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Venezuela: Public Debate and the Management of Oil Resources and Revenues

Ricardo Villasmil

Introduction

Ever since the oil price boom began in 2004, Venezuela has worked hard to become the poster child of natural resources and their revenue streams. Despite having the largest oil reserves in the world and having been at the receiving end of the longest and largest oil price boom in history, Venezuela managed to seriously cripple its domestic oil industry and its national oil company in particular through political capture, saddling it with social and political mandates, non-oil investment-related debt, firing most of its best-trained professionals and destroying its credibility in the oil industry and in the financial markets. Furthermore, the country squandered resources far and beyond the extraordinary revenue

R. Villasmil (✉)
Center for International Development, Harvard University, Cambridge, Massachusetts, USA

International Centre for Energy and the Environment, IESA, Caracas, Venezuela
stream. As a result, Venezuela now finds itself overburdened with high public debt, significant arrears and unsustainable external and fiscal deficits.

Mismanagement has not been confined to the petroleum sector. Venezuelans now experience widespread scarcity of essential goods, exploding inflation, high and growing levels of violence, recurrent violations of political and civil rights, human and financial capital flight, political conflict with neighbouring countries and a rapid deterioration in the capacity of the state to provide even basic public goods, let alone the protection of life and property. Moreover, these problems began surfacing before the oil price collapse of the second half of 2014. And after that, of course, the situation took a turn for the worse.

The extreme nature of the Venezuelan experience makes it a case well-suited for examining the general argument presented in the introductory chapter of this book. With Venezuela, the hypothesis would be that the disastrous evolution described above is the result of dysfunctional institutions for resource and revenue management and that these, in turn, are the result of a lack of open and dynamic public debate in the country. This chapter analyses the validity of this hypothesis in the case of Venezuela.

The first section presents and describes Venezuela’s recent experience from the management of its petroleum resources and revenue. The second section provides an assessment and discussion of the current state of the institutional indicators relevant to the management of petroleum resources and revenues. Next follows an assessment of the role played by public debate in the outcomes described above. The fourth section reassesses the general validity of the general hypothesis of this book in light of a puzzling feature of the Venezuelan experience, at least with regard to the resource curse literature: throughout the five decades that followed the discovery of large-scale oil deposits in 1922, Venezuela’s performance was nothing short of phenomenal in terms of economic, social and institutional indicators. My argument can be summarized as follows: the institutional arrangements that governed the petroleum sector and its relations with key players (mainly the state and Venezuelan society) were efficient in static terms—that is, under the particularly favourable conditions that characterized the period 1922–1972—but
lacked dynamic efficiency, the capacity to evolve and adapt to the radically different environment that emerged afterwards. Open public debate was a key victim of the economic, social and institutional decomposition that followed, and any future attempts to reconfigure the institutional matrix should take this into account. Finally, the fifth section of this chapter sums up the analysis and offers some conclusions.

**Venezuela’s Recent Experience with the Management of Oil Resources and Revenues**

Hugo Chávez came to power in 1999 promising drastic changes in the management of oil resources and revenues. In real terms, oil prices were at a 25-year low and poverty rates just below the 25-year high of 1996. Chávez saw the collapse in oil prices as a natural consequence of the oil glut created by an ill-conceived—and, in the Venezuelan case, illegal—opening up of large oil reserves to foreign investment, a policy that had been designed by the oil majors and large oil-consuming nations, lobbied by the International Monetary Fund and other multilateral organizations and followed by Chávez’s two predecessors.

Chávez adopted a three-pronged strategy: 1) a stridently resource-nationalist rhetoric, 2) radical organizational and legislative changes, enacted through the use of executive powers with scant public consultation and enforced with almost-theatrical violence; and 3) boldness in action, bolstered by a string of early victories and recognition of the opportunities and the leverage provided by momentous changes underway in the world economy and in the oil market in particular. These changes pushed oil prices to record levels and shifted power from the oil majors to national oil companies and from Europe and the USA to China and India.

The government followed this strategy in a patient and piecemeal fashion that proved successful in reshaping key oil resource and revenue management institutions as well as in gaining control of all the relevant players in the game. The former was done chiefly through the enactment and implementation of the new Liquid Hydrocarbons Law of 2001, the
passing of the Central Bank reform law of 2005 and a sequence of special laws governing new taxes on oil revenues.

The first concrete expression of a policy shift came in November 2001, when the government made use of an enabling law to approve a new Liquid Hydrocarbons Law that increased royalty rates from 16 to 30% and lowered the income tax rate applicable to conventional oil activities from 67.7 to 50%, with a 34% rate for non-conventional or extra-heavy oil activities. The new law also stipulated a government share of no less than 51% in any new venture in Venezuela’s oil sector, but did not impose conditions on existing associations, recognizing that the new terms would render them commercially unviable at existing oil price levels. The technocratic management of the national oil company Petróleos de Venezuela (PDVSA) was taken over after a failed oil workers’ strike in 2002.

In 2004, the price of Venezuelan oil jumped to USD 32 per barrel, a sharp increase from the USD 14 per barrel price current when these associations were formed, and royalties on oil production coming from the Orinoco Oil Belt were increased from 1 to 16%. In 2005, the price of Venezuelan oil climbed to USD 46 per barrel. Due to its failure to adjust the parameters of contracts awarded at much lower price levels, PDVSA was paying an average of about USD 18 per barrel to the operators of service agreements—compared with production costs of USD 5 per barrel in PDVSA’s own operations. Again, the government decided to force the companies into accepting the shift to joint ventures established in the 2001 Liquid Hydrocarbons Law in a way that portrayed the companies as bandits. In the end, 26 of the 32 service agreement operators accepted the new terms, perhaps indicating that these terms might have been negotiated without the trauma caused by this process.

In May 2006, the government imposed the terms stipulated in the 2001 law on companies operating in the Orinoco Oil Belt. This included a change in ownership where the government now owned no less than 51% of the shares, the above-mentioned tax structure (royalties at 30% and income tax at 50%) and the jurisdictional sovereignty of Venezuelan courts. BP, Chevron, Statoil and Total agreed to stay under these new
terms. ConocoPhillips and ExxonMobil decided to leave, and the government confiscated their assets.

The 2005 Central Bank reform was arguably the most dramatic change affecting the management of the petroleum sector in Venezuela. Instead of all foreign exchange revenues having to be sold to the Central Bank, PDVSA would now be required to convert only the amount needed to pay its expenses, taxes and other contributions. Together with contributions from the Central Bank above what the government determined to be optimal levels of international reserves, the rest would be transferred into a newly created national development fund, Fondo Nacional para el Desarrollo Nacional (FONDEN). These funds would be managed at the President’s discretion and with no obligation to comply with otherwise mandatory transfers to state and local governments. Between 2005 and 2012, FONDEN received over USD 117 billion, all with negligible accountability and no oversight by the National Assembly.

The most salient special law governing taxes on oil activities is the ‘Decree with the Rank, Value and Force of a Law Creating a Special Contribution on Extraordinary Prices and Exorbitant Prices in the International Hydrocarbons Market’ (Extraordinary Official Gazette 2011). This replaced the Law on Special Contributions over Extraordinary Prices of the International Hydrocarbons Market (the ‘Law’), published in the Official Gazette No. 38.910 dated 15 April 2008, and created a new contribution to be determined by international quotations of Venezuelan crude.

The government gained greater influence over the petroleum sector: by taking control of PDVSA after the failed 2002 oil-worker strike; by absorbing or reducing the leverage of existing private partners, operators and service providers in the oil industry; by taking absolute control of the National Assembly and the Supreme Court after the opposition boycott of the 2005 elections; by selecting PDVSA as provider of choice for a growing number of private and public goods and social services, many outside its sphere of expertise;1 and by silencing the opposition media through political and economic coercion or outright closure or expropriation.
In an extraordinary turn of events, President Chávez regained his powers after the difficulties of 2002 and 2003—two nationwide strikes, dozens of massive demonstrations calling for his dismissal and early opinion polls predicting he would be ousted from the presidency in a midterm recall referendum. Scarcely 3 years later, his hold on power was virtually uncontested and unchecked, particularly when it came to the country’s petroleum resources and revenues.

The drastic nature of the changes in the management of petroleum resources and revenues was ideologically justified by the need to do away with representative democracy, along with other conservative features of a bourgeois state, in favour of participatory democracy and the revolutionary arrangements of twenty-first-century socialism. The price paid for choosing this route, however, was a hefty one. PDVSA became increasingly opaque and spiralled into growing operational and administrative chaos. International agencies (including OPEC and the IEA) as well as independent consultants began to question official production figures and other statistics. Partners and service providers were increasingly paralysed by uncertainty. Production figures tumbled: PDVSA’s 2006–2012 business plan established a production target of 5.837 million barrels per day in 2012—an increase of 2.516 million barrels per day from 2006—but official figures state that production in 2012 was 2.910 million barrels per day (411 thousand barrels per day below target) (Petroleum World 2007). Moreover, accidents during operations increased in frequency and intensity, and despite the rapidly rising oil prices, mounting debt and arrears indicated that the financial situation of PDVSA and the public sector as a whole was becoming increasingly unsustainable—again, long before the oil price collapse of 2014. Venezuela’s annual report on Form 18-K to the US Securities and Exchange Commission for the fiscal year ending 31 December 2013 recognizes the existence of consolidated public sector deficits of 17.5 and 16.9% of GDP for 2012 and 2013. Meanwhile, Central Bank data on foreign public debt rose from USD 26.4 billion at the end of 2003 to USD 38.8 billion by the end of 2008 and USD 112.6 billion by the third quarter of 2014 (the latest available official information). This figure does not include significant and growing arrears with private importers, government partners and service providers, among others.
Current State of Institutional Indicators

Venezuela does not participate in the Extractive Industries Transparency Initiative (EITI), a global multi-stakeholder initiative promoting transparency and good governance in natural resource management. As of November 2016, the EITI had 41 implementing countries. Membership requires from each government a clear commitment to transparency, a work plan setting the objectives for what the country wants to achieve with the EITI and a multi-stakeholder group with the participation of companies and civil society.

Other indicators show significant weaknesses in terms of many relevant variables relevant to the management of petroleum resources and revenues in Venezuela. FONDEN, the oil revenue and excess international reserves fund, provides very little information, and that only sporadically, regarding the use of more than USD 100 billion that have been channelled through it since its establishment in 2005 (Reuters 2012). As mentioned above, PDVSA and the Oil Ministry provide minimal operational and financial information and then only with great delays. Moreover, the government has taken deliberate steps to avoid having to provide information to the US Securities and Exchange Commission. The only information on oil resources and revenues that is regularly published is the basket price for Venezuela’s oil—again, without any details on the presumably varying composition of the basket.2

The 2015 Worldwide Governance Indicators ranking, produced by the World Bank, ranks Venezuela quite unfavourably on all its dimensions. The ranking system indicates the percentage of countries that rate below the given country. Venezuela’s percentile ranking results include: voice and accountability (18.72), political stability/violence (18.93), government effectiveness (10.10), regulatory quality (2.88), rule of law (0.48) and control of corruption (4.81). The Open Budget Index gauges whether governments provide the public with timely access to comprehensive information contained in key budget documents in accordance with international good practice standards and gives countries covered by the Open Budget Survey a transparency score on a 100-point scale. In 2015, Venezuela was placed in the ‘scant to none’ category, 94th out of the 103 countries surveyed. With a score of 23/100, the government was found
to be ‘weak’ in providing the public with opportunities to engage in the budget process; with its score of 39/100, also the legislature was weak in its performance of budget oversight. The 2014 Corruption Perceptions Index ranks Venezuela 161st out of 175 countries, with a score of 19/100. The 2013 Global Corruption Barometer, produced by Transparency International, found that 57% of Venezuelan citizens held that corruption had increased substantially in the preceding 2 years, 8% that it had increased somewhat and 19% that it had remained the same; only 11% felt that it had decreased little and 6% that it had decreased. Moreover, 57% found the government to be very ineffective in attacking corruption, 19% ineffective and 24% very effective.

The situation regarding transparency and accountability worsened considerably in 2015 and 2016. PDVSA and the government have become increasingly opaque regarding operational and financial performance indicators. In its defence, the government has argued that economic performance data are being used by oppositional forces to generate unrest among the population. In late 2015, the Central Bank stopped publishing macroeconomic data, including key statistics such as inflation, GDP and balance-of-payments accounts. In addition, fiscal data provided by the Ministry of Finance are scant and outdated.

**Assessment of the Role Played by Public Debate**

The animosity of the Chávez government towards representative democracy and the promotion by Chávez of ‘participatory democracy’ in its place heralded a new form of public debate in Venezuela. The legitimacy of forums like parliament and the media, and of participants like opposition leaders, government bodies, political parties, NGOs, business and labour organizations and independent media, has been severely questioned; people are shunned, harassed and silenced in various ways. In addition, the separation of powers of government institutions has been all but erased.

places Venezuela in the 168th position out of 197 countries surveyed—and therefore in the ‘Not free’ category:

[President] Maduro’s administration hampered the opposition media by arbitrarily fining outlets, enforcing licensing requirements without respecting due process rights, and excluding certain outlets from access to public information. High-level government officials constantly demonized opposition-aligned outlets and exerted systematic pressure on the tone and content of reporting.

According to the 2014 Human Rights Watch World Report on Venezuela:

the accumulation of power in the executive branch and the erosion of human rights guarantees have enabled the government to intimidate, censor and prosecute its critics. While many Venezuelans continue to criticize the government, the prospect of facing reprisals – in the form of arbitrary or abusive state action – has undercut the ability of judges to fairly adjudicate politically sensitive cases and forced journalists and rights defenders to weigh the consequences of publicizing information and opinions that are critical of the government. (Human Rights Watch 2014)

As the many instances of politically motivated harassment, prosecution and even sentencing attest, the reprisals are all too real.

As an alternative to representative democracy, the regime has advanced the idea of ‘participatory democracy’, implemented through a new architecture referred to as the ‘Communal State’ and defined by new forms of participation of the population, self-organized in popular assemblies, communal councils and other arrangements that underpin what it terms ‘twenty-first-century socialism’. This alternative was rejected in the 2007 Constitutional Proposal—but has nevertheless been advanced, in clear violation of the Constitution, through the approval of a series of laws and executive action by the Ministry of Communes.3

The Communal State is an illiberal state where appointments and decisions are made in assemblies. Elected representation through suffrage and democratic means is replaced by spokespersons who may be dismissed by the assembly. The Human Rights NGO Provea sees it as a ‘type
of community participation that does not comply with the characteristics of freedom of association and assembly, reiterating its discrimination on account of political reasons’ (Provea 2014). And Margarita Lopez Maya, a Venezuelan historian and political analyst, argues that ‘instead of reaching for a greater and deeper decentralization of State powers in order to give way to a strengthening of society, the empowerment of popular organizations and expanded citizenship, we advance instead towards the recentralization of the Petrostate, its strengthening against civil society and the manipulation from above of community organizations from the top…’ (López Maya 2014).


The picture that emerges is one of Venezuela as a classic victim of the ‘resource curse’, certain to be confirmed if the analysis were extended back to the late 1970s, when the country began its long and tragic economic, social and political decline. Indeed, Venezuela during the period 1978–2014 ranks as the worst-performing economy in Latin America and one of the worst in the world. Between 1978 and 2010, Venezuela had the third-lowest cumulative GDP per capita growth rate (a negative 12%) among the 45 countries with data since at least 1978 in the Angus Maddison database.

However, if we look even further back in time, to the first half century after oil was discovered (1922–1973), a strikingly different story of economic, social and institutional emerges, together with sharply different attitudes towards public debate regarding oil resources and revenues. During this period, Venezuela stood out as the one of best economic performers in the world, with noteworthy achievements in public health, literacy, education, basic infrastructure and, importantly, democracy and civil liberties in a region marred by military dictatorships and civil rights abuses. Between 1922 and 1957, Venezuela ranked first in the world in
terms of cumulative GDP per capita growth among the 48 countries with data since at least 1922 in the Angus Maddison database (711%, followed by the USSR with 485%). Extending the analysis to 1972 (the year preceding the oil shock), we see that Venezuela ranked second, a cumulative GDP per capital growth of 756%, surpassed only by the USSR with 892%.

How can we account for this reversal of fortune? How could oil disguise itself as a powerful engine of political, economic and social progress for five decades before revealing itself as a curse? To answer this question, we must go back in time.

On 14 December 1922, Venezuela made the front page of the New York Times with a picture of Los Barrosos II, an oil well in the Maracaibo basin, blowing a column of oil 200 feet into the air after destroying the derrick. ‘The most productive in the world’, read the accompanying article—and immediately, international oil companies began the scramble for oil concessions.

The financial terms governing pre-existing oil concessions were highly favourable for investors, the result of a lack of interest in a malaria-infested tropical country lacking basic infrastructure and with dubious prospects of mineral riches. The eventual discovery and exploitation of oil was followed by legal struggles between the Venezuelan government and the concessionaires, with the latter getting the upper hand time and again as a result of the legal strength of their contracts and the diplomatic leverage of their parent companies with the US and British governments.

In the early 1940s, however, the tide turned in favour of Venezuela’s demands, due to changes in external and domestic conditions as well as skilled negotiating by the Venezuelan government. The most salient external change was the heightened strategic importance of securing access to Venezuela’s oil after the 1938 Mexican Revolution and the USA’s new ‘Good Neighbor’ policy towards Latin America. And on the domestic front, pressures came for modernization in the political arena as a result of rapid economic and social changes.

The 1943 Hydrocarbons Law was subjected to an unprecedented process of public consultation and discussion. On 17 January 1943, the government called for a public discussion in which 20 representatives from
different sectors of society—including Romulo Betancourt, the fiercest and most important opposition leader—expressed their positions in front of more than 50,000 Venezuelans.

The 1943 Hydrocarbons Law and the accompanying 1944 Income Tax Law allowed for a rapid and sustained expansion between 1944 and 1970 of both oil production and tax rates. In turn, the resultant expansion in oil revenues allowed Venezuela to become one of the best economic, social and political performers in the region, perhaps in the world (see Figs. 19.1 and 19.2).

Analysis of two other key events related to oil resource and revenue management—the government’s 1961 decision not to grant new oil concessions and the 1975 Nationalization Law—shows that they were made in the context of widespread consultation and open public debate under a relatively strong institutional framework (see Table 19.1).

Monaldi and Penfold (2014) argue that the oil boom and bust of the 1980s ended a weak cooperative framework based on rent-sharing and sent the country into a downward spiral. The trigger was the 1973 oil boom, misinterpreted as a permanent shock. Under the cooperative game, a growing ‘pie’ meant greater pressure from all players to obtain what each saw as its fair share. When it became evident that the shock had been a temporary one, it was already too late. The authorities were forced to deal with large fiscal and balance-of-payments deficits, significantly amplified by the sudden increase in foreign debt payments due to the hike in interest rates prompted by a contractionary monetary policy aimed at reducing inflation in the USA. The reluctance of the commercial banks to renew sovereign loans after Mexico defaulted in 1982 forced Latin America as a whole into the debt crisis and the protracted recession that became known as ‘the lost decade’. Venezuela became one of the worst economic, social and political performers in the region and in the world (see Fig. 19.3).

As noted by Naim and Piñango (1985) and by Monaldi and Penfold (2014), the institutional framework was simply not designed to deal with large and sudden reductions in oil revenues. The tacit cooperative framework between PDVSA and the government broke down in 1983, as a
Fig. 19.1 Oil production and government take on oil exports, 1926–1970. Sources of data: Ministry of Oil and Mines, Statistical Bulletins
Fig. 19.2  GDP per capita 1922–1978, selected countries. Source: Maddison Historical Statistics of the World Economy
Table 19.1 Main features of key institutional changes in Venezuela’s petroleum sector

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Fig. 19.3  GNI per capita 1974–2010, selected countries. Source: Maddison Historical Statistics of the World Economy
result of the government’s decision to address its desperate need for foreign exchange by taking over PDVSA’s foreign currency deposits. PDVSA retaliated by engaging in a highly controversial foreign investment plan in upstream facilities, justified by the need to guarantee markets for Venezuelan oil but widely seen as a roundabout way to hide funds that would otherwise be confiscated by the state. A few years later, PDVSA started to open up large-scale oil reserves to foreign investment, a measure with a questionable legal basis that encountered strong opposition from the left-wing parties that would eventually rally around Chávez (see Table 19.1).

Hausmann and Rodriguez (2015) hold that the distinguishing feature of resource-abundant countries is not their aggregate growth performance but their incapacity to recover from adverse shocks. The case of Venezuela indicates that oil price volatility, the misinterpretation of temporary price shocks as permanent ones and the incapacity to change course once this became evident may have been at the root of the country’s prolonged decline from the 1980s onwards (see Fig. 19.4).

The institutional arrangement that had proven so successful until 1973 in a context characterized by stable prices, production increases and growing fiscal take was not well suited to the new environment of volatile prices, declining production and falling fiscal take. In his seminal work on institutions, Nobel Memorial Prize economist Douglass North argued:

[I]t is adaptive rather than allocative efficiency which should be the guide to policy. Allocative efficiency is a static concept with a given set of institutions; the key to continuing good economic performance is a flexible institutional matrix that will adjust in the context of evolving technological and demographic changes as well as shocks to the system. (North 1990)

Pascale et al. take this argument one step further, and hold that, although long periods of equilibrium may appear ideal, they are in fact a curse:

Coping mechanisms that have atrophied during long periods of equilibrium usually prove inadequate for the new challenge … At certain scales
Fig. 19.4  Oil price volatility, 1946–2015. Source: St. Louis Fed database
(i.e., small) and in some time frames (i.e., short), equilibrium can be a desirable condition. But over long intervals of time and on very large scales, equilibrium becomes hazardous. Why? Because the environment in which an organism (or organization) lives is always changing. At times, it is turbulent. Prolonged equilibrium dulls an organism’s senses and saps its ability to arouse itself appropriately in the face of danger. (Pascale et al. 2007, 21)

Conclusions

Although Venezuela’s experience since the 1980s seem to make it a classic example of the resource curse, I argue that a resource curse perspective fails to explain the country’s spectacular economic, social and institutional performance through five decades after oil was first produced on a large scale. This period was characterized by a relatively strong institutional framework, open public debate and widespread consultation regarding how to manage the petroleum sector and its resources.

A longer view of the Venezuelan experience shows that the country’s impressive performance between 1922 and 1972 was fragile, given its incapacity to adapt to the drastically different environment that evolved afterwards, characterized by high oil price volatility and large and abrupt declines in oil revenues. As a result, the country opted to rely increasingly on what Naim and Piñango (1985) have called the ‘illusion of harmony’. Lopez Maya (2011) argues that, as faltering performance became evident, Venezuelans began questioning the model and the hegemonic arrangements of a democracy that was dominated by the narrow interests of the political parties. When Hugo Chávez proclaimed this as a defining principle of a new order, he was voicing an idea that already enjoyed considerable agreement and legitimacy among a significant number of Venezuelans.

And what of public debate? Considering the scope and magnitude of the economic, social and institutional devastation, it would be naïve to think that public debate in Venezuela could have survived, yet alone prosper. No, it should be counted—to paraphrase Aeschylus—as one of the first casualties. Today it has become imperative to rescue and
encourage public debate, consciously and actively given its specific importance in the promotion of adaptive as opposed to merely static efficiency.

Notes

1. PDVSA Agriculture and PDVAL in food production and distribution; PDVSA Services in exploration, drilling and other oil services; PDVSA Industrial in manufacturing; PDVSA Engineering and Construction; PDVSA Shipping; PDVSA Urban Development; PDVSA Communal Gas.
2. The basket price is the weighted average of the price at which the different qualities of crude oil exported are sold in a given period.
4. For a detailed account of the negotiations between Venezuela, the oil companies, the US State Department and the British Foreign Office that led to the 1943 Hydrocarbons Law and the 1944 Tax Law, see Rabe (1982). Machado (1990) also deals with the public debate on this issue.

References