these sectors, or if it is delayed due to the lack of political cooperation or weak state capacities, the country could easily reverse course politically or quickly breed social instability due to slow economic growth. Venezuela is one of the most urbanized countries in Latin America, and, as a consequence, the restoration of these services needs to be focused on the largest cities, such as Caracas, Maracaibo, Valencia, Puerto la Cruz, Barquisimeto, Puerto Ordaz, and San Cristóbal. Electricity blackouts are particularly severe in the western provinces. Water supply rationing and the low quality of water have become particularly acute in the large metropolitan areas in the coastal areas.<sup>104</sup> In Caracas, more than a million inhabitants are exposed to contaminated water. Nationwide, only 30 percent of the population has access to safe drinking water, compared with 60 percent two decades ago.<sup>105</sup> Most public transportation systems have been abandoned because the infrastructure, particularly buses and trains, has been degraded.

If political change does in fact occur in Venezuela, citizens will expect this transformation to rapidly be translated into a better quality of life. Therefore, the speed of reforms, as well as adequately managing people's expectations on the timeline of the restoration of basic services, should be a central concern for any policymaker. In other words, the diagnostics and the planning of needed resources, as well as the identification of potential hurdles, should be determined in advance to be ready to go from day one. If some of these obstacles are so significant that they could have a serious impact on the speed for restoring these basic services, then policies should also account for temporary solutions that can alleviate the situation in the short term. Otherwise, a disruptive social



or political event could easily jeopardize the success of any reform program. Planning for a persuasive communication campaign to manage citizens' expectations on this subject will also prove to be critical.

**Social unrest.** Low-income sectors have become extremely dependent on the government's clientelistic social programs, independently of whether they are in the form of food or cash transfers.<sup>106</sup> Obviously, the need to maintain and reinforce some of these social outlets will be needed. However, introducing targeting mechanisms to improve these programs and introducing changes to reduce the influence of clientelistic distribution networks or even remove existing groups, such as the *colectivos*, that currently manage some of these programs, will be very challenging.<sup>107</sup>

On one hand, due to people's low trust in public institutions, any change in these programs needs to be effectively perceived by citizens as a better solution than the previous system. If reformers fail to convince the population, citizens might perceive that they are being deprived from these subsidies, even if they are not, in a moment when they are more dependent on them. On the other hand, modifying clientelistic practices can incentivize chavista political groups with powerful social grassroots networks, such as the *colectivos*, against these changes, helping them mobilize violently in the streets against reforms. In other words, policy changes in social programs should be made with extreme care, without altering their scope and by addressing the risks involved in dismantling powerful clientelistic interest groups that could promote social unrest.

**Organized crime.** In order to recover the rule of law and reduce crime rates, any new transition government will need to restore territorial control over areas dominated by *colectivos*, megabandas, and guerrilla movements. Most of these groups currently control, or influence, the drug trade, gasoline smuggling, and illegal mining in the country, especially along the Arco Minero del Orinoco.<sup>108</sup> Organized crime has also been able to penetrate several state institutions, including the Armed Forces and police agencies.<sup>109</sup>

Therefore, any attempt to recover the rule of law and strengthen security and police agencies will be violently resisted by these armed groups. In other words, political change might create new imbalances of power that could foster violent conflict, not only between the state and organized crime but even between these different groups in their attempt to protect their existing territory or expand to new ones.<sup>110</sup> This risk is so important that any reform should seriously consider including internal security and tackle organized crime, as well as strengthen the judicial branch. If this aspect of reforms is not addressed correctly, there will be two risks. First, if not weakened, organized crime could potentially capture any well-intentioned new policymakers and derail reform efforts. Second, citizens might perceive that political change has not been able to reduce crime rates in the country and expand the control of the state over the territory. Both these risks could significantly hurt institutional changes.

**The Armed Forces as a corporate actor.** Restoring civilian control over the military will be a critical challenge for any transition government in Venezuela attempting to consolidate democracy. However, the Armed Forces are not only a critical political player—with a strong presence in many different state agencies at all levels of government—but they also hold control over strategic industries such as oil, construction, agriculture, mining, and petrochemicals.<sup>111</sup> Refocusing their activities onto security and defense, rather than on social and economic development, will not be an easy endeavor, particularly given the fact that they control huge rents from these different sectors outside their core function.<sup>112</sup> As a consequence, the Armed Forces could block or veto potential key sectoral economic decisions, particularly those oriented to opening these sectors to private investment and to restructuring state-owned enterprises. Policymakers should not underestimate the potential of this actor to spoil these types of reforms. The only way to reduce these risks is to conceptualize a reform program that allows the Armed Forces to play a key role in the reconstruction of the country—by, for example, reinforcing their role in restoring security and defense, and at the same time, giving them a fiscal benefit from these changes in order to secure alternative rents for the institution.<sup>113</sup> If neither of these conditions is met, the probability that the Armed Forces could undermine reforms is very high. The military could even decide to directly politically destabilize the democratization process.

**The COVID-19 Shock:** On March 13, 2020, Venezuela reported its first two cases of COVID-19, the virus that brought the world to a halt.<sup>114</sup> COVID-19 tested public health systems and government administrations' abilities to manage the crisis. Latin America became the epicenter of the virus, and Venezuela's already-present risks and challenges were exacerbated.<sup>115</sup> Even as Venezuela's situation worsened, tens of thousands of Venezuelans returned to the country; considering that 75 percent of Venezuelans work in the informal sector in Colombia and 90 percent in Peru, it was practically impossible to find sources of income during the pandemic.<sup>116</sup>

With only one laboratory conducting polymerase chain reaction tests for COVID-19 in the country and an underreporting rate of over 95 percent, Venezuela's limited basic infrastructure cannot hold.<sup>117</sup> Venezuela ranks 176th out of 195 in the Global Health Security Index, has the worst testing capacity in the region, has hospitals that lack running water, has a public health sector with only 80 intensive-care-unit beds for the entire population, and has fairly common blackouts.<sup>118</sup> Returning migrants have been stigmatized and considered "bioterrorists" and "biological weapons" by the state and, according to Amnesty International, are sent to quarantine centers with dire conditions surveilled by the military.<sup>119</sup>

The state's Armed Forces have increasingly used coercive means to ensure compliance with quarantine measures.<sup>120</sup> Additionally, due to the United States' secondary sanctions against Venezuela, oil has become a scarce resource, closely controlled by the military.

With reduced gasoline, the logistical distribution of food and essential goods has become very costly and challenging, and has, by extension, had an impact on basic food prices.<sup>121</sup> According to a woman interviewed by *The New Yorker*, “eggs now cost more than the monthly minimum wage.”<sup>122</sup> Famine has also been one of the detrimental results of the pandemic.<sup>123</sup> Most recently, a pair of senior citizens, Silvia and Rafael Sandoval, were found dead due to famine.<sup>124</sup>

In addition to worsening access to food and basic services and medical assistance, the COVID-19 pandemic has also become an excuse for the regime’s Armed Forces, colectivos, and other armed groups to exercise greater coercion under the premise of security, and thus further concentrate power and authority.<sup>125</sup> Between May and July 2020, Foro Penal reported 257 arbitrary arrests.<sup>126</sup> With severe, even deadly repercussions for violating lockdown measures, protests have dropped by almost 70 percent, from over 440 before the pandemic to less than 140 during the lockdowns.<sup>127</sup>

During the pandemic, opposition cooperation has also faltered as the legislative elections have approached. According to Datanálisis’ May 2020 Omnibus survey, respondents had a more favorable view of Maduro’s management of the pandemic and Juan Guaidó’s approval has weakened, and Maduro’s regime has strengthened as an authority figure during the pandemic.<sup>128</sup> The approaching legislative elections have raised concerns among opposition leaders, who have consequently fragmented along their stances on the means for a transition and on the veracity of the legislative elections.<sup>129</sup> In addition, according to Datanálisis, only 16 percent of Venezuelans would vote in the legislative elections.<sup>130</sup>



Venezuelan line up to buy a food in Caracas.  
Photo courtesy of Shutterstock.com/ Rommel Gorosabel

## ENABLING REFORMS

Venezuela can reconstruct the country around different factors that can empower political, economic, and social actors in order to successfully rebuild its institutions, reduce the risk of violence, mitigate social unrest, and diminish the likelihood of political and policy instability. Highlighting these factors is tremendously important in order for policymakers to leverage them and therefore increase the probabilities for success in different policy areas. Some of these enabling factors will be the result of quick wins from the reform process itself; others could be considered strengths inherited from Venezuela's history or from its immediate previous situation. In either case, these enabling factors will be critical for providing support in the mobilization of resources and fostering popular support for the reconstruction of the country.

**Macroeconomic reforms.** Due to hyperinflation and economic depression, stabilizing prices and resuming economic growth will be extremely popular across all income sectors. Unlike reform efforts in the past, when reforms were unsuccessfully conducted after an oil boom, macroeconomic stabilization will now take place after the largest oil bust in the country's history.<sup>131</sup> If the macroeconomic stabilization program is credible and adequately implemented, and if social and humanitarian assistance is also implemented effectively, rapid gains from reforms should be observed. These gains, in turn, should empower reformers to continue pushing for more complex changes in public services and institution building. In several Latin American countries that have experienced hyperinflation—such as Bolivia, Peru, Argentina, and Brazil—macroeconomic stabilization programs have translated politically into popular presidents capable of implementing a reform agenda. In this sense, the dramatic backdrop of Venezuela's economic collapse might provide fertile ground for people to not only demand a stabilization program but also support it over time.

**The oil sector.** Although oil might be seen as a curse, because the country needs to diversify its economy to be less exposed to changes in crude prices, it is also Venezuela's most important asset in the short term to attract private investment, recover production, and generate more exports.<sup>132</sup> Therefore, economic growth can be rapidly resumed by opening up the oil sector to private investment. New capital investment will most likely not be attracted in the initial phase. However, operational expenditures through different arrangements between PDVSA and the private sector may be developed, even under the current legislation, to grow production.<sup>133</sup> The fact that several important global oil players, which know the operational barriers faced to increase production, are already in the country could facilitate the private sector's appetite to expand its production presence in the country. In a second phase, once the hydrocarbon legislation is reformed to attract new foreign investment, the oil sector could expand further.

Since 2017, due to bad economic policies and poor management, but also because of severe financial and oil trade sanctions by the United States, oil production has declined by more than 1 million bpd. Since secondary sanctions were enacted in August 2019, several operators, such as Rosneft and Chevron, have either closed or been forced to wind down production. India has also been forced to stop buying oil from PDVSA, and China has reduced its commercial risk exclusively to its own production in the country.<sup>134</sup> As a consequence, Venezuela was producing less than 350,000 bpd in September 2020. In a scenario where political change occurs and oil sanctions are lifted, the private sector could help increase production, under appropriate conditions, by a margin of 150,000 to 200,000 bpd.

Therefore, it could take 9 to 16 years to bring oil production back to where it was before Chávez's arrival to power in 1998 (if the investment environment is adequate), for a total reconstruction of the oil sector. According to Francisco Monaldi, "for each 100,000 [bpd] per year of production increase, about \$4 billion per year in additional investment would be required."<sup>135</sup> Overall, rebuilding the oil sector to where it was will take almost a decade. In addition, rebuilding the sector during that same period will require attracting more than \$160 billion in investments, which will certainly help fuel economic growth.

**The private sector.** Unlike other foreign debt crises in Latin America, Venezuela's private sector was not leveraged internationally. The foreign debt crisis in Venezuela has been circumscribed to the public sector. This is because the private sector could not access international credit due to foreign exchange controls for almost two decades. As a result, if the private sector perceives that the reform effort is both credible and sustainable, and if property rights are protected and consumption recovers, it will be willing, in the short and medium terms, to leverage its current idle capacity in order to monetize.<sup>136</sup> Multilateral institutions working on private-sector development will be key for Venezuela's economy to rapidly restore its access to international trade finance as well as to foreign capital investments. In addition, recapitalizing Venezuela's financial sector and opening it again to foreign investment will be essential.<sup>137</sup> Therefore, the private sector will be in a privileged position to support the expansion of the economy, from the very start, if it perceives that political and the institutional change is irreversible, and if the macroeconomic economic stabilization program delivers appropriate results.

**Existing infrastructure.** Before Venezuela's economic collapse, the country enjoyed a reasonable infrastructure for Latin American standards, especially in telecommunications, electricity, water, and roads. Because of the economic collapse, the country has underperformed the regional median in most infrastructure indicators. Most of the degradation of the existing infrastructure stemmed from the lack of capital investments, low maintenance expenditures, poorly managed state-owned enterprises, pervasive corruption, and poor regulation—in other words, from poor service provision.<sup>138</sup> Because of these problems, there is no doubt that part of this infrastructure is obsolete, though



some is still recoverable; the real question is how much time will it take for infrastructure to become operative. If the reform effort is able to remove some of these constraints, the country could quickly restore parts of this existing infrastructure. If achieved, citizens will rapidly perceive these improvements in their quality of life, and people could consequently continue supporting reforms.

**Citizens' preferences for democracy and market reforms.** The values of most Venezuelan citizens remain prone to supporting democracy and market reforms. In general, people are open to trade and to the participation of the private sector. However, citizens do believe that, in an oil economy, the state should provide them with social protections both in good and bad times. According to Latinobarómetro, a strong majority of Venezuelans support democracy, are open to international trade, and position themselves at the center of the ideological spectrum.

However, most Venezuelans have very low levels of social trust toward other citizens, perceive the state as corrupt, believe that public decisions are made to favor powerful interests, and think that the distribution of income is unequal. Acknowledging these strong beliefs could be very important in helping cement public discourse that supports the modernization of the state, strengthening the rule of law, and the promotion of market reforms as long as social benefits are progressive, accessible, and stable. The real challenge for reformers will not be convincing citizens of the need for institutional and economic change; rather, it will be to balance fiscal policy that can deliver good social services to low- and middle-income sectors while opening the country up to private investment. These policies will be supported as long as the government, at all levels, is able to strengthen transparency, promote competition, and improve democratic accountability.

**The diaspora and remittances.** The diaspora could be seen as a potential risk rather than a resilience factor for Venezuela's recovery. If economic and political change occur, refugees might return and could, in turn, add more social stress to an already fragile situation. However, their return could also pose an important element to reunite families and the country. In fact, the diaspora could support the recovery process in Venezuela through two very different channels: remittances and professional networks.

As the size of Venezuela's 5 million diaspora continues to grow, the importance of remittances will also increase dramatically. According to a recent Inter-American Dialogue report, remittances represent the second-largest source of foreign earnings, after oil.<sup>140</sup> In 2019, unofficial estimates projected that remittances surpassed \$4.5 billion a year, or over 7 percent of GDP for 2019. More than 35 percent of the country's households receive remittances from abroad on a regular basis, receiving between 40 and \$200 per person a year.<sup>141</sup> Overall, remittances have become a crucial source of income for the population in Venezuela across socioeconomic classes.



In the scenario of political change, most of the diaspora will not necessarily return in the short and medium terms, but will most likely continue supporting their relatives in Venezuela. In fact, those who return in a first wave may be refugees or individuals who have been unable to find stable jobs abroad. But more important, if the rest of the diaspora with stable jobs abroad perceives an improvement in the country's situation, they will be more willing to send higher amounts of remittances to Venezuela as a means to invest in housing or small businesses, as is the case in Ecuador, El Salvador, the Dominican Republic, and Colombia. As of today, the diaspora uses remittances as a way to share their income with relatives as a means of survival or to supplement their current income—not as an instrument for savings or investment at home. If political and economic conditions improve substantially, remittances could become an important short- to medium-term source of revenue that would be key to the revival of consumption and igniting the local economy.

The Venezuelan diaspora, due to its size, is also well organized abroad. Global networks have been formed, particularly among professional groups. The likelihood that these individuals will return to Venezuela to participate in the reconstruction process is low—unless they perceive that the returns from their human capital are much higher in the country, despite the degree of political uncertainty encompassing the process. For example, oil engineers might feel more likely to return than other professionals such as doctors, software developers, or well-trained managers. Notwithstanding, many of these professionals remain committed to participating in the reconstruction from abroad indirectly, or even directly.

As with similar diasporas from India or Pakistan, Venezuelans will rapidly engage with their local counterparts by using modern telecommunications technologies to create knowledge communities and, thus, provide innovative solutions to different problems, mentor or finance local business or social entrepreneurs, contribute to rebuilding universities and research centers, actively participate in social programs, and contribute to cultural activities that can help restore the country's social capital and its national pride. In other words, the diaspora will become a fundamental pillar of the country's reconstruction, especially from a moral, financial, and knowledge perspective.

**Regional and local governments.** Venezuela has historically had a very centralized government. Federalism has been a dormant political aspiration, with some significant efforts to introduce administrative and fiscal decentralization in the 1990s. However, regional identities both in the eastern and the western parts of the country are very strong. Beyond Caracas, Venezuela has more than seven cities with large populations. Some of them have very strong business communities backed by a resilient entrepreneurial culture. The best way to restore public services, and to address the delivery of health care and the quality of education, will be by engaging regional and local governments. The local economy will be easier to rekindle if regional business

communities feel included in the reconstruction process. Local communities will also feel more democratically empowered if they perceive that regional and municipal governments are more accountable. Otherwise, a bloated central government, with weak state capacities plagued by corruption, will most likely fail at this huge task. By contrast, decentralizing these responsibilities could help—although it will not be a guarantee—to mobilize territorial resources for the reconstruction and recovery process, and can simultaneously, contribute to the modernization and democratization of the state.



Girl sings the national anthem at rally in support of Venezuelan National Assembly President Juan Guaidó.  
Photo courtesy of Shutterstock.com/ Ruben Alfonso

## CONCLUSION

Two decades of chavismo had left behind a legacy of social, political, and economic structures that now represent the biggest obstacles to the successful reconstruction of Venezuela. Chávez and Maduro after him successfully created the kind of state that would ensure their hold on power. From weak institutions to a military that controls the country's key industries, and armed groups that distribute rents, Venezuela's Bolivarian revolution seemed designed to perpetuate itself indefinitely.

The reasons why the country collapsed—the legacy—and the reasons why this collapsed state has endured so long, are the same reasons that constrain the ability of future policymakers to solve some of these problems. Designing solutions for big development problems will be easier than effectively implementing them.<sup>142</sup> This does not mean that a reform program during a transition period will most likely fail; it just suggests that policy implementation will require much planning and will need to mobilize political support and international financial resources in the right direction. According to Abraham Lowenthal and David Smilde, the first step toward an effective transition is negotiations grounded in stakeholders' shared interests and their will to compromise.<sup>143</sup>

One factor that could ease the effects of the chavismo legacy is the type of political change that may occur in Venezuela in the near future. Ideally, a clean break with the past resulting from domestic and international pressures would increase the leverage of a transition government to cope with these barriers and, thus, consolidate democracy and promote market reforms. Regretfully, it is still uncertain whether political change will occur, and if it does, it is unlikely that the break will be clean cut. The factors sustaining the status quo pose formidable obstacles.

But the odds against political change are also debatable because of the size of Venezuela's collapse and the intensity of the international pressure to address the underlying legitimacy and governability crisis in the country. International calls seeking a political solution, particularly via some type of negotiation, have emerged not only from countries in the Western Hemisphere and Europe but also from China and Russia. During the last two years, both the regime and its political opposition have sought a negotiated solution; however, the process, under the mediation of Norway, stalled. One scenario is that these talks could resume and that a political settlement could be reached allowing for some type of consensual political settlement as well as for free and fair democratic elections.

As of today, however, a conflict-ridden path remains more likely in Venezuela. The opposition bets that the legitimacy crisis, street protests, and international pressure will be sufficient to break the military's support for the regime. But as time passes,

the likelihood of this outcome is nil. The military is a corporate actor with very large vested political and economic interests. Therefore, it has become the pivotal actor in any noncooperative solution to changing the status-quo. As a corporate actor, it will privilege any political path that shields it from what it might perceive as threatening international and domestic actors trying to divide it or jeopardize its vested interests. In other words, the alternative that the opposition has been pushing for, as its preferred theory of political change, is viewed by the military as a scenario that threatens its interests—hence its continued protection of the regime.

As a consequence, the military will only favor a path toward democracy, most likely with other internal factors within the regime—and some support from more moderate opposition actors—that allows it to play that same pivotal role, protect its rents, and simultaneously obtain sufficient institutional guarantees. If true, this scenario will create enormous challenges for reformers, particularly in those areas in which policy change could affect the Armed Forces' interests.

In any of these different scenarios, here is a set of seven common policy recommendations for policymakers in general:

1. Reform efforts should focus most of their resources on restoring macroeconomic stabilization, reigniting growth, fighting poverty, and fixing Venezuela's infrastructure. But by themselves, these reforms will not guarantee sustainability, even in the short term. There are many factors, beyond macroeconomic stability, that policy-makers will need to tackle to achieve sustainability emerging from deeply rooted institutional and social problems in the country.
2. The biggest challenge in Venezuela is building state capacities. If the country is not able to strengthen these capacities, economic and social reforms will struggle. Therefore, any program should include, as one of its main objectives, strengthening these capacities within the state. Due to the enormous challenge that this process entails, attracting human capital to the public sector, with the knowledge and appropriate skills, will be one of the most critical factors. Therefore, international financial institutions should facilitate resources to support the public sector directly by enabling it to attract this type of talent.
3. The transition toward open markets will be a critical component of any reform agenda. Due to the state's heavy involvement in the economy, which includes large and inefficient state-owned enterprises in almost every productive sector, this effort will require strengthening the rule of law, reinforcing property rights, redesigning legislation, setting up adequate regulatory agencies, and promoting public-private partnerships and the privatization of some of these state-owned enterprises. As a consequence, private-sector development should also become a key focus of reform.

4. Institutional reforms should aim at reducing rent seeking and corruption as well as modernizing the public sector to make it more efficient and transparent. International cooperation could play a key role in helping the country set up institutions that enforce fiscal sustainability rules, change public procurement rules, reduce corruption, and increase transparency.
5. Organized crime is one of the biggest threats to Venezuela's economic and political development. The Armed Forces and police forces need to regain control of the territory in order to displace these different groups. This process will not only entail the use of force to combat crime but will also encompass shrinking the size of illegal markets by reducing price subsidies and changing and enforcing regulations. A comprehensive reform agenda needs to address these issues in order to reduce the risks fostered by organized crime. However, breaking up these groups, without a clear policy oriented to redress their interests, could lead to a wave of violence like in El Salvador, Honduras, Mexico, or Colombia.
6. The different problems that emerge from clientelistic practices embedded within existing social outlets need to be addressed. However, changing these outlets entails huge political and social risks. Therefore, policymakers need to guarantee that any improvement in the scale, focus, and distribution of these social benefits is perceived as a better outcome than the existing system. Otherwise, social violence could be sparked, either spontaneously or by organized political groups, which would in turn destabilize the whole political process underpinning reforms.
7. Finally, Venezuela's political system is extremely volatile, and therefore consensus building will be required. Consultation mechanisms that guarantee consensus building through a democratic deliberation about policy reforms should be promoted in the different areas where different types of changes are being planned.

## Notes

- 1 The data used in the report combine information from independent, international, and local organizations and institutions, in order to complement nationally reported data, as they tend to be manipulated.
- 2 See Emmanuel Abuelafia and José Luis Saboin, *A Look to the Future for Venezuela* (Washington: Inter-American Development Bank, 2020), 1, <https://publications.iadb.org/publications/english/document/A-Look-to-the-Future-for-Venezuela.pdf>.
- 3 The figure on child malnutrition has been reported by Caritas, the largest Venezuelan NGO working on nutritional issues in the country. See Caritas, “Venezuela Exports Migrants with Acute Malnutrition,” February 12, 2019, <https://www.caritas.org/2019/02/malnutrition-venezuela/>. These numbers improve once remittances are considered given their positive impact on poverty alleviation.
- 4 Abuelafia and Saboin, *Look to the Future*, 21–23.
- 5 See Macartan Humphreys, Jeffrey Sachs, and Joseph E. Stiglitz. *Escaping the Resource Curse* (New York: Columbia University Press, 2007); and Michael L. Ross, *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (Princeton, NJ: Princeton University Press, 2013).
- 6 See Javier Corrales and Michael Penfold, *Dragon in the Tropics: The Legacy of Hugo Chavez* (Washington: Brookings Institution Press, 2015); and Miriam Kornblith, “Latin America’s Authoritarian Drift: Chavismo After Chávez?” *Journal of Democracy* 24, no. 3 (2013): 47–61.
- 7 See Corrales and Penfold, *Dragon in the Tropics*; and Orçun Selçuk, “Strong Presidents and Weak Institutions: Populism in Turkey, Venezuela and Ecuador,” *Southeast European and Black Sea Studies* 16, no. 4, (2016): 571–89.
- 8 Robert Rotberg, “The Failure and Collapse of Nation States,” in *When States Fail: Causes and Consequences*, ed. Robert Rotberg (Princeton NJ: Princeton University Press, 2004), 1–50.
- 9 Dorothy Kronick, “Profits and Violence in Illegal Markets: Evidence from Venezuela,” *Journal of Conflict Resolution* 64, nos. 7–8 (August 2020): 1499–1523 ; International Crisis Group, “Gold and Grief in Venezuela’s Violent South,” International Crisis Group, February 28, 2019, <https://www.crisisgroup.org/latin-america-caribbean/andes/venezuela/073-gold-and-grief-venezuelas-violent-south>.
- 10 Charles Larratt-Smith, “Here’s Why Venezuelan President Nicolás Maduro Is Still in Power,” *Washington Post*, August 14, 2019, <https://www.washingtonpost.com/politics/2019/08/14/heres-why-venezuelan-president-nicolas-maduro-is-still-power/>.
- 11 Venezuelan Investigative Unit, “Colombia and Venezuela: Criminal Siamese Twins,” InSight Crime, June 27, 2019, <https://www.insightcrime.org/investigations/colombia-venezuela-criminal-siamese-twins/>.
- 12 John Polga-Hecimovich, “Organized Crime and the State Under Chavismo,” in *The Criminalization of States: The Relationship Between States and Organized Crime*, ed. Jonathan Rosen, Bruce Bagley, and Jorge Chabat (Washington: Lexington Press, 2019), 189–207.



- 13 See Ross Dayton, "Maduro's Revolutionary Guards: The Rise of Paramilitarism in Venezuela," in *CTC Sentinel* 12, ed. Paul Cruickshank (West Point, August 2019), 31–36; and Kyra Gurney, "Venezuela's Leftist Collectives: Criminals or Revolutionaries?" *InSight Crime*, March 1, 2019, <https://www.insightcrime.org/news/analysis/venezuela-leftist-collectives-criminals-or-revolutionaries/>.
- 14 Tom Phillips, "Venezuela: Opposition Leader Declares Himself Ready to Assume Presidency," *Guardian*, January 11, 2019, <https://www.theguardian.com/world/2019/jan/11/venezuela-maduro-juan-guaido-assume-presidency>.
- 15 Datanálisis, Encuesta Nacional Ómnibus, August 2019.
- 16 See Benedicte Bull and Antulio Rosales, "Into the Shadows: Sanctions, Rentierism, and Economic Informalization in Venezuela," in *European Review of Latin American and Caribbean Studies / Revista Europea de Estudios Latinoamericanos y Del Caribe*, no. 109 (2020): 107–33.
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- 18 See Ricardo Hausmann and Francisco Rodríguez, *Venezuela: Anatomy of an Economic Collapse* (State College: Pennsylvania State University Press 2014); and Corrales and Penfold, *Dragon in the Tropics*.
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Venezuelans protest in the street against the government for human rights violations and killings of civilians in peaceful demonstrations. Photo courtesy of Shutterstock.com/ GMEVIPHOTO



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