

Chapter 4 The Critical Role of Economic Freedom in Venezuela's Predicament

Hugo J. Faria and Hugo M. Montesinos-Yufa

1 Introduction

The goal of this introduction is to clarify important terms that are employed in the analysis of the Venezuelan predicament. Rising income per capita across an increasing number of countries is ultimately associated with the quality of formal economic institutions and informal institutions also known as culture.¹ According to North (1990), formal institutions, which are created by the polity, comprise rules and laws, as well as constitutions. Informal institutions, which are intergenerationally transmitted, are made up of norms of behavior, conventions, and self-imposed code of enforcement (Alesina and Giuliano, 2015).

In this paper, formal economic institutions are measured by the index published in *Economic Freedom of the World* (EFW) by the Fraser Institute and built over the years by James Gwartney, Robert Lawson, and Joshua Hall. The EFW index contains a set of economic institutions and policies that provide the rules of the economic game. High levels of economic freedom (EF) create an environment conducive to the maximization of voluntary transactions given demand and supply.²

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- 1 For recent evidence, see Ang, 2013; Acemoglu, Gallego, and Robinson, 2014; Faria, Montesinos, Morales, and Navarro, 2016; and Bennett, Faria, Gwartney, Montesinos, Morales, and Navarro, 2016; and Bennet, Faria, Gwartney, and Morales, 2016.
 - 2 Increasing EF can also expand voluntary transactions by shifting to the right demand and supply functions. For example, improvements in the protection of property rights may reduce the risk perception of the country, shifting the supply to the right both by the entrance of new suppliers and by a reduction in the cost of doing business. Similarly, lowered risk perception may enhance confidence, enticing new consumers into the market, and shifting demand curves to the right.

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Rules that maximize voluntary transactions are inclusive institutions. Free trade, legal infrastructure protective of properly acquired private property, and sound money are examples of inclusive institutions. Rules that unnecessarily diminish voluntary transactions are exclusionary institutions. Examples of exclusionary institutions are price controls, minimum wage laws, and nationalizations of companies (Faria and Filardo, 2015).³

Political institutions are measured by Political Freedom (PF), which is a proxy for democracy, and is calculated as the average of the civil and political rights indices, published by Freedom House (2015). Culture is measured by trust and the individualism-collectivism cleavage. Data on these two cultural variables are provided by Alesina and Giuliano (2016).

The rest of the paper has the following structure. Section 1 presents a brief historical account concerning the economic and political institutions of Venezuela. Section 2 compares the behavior through time of Venezuela and Latin America in the EFW index and discusses the joint behavior of economic and political institutions for Venezuela starting in 1980. Section 3 documents the variations of Areas and components of EFW responsible for the changes in economic freedom documented in Section 2. Section 4 attempts to uncover the influence of cultural legacy, French legal origin, and human capital on the evolution of economic freedom, while Section 5 concludes, addressing the manifold consequences of having a low level of economic freedom.

1.1 Brief historical account of Venezuela from the 1800s to 1960

Simon Bolivar, who is known as the liberator and the main founder of Venezuela as a nation, was highly skeptical of the virtues of democracy for Venezuelans (Bolivar, 2003; Hernandez, 2012). Moreover, it can be argued that, while American founders wanted freedom, Venezuelan generals (*caudillos*) wanted independence from Spain. The intent was to replicate locally the vices that existed with the crown (Uslar, 1962; Fronjosa, 2011). Indeed, the privileges that the local aristocracy had obtained during the colonial period persisted in the aftermath of the independence war (Angeles, 2007; Bruhn and Gallego, 2012).

The war for independence was really a civil war in which most participants of non-European descent, led by Spanish generals, fought in defense of the crown against the local European elites who were perceived, correctly, as oppressors. In fact, Venezuela's independence was established in 1821 by European descendants and for European descendants (Faria and Filardo, 2015 and references therein).

Venezuelans' first taste of democratic rule with free and contested elections in a multi-party system as well as universal suffrage came in 1959, nearly 140 years after independence. This democratic transition was catalyzed by unprecedented years of prosperity starting in 1920, featuring sustained high growth rates, and ending in 1957 (Baptista, 2011; Heston, Summers and Aten, 2012).⁴ These four decades

3 These examples of exclusionary institutions are instances of government failures, on that they needlessly reduce society's welfare. The adverb "unnecessarily" is motivated by the notion that sparingly and intent upon causing the least amount of harm, the government should step in and in the short term reduce voluntary transactions to a level consistent with the social optimum, for example, in the case of negative externalities that are generalized and harmful to society.

4 Venezuela's real income per capita reached its pinnacle back in 1978, and the years between 1958 and 1978 were characterized by low growth rates in comparison to estimated growth experienced from 1920 to 1957. See Faria, 2003, based on data provided by the Central Bank of Venezuela.

of extraordinary economic expansion were triggered by discovery of enormous oil reserves in 1914. Thus, circa 1920 Venezuela decidedly started to escape the Malthusian trap leaving behind the epoch of per-capita income stagnation.

During these years, Venezuela experienced relatively high levels of economic freedom. The period from 1920 to 1957 witnessed remarkable monetary stability made possible either by free banking or a currency board, which through a fixed exchange rate with the US dollar linked the local currency (*Bolivar*) irrevocably to the US dollar. The government owned very few enterprises, the personal marginal tax rate was 12%, oil was extracted and refined by multinational companies, regulations were few, labor laws were flexible, private property was protected, in economic matters people were treated evenhandedly by the judicial system, decentralized corruption was minimal, and the crime rate was low. Finally, fiscal discipline prevailed to the point that government's external and internal debt was paid in full by 1930 (Lahoud, 2015; Sanchez-Coviza and Olcoz, 1966).⁵

Arguably, the advent of democracy and political freedoms sprang from high levels of economic freedom that promoted a flourishing economy. In 1960, income per capita of Venezuelans was equal to 45% of the US per capita income (Heston, Summer and Aiten, 2012). Further, the Venezuelan average growth rate in the 1950s clearly exceeded the growth rate of the so-called German economic miracle (Sanchez-Coviza and Olcoz, 1966). Germany was recovering from the devastation wrought by World War II and therefore, like Venezuela, was benefitting in 1950 from the Hayekian "advantage of backwardness". However, Germany had the extra advantage of a high level of human capital per war survivor, whereas Venezuelan human capital was very low. As will be shown later, inclusive economic institutions prevailing at the time that oil was discovered easily compensated for the human capital deficit of Venezuela.

1.2 The democratic period from 1959 to 1980—sowing the seeds of democracy's destruction

Unfortunately, the onset of democracy in 1959 brought along with it accelerated deterioration of economic freedom and thus of economically inclusive institutions and policies. Between 1959 and 1980, many exclusionary policies were adopted (see box, page 216, for a list of the most salient). For a better understanding of this accelerated transition from inclusive to exclusionary economic institutions with the onset of democracy, it helps to bear in mind the economic philosophy of the former presidents who presided over the deterioration in institutional quality. Rómulo Betancourt, while in exile during the Gomez administration in the early 1930s, was instrumental in organizing the communist party in Costa Rica. However, over the years Betancourt gradually became a democratic socialist. Rafael Caldera was a "Social Christian", educated by the Jesuits, a religious order of the Catholic faith that is often antagonistic to

5 After independence and prior to the advent in 1908 of J.V. Gomez, a ruthless dictator who died in power in 1935, the country was mired by numerous internal armed conflicts and concomitant political instability, rendering economic development impossible. However, Gomez pacified the country providing the foundation for a system of private enterprise. Thus, in economic matters, Gomez as a Venezuelan head of state was an outlier. Manuel Caballero, a well-known Venezuelan historian, wrote a book titled *Gomez, the Liberal Tyrant* (2007), clearly suggesting that Gomez's economic instincts were congruous with the classical Liberal economic philosophy. We will have more to say on Gomez in section 5.

The Most Salient Exclusionary Policies Adopted by Venezuela, 1959–1980, and the Presidents Who Initiated the Policies

- 1 European and Latin American immigration was substantially curbed—Rómulo Betancourt;¹
- 2 creation of OPEC, founded by the Venezuelan secretary of energy—Rómulo Betancourt;
- 3 establishment of CORDIPLAN, an economic planning agency—Rómulo Betancourt;
- 4 an end to the extension of tract lands to oil multinationals to find and extract oil reserves—Rómulo Betancourt;
- 5 creation of the *Corporación Venezolana del Petróleo (CVP)*, a government company in the oil business—Rómulo Betancourt;
- 6 agrarian reform, or redistribution of agricultural lands, where the new “owners” did not receive a property title but only a right to farm the land—Rómulo Betancourt;
- 7 marginal income-tax rates at the personal level were tripled from 12% to 36%, and numerous tax brackets created, increasing complexity of the tax system—Rómulo Betancourt;
- 8 rent controls and strengthening the legal capacity of the rent-payer to remain in the property after contract expiration and against the will of the owner—Rómulo Betancourt;
- 9 exchange-rate controls and devaluation of the Bolívar—Rómulo Betancourt;
- 10 price controls—Rómulo Betancourt and Raúl Leoni;
- 11 the Central Bank Law was amended to allow lending to the government by the central bank—Rómulo Betancourt;
- 12 minimum-wage decrees and rulings to prohibit dismissal of workers—Carlos Andrés Pérez;
- 13 nationalization of the Central Bank (which had been 49% owned by the private sector), iron industry, and oil industry—Carlos Andrés Pérez;
- 14 rampant corruption at all levels of government, including the judicial system—Rafael Caldera and Carlos Andrés Pérez;
- 15 national policy of “import substitution”, increasing the cost of living to average Venezuelans as well as reducing the benefits conferred by a greater choice of goods to buy, let alone the inefficient allocation of resources—Rómulo Betancourt and Raúl Leoni;
- 16 complex regulations that stymie business formation, increase the cost of dismissal, and compel banks to allocate loans to sectors deemed by the government as strategic—Carlos Andrés Pérez.²

¹ See on this Centro Latinoamericano y Caribeño de Demografía (CELADE), 2000.

² For a more detailed account, see Faria, 2008.

free markets.⁶ He turned out to be no less socialist than Betancourt. Carlos Andrés Pérez turned out to be more of a pragmatist, particularly during his second term. However, during his first constitutional term the central bank, and the oil and iron industries were nationalized, and these policies epitomize socialism.

A complementary factor explaining nationalizations is the accompanying power associated with *de facto* ownership by politicians in the government of enormous corporate resources. The irony of the socialist rhetoric is that nationalizations are performed allegedly to empower the people by bestowing on them ownership of key corporate resources. However, these “owners” cannot sell their share in the business and do not receive any income generated by the business operation. Meanwhile, elites in the private sector salivate over these policies, destructive of markets, because it is their custom and culture to accumulate wealth through political connections.

2 Pattern of economic freedom 1980 to the present

2.1 Comparison of the evolution of economic freedom in Venezuela and Latin America

The EFW rating of Venezuela in 1980 was relatively high: it had a score of 6.69 (figure 4.1). However, to place this rating in perspective, in the same year Hong Kong's rating was 8.62, nearly two points higher. Further, Venezuela's 1980 rating was markedly lower than its rating of 7.0 in 1970. This result should not be surprising based on some of the exclusionary policies adopted (Section 1.2). It is also worth noting that in 1980 Venezuela's EFW rating was substantially higher than Latin America's average of 5.06.⁷ In other words, Latin America enjoyed only 75% of Venezuela's economic freedom.

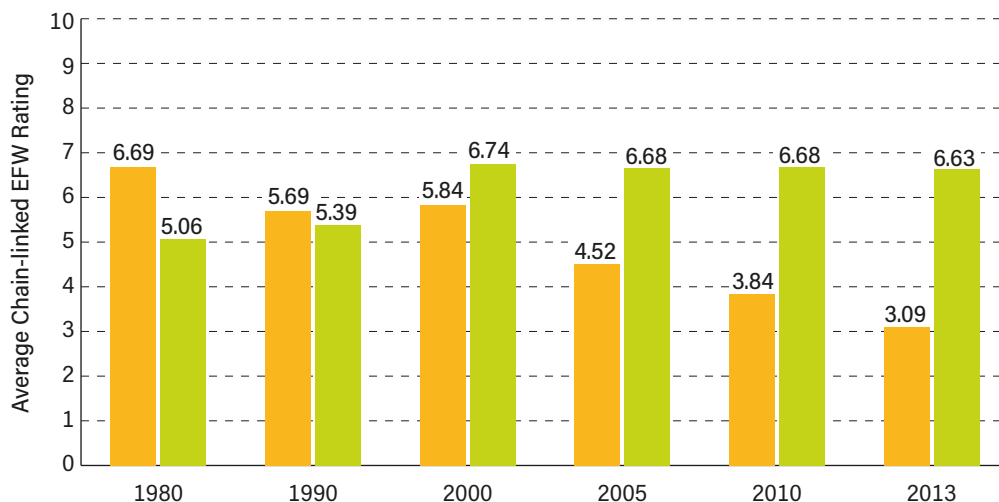
By 1990, ten years later, the ratings for economic freedom of Venezuela and Latin America were nearly the same, as Venezuela's had dropped by a full point to 5.69 and Latin America's had moderately increased by a one third of a point, rising to 5.39. The main culprit for Venezuela's decline in economic freedom was the accelerated inflation suffered by the country in the wake of the 1983 devaluation.

In the year 2000, there was a marginal increase in Venezuela's rating for economic freedom of 0.15 in comparison to 1990. This increase masks a precipitous decline to 4.3 observed in 1995, spawned by major reversals of some policies of economic liberalization adopted in 1990 but overturned with a vengeance by reinstating unnecessary regulations and controls in 1995. The spike in 2000 is owed to the International Monetary Fund's economic recipe, which the government reluctantly accepted in 1996/1997 in the face of the major disarray and prostration of the economy. It goes without saying that the crisis of 1996 originated in the economic U-turn of 1994/1995.

6 Fidel Castro was a Jesuit alumnus in Cuba. Pope Francis, who for Catholics has profound and enlightening reflections on religious issues but, lamentably, generally ignores the achievements of markets and fails to distinguish between cronyism and market allocation, is also a Jesuit. One of the co-authors of this article was educated by the Jesuits and can attest to the anti-market bias instilled into numerous cohorts of students in Jesuit schools.

7 The following 18 countries were included in the calculation of the simple arithmetic average of the chain-linked EFW index for Latin America in the year 1980: Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela. Data for these countries was also used to calculate the average for Latin America in figure 4.1; data for Guyana was included from 1995 onward.

Figure 4.1: Pattern of Economic Freedom for Venezuela and Latin America, 1980–2013



Sources: Gwartney, Lawson and Hall, 2015a; authors' calculations.

After the almost serendipitous freedom increase of the year 2000, economic freedom in Venezuela has headed in a single direction: downhill. This descent remains the case up to the day of this writing. The overall cause of this loss of economic freedom is the exacerbation of the exclusionary policies and institutions adopted after 1959 and through to 1999, prior to the advent of the Chavez-Maduro administrations. More specifically, there is no qualitatively discernible difference between the economic policies and institutions adopted throughout the so-called Fourth Republic, spanning the years from 1959 to 1999, and those policies adopted by the Chavez-Maduro regime, also known as the Fifth Republic. The difference is quantitative. To mention a few, higher inflation, more nationalization, greater numbers of goods and services subjected to price controls, and more shortages as well. In sum, more unnecessary reductions of voluntary transactions spawned by additional exclusionary institutions.

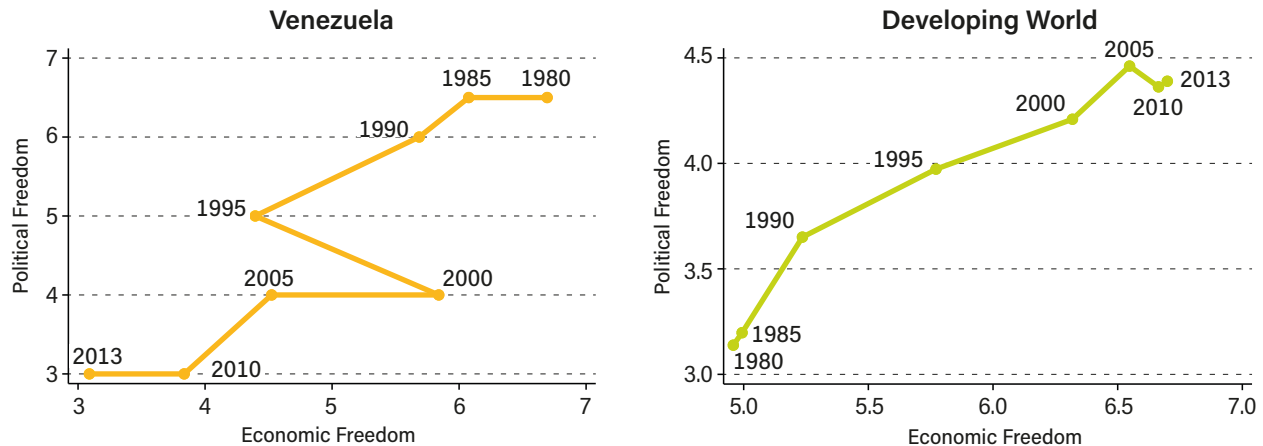
The qualified good news is that, in spite of Venezuela's performance, Latin America's average level of economic freedom has increased. The drawback is that economic freedom in Latin America has remained at a plateau of approximately 6.68 since the year 2000, with a slight tendency to decrease. To provide some perspective, a country with a rating of 6.68 in the latest edition of the EFW index would be ranked 100th in the world out of 157 countries, down among the third quartile of countries.

2.2 Evolution of Venezuela's economic and political freedoms from 1980 to 2013

This subsection attempts to cast light on the co-evolution of political freedom and economic freedom in Venezuela. To glean a greater understanding of this issue we will contrast Venezuela's results with those of the developing world and the world as a whole aided by graphical results. Further, we inquire if the graphical results are compatible with the hypothesis of portraying economic freedom as a predictor of political freedom.⁸

⁸ Figures 4.2, 4.3, and 4.4 are based on the graphical exhibits of Lawson and Clark, 2010.

Figure 4.2: Contrasting the Historical Evolution of Political and Economic Institutions in Venezuela and in the Developing World



Sources: Gwartney, Lawson and Hall, 2015a; Freedom House, 2015.

Figure 4.2 presents contemporaneous behavior of both freedoms. The Venezuelan graph to the left suggests that starting in 1980 economic institutions and policies measured by the EFW index generally deteriorated with the sole exception of the spike from 1995 to 2000 discussed earlier. The graph discloses a deterioration of political freedom concurrent with that of economic freedom.

Importantly, for the Venezuelan case, both freedoms generally move from the top right to the bottom left suggesting a decaying process. On the contrary, for the developing world, both freedoms move from the bottom left to the top right of the graph, suggesting an increase of both freedoms and implying an improvement of the political and economic institutional quality.

Figure 4.3 is similar to figure 4.2 except that economic freedom is lagged five years in relation to political freedom. The graph for Venezuela on the left conveys information qualitatively similar to that in the corresponding graph in figure 4.2. In spite of the five year lag of economic freedom, both freedoms move in tandem. That is reductions in economic freedom are a precursor of declines in political freedom.

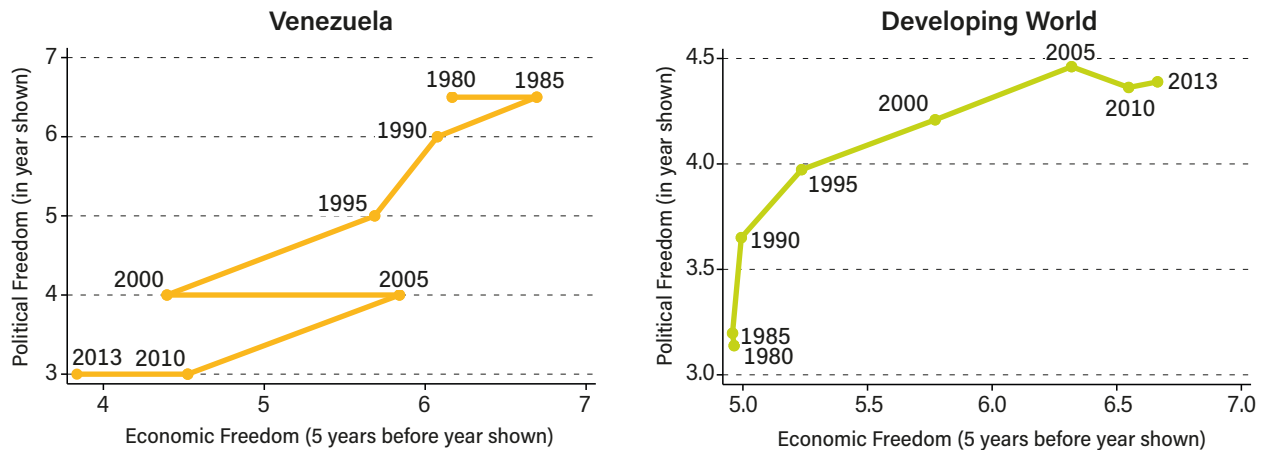
We note that this is what the emblematic English case would predict except, of course, that in England economic and informal institutional quality improved preceding the advent of rule of law and democracy. Venezuela, in contrast, is a case where democratic leaders valued political freedom over economic freedom, resulting in the dissipation of both freedoms.

For the developing world and using lagged EFW data, we find results similar to those in figure 4.2. In fact, lagged increases in economic freedom generally lead to higher levels of political freedom.

Figure 4.4 displays the co-evolution of economic and political freedoms for the world. The graph to the left shows contemporaneous behavior of both freedoms, while the graph to the right lags EFW by five years. For both graphs, political and economic freedoms jointly evolve from the bottom left corner to the top right corner, conveying the information of increasing world freedoms for the period from 1980 to 2013. In addition, the graph on the right-hand side suggests that lagged increases of EFW data predict greater political freedom.⁹

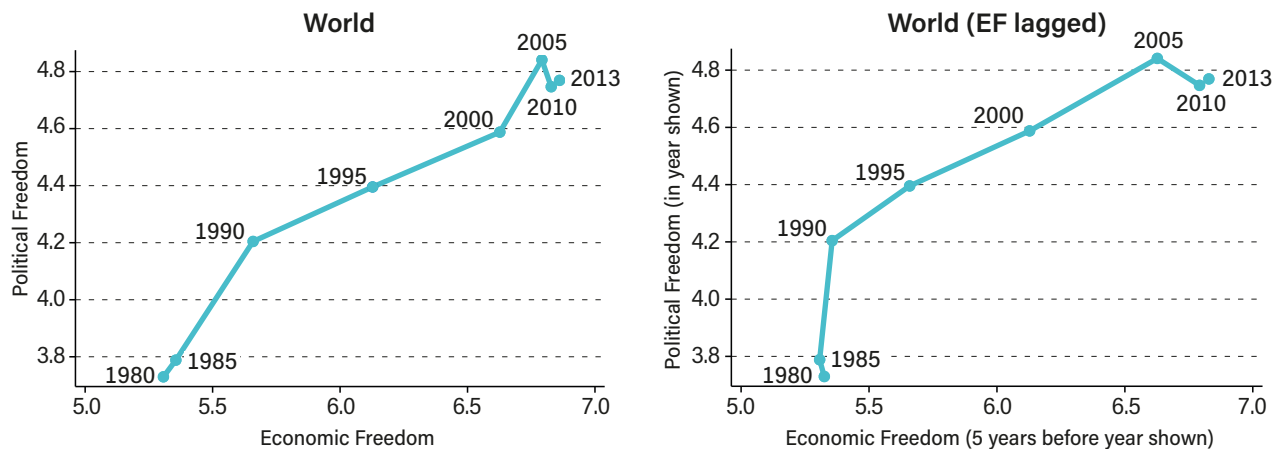
9 For a formal treatment of these issues, see Montesinos, 2016; Boudreaux and Holcombe, forthcoming.

Figure 4.3: Contrasting the Historical Evolution of Political And Economic Institutions in Venezuela and in the Developing World—Economic Freedom Lagged 5 years



Sources: Gwartney, Lawson and Hall, 2015a; Freedom House, 2015.

Figure 4.4: Evolution of Economic and Political Freedoms for the world



Sources: Gwartney, Lawson and Hall, 2015a; Freedom House, 2015.

We suggest a potential channel of influence of economic freedom on democracy for the Venezuelan case. Based on English constitutional history and the Parliament’s auspicious decision to starve the Crown, we contend that it is very difficult to sustain a flourishing democracy when the government obtains substantial revenue that is not financed by taxes levied on the people.¹⁰ In Venezuela, more than 50% of the government’s revenue derives from oil production; thus, the government is the *de facto* owner of the oil wealth, resulting in the citizens’ dependence on the government for sustenance. Yet, a reverse condition—whereby the politicians and bureaucrats are financially supported by the people—is a necessary condition for a sustainable democracy with good quality of government.

10 Pipes (1999: 133) argues that Parliament made sure the Crown did not gain fiscal independence. Milner argues that “[t]he Crown became poorer and poorer, and when compelled to resort to Parliament, had to surrender constitutional rights in return for funds” (1931: 248). On the contrary, the basis of absolutism in France and Spain was the Crown’s financial independence (Pipes, 1999: 154).

State ownership of the “commanding heights” of the economy is another insidious socialist institution that deprives people of democracy, as well as an accountable and high-quality government. One potential reform consistent with both economic freedom and accountability of government would be to distribute the oil proceeds among all citizens born in Venezuela that are at least 21 years of age. A government deprived of the oil revenues would be more sensitive to the costs and benefits accompanying taxation and spending¹¹

3 Analysis of major changes in the Areas and components of the EFW index

A closer examination of the Areas and components of the index from *Economic Freedom of the World* reveals a footprint of the economic institutional path in Venezuela. **Table 4.1** displays the chain-linked summary index and chain-linked areas in Venezuela for the years 1980, 1990, 2000, 2005, 2010, and 2013. In addition, it shows the corresponding average ratings for Latin America, the 24 long-standing OECD countries, and the World in the same period. This allows a comparison of Venezuela with these groups of countries in terms of the relative quality of their institutions in each of the five main areas of the index.

The first striking observation is that institutions in Venezuela deteriorated almost systematically and uniformly in all periods and areas. The only exception to this dramatic decline is in the 1990s and it is due to increases in Area 3: Sound Money, Area 4: Freedom to Trade Internationally, and Area 5: Regulation. These increases, however, are substantially lower than the gains achieved in the rest of the world and Latin America, in particular. Venezuela's EFW summary rating in 1990 was 5.69 and it went up to 5.84 in 2000, an increase of 0.25 points. In this period, however, Latin America and the World exhibit a greater, and their greatest, increase. Latin America's average EFW rating in 1990 was 5.39 and by 2000 it was 6.74, an increase of 1.35 points. The World's average EFW rating in 1990 was 5.66 and it went up to 6.63 in 2000, a 0.97 point increase. The long-standing OECD countries also went up from an average of 7.23 in 1990 to 7.90 in 2000, an increase of 0.77 points. During the 1990s, Venezuela's EFW rating moved from being above the World and Latin American averages, in 1990, to being below average in 2000.

3.1 Decline of Area 2: Legal System and Property Rights

The second striking observation is the systematic and dramatic decline in Area 2: Legal System and Property Rights during the period from 1990 to 2005. The chain-linked rating for Venezuela in Area 2 was 5.70 (already low) in 1990 and it went down to 3.75 in 2000, a decline of 1.95 points. Then it went further down to 1.64 in 2005, the second lowest rating for Area 2 in the World: only the Democratic Republic of Congo, with a rating for its legal system of 1.42 in 2005, was lower. It was the eve of something very bad that was about to take place in Venezuela. The realizations of gains from trade, investment, and entrepreneurial discovery depend critically on the existence of a legal system that protects property rights, provides rule of law, and enforces contracts objectively. By 2010, the Area 2 rating of Venezuela went

11 Another issue, of course, is which taxes ought to be levied to minimize taxation's excess burden and foment accountability.

Table 4.1: Economic Freedom of the World (EFW) index and its five Areas for Venezuela, Latin America, OECD countries, and the World, 1980–2013

Venezuela							Latin America						
	EFW	Area 1	Area 2	Area 3	Area 4	Area 5		EFW	Area 1	Area 2	Area 3	Area 4	Area 5
1980	6.69	6.29	6.22	7.40	8.59	4.92	1980	5.06	5.95	3.98	5.01	3.93	5.55
1990	5.69	5.95	5.70	4.74	7.14	4.89	1990	5.39	6.56	4.26	4.86	5.48	5.37
2000	5.84	5.95	3.75	5.56	7.91	6.05	2000	6.74	7.07	4.84	7.89	7.54	6.41
2005	4.52	4.91	1.64	5.10	5.50	5.40	2005	6.68	7.17	4.50	8.11	7.14	6.50
2010	3.84	4.96	1.46	4.72	3.40	4.51	2010	6.68	7.03	4.54	8.16	7.05	6.62
2013	3.09	4.71	1.20	2.74	3.11	3.60	2013	6.63	6.98	4.58	8.18	6.87	6.55
Avg.	4.94	5.46	3.33	5.04	5.94	4.89	Avg.	6.21	6.80	4.46	7.03	6.36	6.20

OECD							World						
	EFW	Area 1	Area 2	Area 3	Area 4	Area 5		EFW	Area 1	Area 2	Area 3	Area 4	Area 5
1980	6.44	4.29	7.18	7.16	7.35	6.23	1980	5.31	5.02	4.96	5.98	4.72	5.48
1990	7.23	4.82	7.90	8.58	8.21	6.64	1990	5.66	5.53	5.25	6.28	5.50	5.59
2000	7.90	5.42	8.57	9.28	9.00	7.21	2000	6.63	6.21	5.97	7.59	7.13	6.32
2005	7.80	5.74	8.35	9.32	8.06	7.52	2005	6.79	6.55	5.86	7.94	6.94	6.70
2010	7.51	5.11	8.05	9.41	7.94	7.06	2010	6.83	6.39	5.88	8.11	7.01	6.76
2013	7.53	5.24	7.93	9.49	7.71	7.29	2013	6.86	6.45	5.78	8.18	6.93	6.88
Avg.	7.40	5.10	8.00	8.87	8.05	6.99	Avg.	6.39	6.05	5.66	7.37	6.44	6.32

Sources: Gwartney, Lawson, and Hall, 2015a; authors' calculations.

down further to 1.46 (last in the World) while the Democratic Republic of Congo moved up to 2.12. By 2013, Venezuela's rating for its legal system was 1.20. Based on the chain-linked rating for Area 2, Venezuela has been in the last position in the World continuously since 2009, among the three worst positions in the World continuously since 2001, and in the fourth (least free) quartile continuously since 1995.

The decline of the quality of the legal institutions in Venezuela was almost uniform as reflected by specific components of Area 2. The components of greatest change since 2000 were: [1] Integrity of the legal system (2E), where the rating went from 6.67 in 2000 to 1.67 in 2013; [2] Impartial courts (2B), where the rating was 3.67 in 2000 and 0.64 in 2013; [3] Protection of property rights (2C), where the rating was 3.40 in 2000 and 0.87 in 2013; [4] Military interference in rule of law and politics (2D), where the rating was 3.33 in 2000 and 0.83 in 2013; [5] Judicial independence (2A), where the rating was 1.67 in 2000, dropping to 0.19 in 2013. All these ratings were initially low on the scale of 0 to 10 and became substantially lower by 2013.

It is not a surprise that the deterioration of the legal system in Venezuela would permeate other areas of the economy and would have implications both for the current Venezuelan crisis and for the fall in other institutional dimensions. Virtually

no country in the world performs well with a low rating for Area 2 because without a good legal structure there is no room for progress. This is the problem of Latin America, where the average rating for Area 2 has been systematically low (below 5.0) despite substantial improvements in monetary stability (Area 3) and mild and erratic improvements in trade (Area 4).

3.2 Decline of Area 3: Sound Money

For Area 3: Sound Money, as table 4.1 shows, Venezuela's rating went from 7.40 in 1980 to 4.74 in 1990; a reduction of 2.66 points. A conspicuous exclusionary institution and policy implemented in 1983 during the government of Luis Herrera was the devaluation of the Bolivar and the adoption of exchange-rate controls. Venezuela's government receives oil revenues in dollars from different types of taxes plus dividends, when they exist, from *Petroleos de Venezuela Sociedad Anonima* (PDVSA), the state-owned oil holding company. When the executive branch devalues the currency, oil revenues denominated in Bolivars automatically increase. Higher Bolivar proceeds allows for more government expenditures and simultaneous expansion of the monetary base, creating inflationary pressures. In Venezuela, therefore, there exists a direct link between devaluation and money creation injected into the economy by means of government spending. Moreover, the government typically devalues for fiscal considerations, influenced by low oil prices, and oil revenues represent on average no less than 50% of total tax revenues.

After a slight increase in Venezuela's rating for Area 3 in 2000, it went systematically down to reach 4.72 in 2010 and 2.73 in 2013. Accelerating inflation accompanied with high volatility, exchange-rate devaluations, and exchange-rate controls are important factors explaining the decline of Area 3 since 2000. The inflationary problem has become increasingly severe, inflicting excruciating pain on average Venezuelans. The latest reports provided by the Troubled Currencies Project from the Cato Institute (Hanke, 2016) indicate that Venezuela's annualized inflation rate hovers around 700%, at the threshold of hyperinflation.

In contrast, Latin America's average rating for Area 3 was 5.01 in 1980, 7.89 in 2000, and 8.18 in 2013. The World's average rating for Area 3 was 5.98 in 1980, 7.59 in 2000, and 8.18 in 2013. The long-standing OECD countries had an average rating for Area 3 of 7.16 in 1980, 9.28 in 2000, and 9.49 in 2013, showing a systematic increase in this area. Therefore, in a World and a region showing substantial progress in providing access to sound money, Venezuela has moved dramatically in the opposite direction. The high and volatile inflation rate creates uncertainty that makes it difficult for Venezuelans, and potential foreign investors, to make intertemporal decisions. The poor performance in Area 3, together with the low rating in Area 2, substantially increases the cost of entrepreneurial activity and doing business.

3.3 Decline of Area 4: Freedom to Trade Internationally

For Area 4: Freedom to Trade Internationally, Venezuela had a rating of 8.59 in 1980, 7.14 in 1990, 7.91 in 2000, 5.50 in 2005, 3.40 in 2010 and 3.11 in 2013. This systematic decline prevents citizens from trade gains and from developing their comparative advantages. Latin America, in comparison, had an average rating for Area 4 of 3.93 in 1980 that went up to 6.87 in 2013. The World had an average rating of 4.72 in 1980 and of 6.93 in 2013. Again, we observe a World and a region moving substantially toward trade liberalization particularly in the period from 1980 to 2000, while in Venezuela freedom to trade internationally is becoming more and more restricted,

particularly since 2000. Venezuela's policy of foreign-currency control that started in 2003 significantly reduced freedom to trade internationally. Since 2003, the approval of the government is legally required to obtain foreign currency using Bolivars (the domestic currency) or *vice versa*. The request is denied in many cases but most often it imposes additional transaction costs that discourage productive activity and encourage unproductive activities. It was customary for people to specialize in obtaining the government's approval to obtain foreign currency in order to sell it in the black market and to repeat the process again for profit.¹² This was possible because of the controls on foreign currency and the high premium on the black-market exchange rate.

The rating of Venezuela in the black market exchange rates component (4C) was 10 in 2000 and has been 0 almost continuously since 2002. At the present time (2016), the situation has worsened compared to 2013. To give an idea of the most recent monetary situation in Venezuela: the average daily black-market exchange rate in the year 2012 was 11.03 bolivars per US dollar (Bs/\$); it was 37.75 Bs/\$ in 2013, 90.71 Bs/\$ in 2014, and 520 Bs/\$ in 2015. The partial average computed up to April 30, 2016 is 1,060 Bs/\$. Thus, in just four years, the number of Bolivars required to purchase a US dollar has increased by approximately one-hundred fold.

3.4 Decline of Area 5: Regulation

For Area 5: Regulation, Venezuela has also experienced a systematic decline from 2000 to the present. With a rating of 4.92 in 1980, it went up to 6.05 in 2000 and then down to 4.51 in 2010 and 3.60 in 2013. Latin America, instead, increased its average rating from 5.55 in 1980 to 6.41 in 2000 and then maintained a relatively stable rating, reaching 6.55 in 2013. The World average reveals a systematic but small improvement in the area of regulation. The average rating for Area 5 for the World was 5.48 in 1980, 6.32 in 2000 and 6.88 in 2013.

The general decline in Area 5 can be seen in its components. Venezuela scored 8.55 in Credit market regulations (5A) and the score here remained high until 2009. By 2010, it went down to 5.93 and by 2013 was 4.76. Latin America's rating, in contrast, for Credit market regulations improved from an average of 5.87 in 1980 to 8.33 in 2000. It has remained relatively stable since then. The World had a path similar to that of Latin America. It started with 5.42 in 1980 and scored 8.33 in 2013. In the component 5B (Labor market regulations), Venezuela exhibited a very low, and decreasing, rating: 4.03 in 2000, 3.61 in 2010, and 2.29 in 2013. Latin America has made progress in Labor market regulations but is still at relatively low level. The average rating of component 5B was 3.73 in 1980, 5.15 in 2000, and 5.58 in 2013. The World has made a little more progress in Labor market regulations, moving from 4.77 in 1980 to 5.16 in 2000 and 6.45 in 2013. Finally, in terms of Business regulations (5C), Venezuela had a rating of 5.57 in 2000, which declined to 3.39 in 2013, a very low level. Latin America's rating has been steady with an average rating of 5.58 in 2000 and 5.89 in 2013. The World has also had a steady rating but with a higher average figure than Latin America. The average rating for the World in the Business

12 For instance, the government imposed foreign currency quotas per person, per year. Soon after a market for those quotas arose. People specialized in buying the quotas for profits. Once they bought the quota, they were allowed (after a certain number of bureaucratic procedures) to buy foreign currency at the official (cheaper) exchange rate. Then, they were able to sell the foreign currency at the black-market (more expensive) exchange rate for profit. They were able to repeat this process again and again.

regulation component was 6.54 in 2000 and 6.41 in 2013. All the numbers for the World and Latin America are higher than the figures for Venezuela, which reflects a tradition of high business regulation and, therefore, low competition in Venezuela.

4 Other deeply rooted factors that have influenced Venezuela's economic freedom since 1980

4.1 Culture

High levels of economic freedom imply a free-market economic system characterized by [1] personal choice, [2] voluntary exchange coordinated by markets, [3] freedom to enter and compete in markets, and [4] protection of persons and their property from aggression by others. However, cultural factors may conspire against the establishment of an economic system characterized by high levels of economic freedom.

For the Venezuelan economy, we discuss the two cultural traits most intimately related to development. First, trust in others, which is the cultural dimension most widely studied in the literature about economic growth. Its importance dates back at least to Arrow (1972), who argued that virtually every transaction has an element of trust and blamed the lack of trust for much of economic backwardness. Algan and Cahuc (2010) identify a significant impact of (inherited) trust on growth.

Dividing by quartiles, from low to high, trust measurements for countries around the world, Venezuela appears in the first quartile. That is, Venezuela is among the countries of the world with the lowest trust level (Alesina and Giuliano, 2015). Other Latin American countries showing up in the lowest-trust quartile are Brazil, Colombia, and Peru. The Latin American country with the best performance for trust is Uruguay, situated up in the third quartile.

Second, the gap between individualism and collectivism is considered by numerous cross-cultural psychologists as the most important cultural cleavage across countries (Heine, 2008). Individualistic societies privilege personal freedom, achievement, and innovation as well as individual rights. Collectivistic societies, in contrast, accentuate conformity and the notion of individuals embedded in large groups, and discourage individuals from dissent and standing out (Gorodnichenko and Roland, forthcoming). These authors uncover a strong and robust relation between individualism and growth.

Venezuela's measure of individualism, in conjunction with the rating of Colombia, Ecuador, and Peru, fall in the lowest quartile among rated countries in the world. Thus, these two key measures of a culture's proclivity to adopt institutions capable of igniting sustained growth show values suggesting a culture inimical to free markets in Venezuela and, in general, in Latin America. This clash between culture and institutions contributes to explain Latin America's rejection of free markets.

Revealingly, the last two decades have witnessed a wealth of research in cultural economics strongly indicating the existence of a direct channel running from institutions to culture. Prominent research in this area are the contributions of Bowles (1998), Di Tella, Galiani, and Schargrodsky (2007), Alesina and Fuchs-Schündeln (2007), Giuliano and Spilimbergo (2014), and Becker, Boeckh, Hainz, and Woessmann (2016). Given the considerable slow-moving nature of culture over time and formidable obstacles to changing it through education, it seems more reasonable to attempt institutional reforms, mostly in the economic sphere, that deliver growth and potentially faster cultural change.

Adoption of institutions and policies consistent with greater economic freedom will spur growth and improved material well-being.¹³ This process elicits a “learning by doing” dynamic, whereby support for the reforms among the people is forthcoming by virtue of their improved standard of living, which in turn may promote an environment more conducive for a cultural change. The changing culture may lead to a set of beliefs and values more amenable to the merits of higher levels of economic freedom. A prime example of this is England, described in section 2.2, where economic institutions in the Malthusian era led to a major cultural change, setting the stage for the onset of the Glorious and Industrial revolutions. Gwartney, Stroup, Sobel, and Macpherson (2015) provide evidence on institutional reforms across the world and over several decades indicating the timing of the reforms. This evidence clearly suggests that economic institutional change of a higher caliber, in terms of inclusiveness, is feasible.

4.2 Historical origin of a country's laws

Another deeply rooted factor that may work against institutional reform of a higher quality is the country's legal origin. Numerous research papers in the field of legal origins have documented that countries belonging to the French civil legal tradition, in comparison with countries in the legal family of English common law, are burdened by higher levels of legal formalism in judicial procedures, less judicial independence, lower protection of corporations' outside investors, higher entry regulations, more rigid labor markets, and greater government ownership of banks and media as well. Moreover, countries in the French civil legal tradition exhibit greater levels of government intrusion via ownership of resources and regulation than common-law countries.

Interestingly, La Porta, Lopez-de-Silanes, and Shleifer (2008) argue that legal origins are central to understanding the different styles of capitalism. Specifically, common-law countries are naturally inclined to rely on market solutions whereas in civil-law countries, particularly in countries where the legal system is of French origin, policies such as nationalization and market suppression are more frequent. Based on the evidence presented, Venezuela can be construed as an extreme case of a country with a legal system originating in French civil law. Venezuela embraces socially conditioned private contracting and not unconditional private contracting; policy implementing and not market-supporting solutions; government allocation of resources replacing markets and not market-driven allocating mechanisms.

Fortunately, the EFW index provides ratings on critical legal institutions that may suggest that a legal reform friendlier to development is convenient. These reforms do not entail a change of legal tradition that would be a radical and more difficult revamping of the legal infrastructure to enact. Reduction of entry barriers and streamlined labor laws are two examples. In other words, like culture, legal origin does not have to be fate.

4.3 Legacy of human capital and the EFW index

Another factor having a negative impact on the EFW index is the low level of educational attainment and particularly of educational achievement. Faria and colleagues

13 To the best of our knowledge, the most recent evidence on the nexus between the data from EFW and development is provided by Faria, Montesinos, Morales, and Navarro, 2016a; Bennet, Faria, Gwartney, Montesinos, Morales, and Navarro, 2016; and by a working paper by Faria, Montesinos, and Navarro, 2016b, who report that economic freedom is a better predictor of development than the individualism-collectivism cultural trait.

(2016a, b) and Bennett and colleagues (2016) provide strong evidence suggesting that cognitive skills, a proxy for the quality of education, have a systematic positive effect on the quality of economic institutions.

Education, a critical component of human capital, historically lagged behind that of the United States and Canada in Latin American countries and particularly in Venezuela. Indeed, Argentina, Costa Rica, and Uruguay, which were the pioneering Latin American countries in promoting education for the population, trailed behind the United States and Canada by more than 75 years. In 1925, Venezuela's literacy rate occupied the penultimate position among Latin American countries, surpassing only Guatemala (Sokoloff and Engerman, 2000). Lamentably, a great misfortune still plagues Venezuela's educational quality. Hanushek and Woessmann document that Venezuela within Latin America ranks next-to-last in translating years of schooling into cognitive skills, as measured by international test scores (2012: 502, fig. 3; 504, fig. 4).

Perhaps not surprisingly, to surmount the deplorable state of Venezuela's educational quality, an institutional change congruous with higher economic freedom is urgently needed. The educational institutional reform should have the imprint of greater competition among schools and teachers, as well as promote equal educational opportunities.

To summarize this section, we note that economic institutional reform is the common denominator of all efforts to overcome historical legacies that machinate against high levels of economic freedom. Although the reasoning may sound circular, it is not, due to the material well-being consequent on high levels of economic freedom. High levels of economic freedom lead to prosperity, which is the most convincing argument in support of the claim that soaring economic freedom is the road out of serfdom and into freedom, self-reliance, independence, and mastery. This road out of serfdom should be illuminated with unremitting dissemination of information, explaining the link between enhanced standards of living and augmented economic freedom. This educational endeavor conducted in the media remains true to Jefferson's dictum: The cost of freedom is eternal vigilance.

5 Impact of economic freedom developments on the economy and other relevant variables

We consider two categories of variables that are affected by economic freedom—those directly related to growth and those in the domain of public choice analysis.

5.1 Effect of economic freedom on variables directly related to growth

Low levels of economic freedom adversely affect economic growth to the point of potentially inducing negative growth over a lengthy expanse of time. Venezuela is a case in point. In the economic literature, Venezuela is known as a growth disaster, as between 1960 and 2000, average growth of per-capita real income was negative. Importantly, with the exception of 2000, this entire period elapsed before Hugo Chávez came to power.¹⁴ Negative to low growth rates result in poverty, lower

14 Some published papers and books describing the disastrous lack of growth of the Venezuelan economy are Jones, 1999; Barro and Sala-i-Martin, 2004; Jones and Romer, 2010; Hanushek and

health, reduced life expectancy, increased infant mortality rates, stubbornly high unemployment, diminished nutritional intake, lower impetus for educational attainment, reduced physical capital and infrastructure, and reductions in both civil and political liberties. This is precisely the Venezuelan case.

5.1.1 *Economic freedom and geographical endowments*

A cursory look at the world map immediately reveals a general positive correlation between distance from the equator and national wealth. Various scholars, dating back to Machiavelli (1519/1996) and up to Dell, Jones, and Olken (2014), have argued that climate and temperature, the disease environment, natural resources, and transportation conditions have a strong explanatory power when examining the regularity between latitude and development.

Prior to the first important oil discovery in 1914, Venezuela's main economic activity was agriculture. Given the scarcity of land suitable for agricultural,¹⁵ geography was not benevolent to Venezuela and available evidence suggests that economic development was meager. However, discovery of an important oil field on April 15, 1914 unleashed the country's potential for revenue from oil, ushering in decades of high growth rates, as previously mentioned. By 1935, some 20 years after the major oil-field discovery, Venezuela was the second-largest oil producer of the world, and had become a reliable supplier of oil to the US Atlantic seaboard as well as a strategically important nation to the British Empire.

This experience illustrates how geography can exert an indirect differential effect on development depending on the time period considered. Economic institutional quality, however, is the main driver of this Venezuelan experience. The dictatorship of Juan Vicente Gomez, which encompassed the period from 1908 to 1935, allowed multinational companies to develop subsoil oil reserves. This opening of the economy was made possible by Gomez's pacification of the country, protection of private property, and low taxation, as well as respect for contract agreements. In other words, with Gomez Venezuela started to benefit from the presence of state capacity, captured by monopolization and regulation of violence, though sometimes abused, collection of taxes, protection of property rights, and legal services, as well as provision of public goods crucial for development such as a peaceful country.¹⁶

The Venezuelan experience contrasts sharply with Mexico's economic rules of the game, influenced by oil nationalization, led by President Lazaro Cardenas in 1935. In 1957, Mexico became a net importer of oil, a direct consequence of

Woessmann, 2012. Jones and Vollrath (2013) extend the calculations up to 2008, and Venezuela shows up as a growth disaster for the period from 1960 to 2008 as well. For evidence on the deplorable state of Venezuela's current social indicators, see the report of secretary-general of the Organization of American States (OAS) and references therein (Almagro, 2016). For cross-country evidence, see for example the PowerPoint presentation at <www.freetheworld.com/2015/EFW2015-Presentation.ppt> and numerous academic papers published that use the annual reports of *Economic Freedom of the World* <www.freetheworld.com/papers.html>. See as well Hall and Lawson, 2014 for a recent account of the academic literature discussing the EFW index.

15 For instance, according to the World Bank's World Development Indicators (2016) and our own calculations, both Venezuela's arable land and its agricultural land are relatively sparse. Both indicators, when compared to the rest of the world, are in the lowest quartile and fall below the average for Latin America. This suggests that agriculture is not an area in which Venezuela has a comparative advantage.

16 See Acemoglu, Moscona and Robinson, 2016 on the issue of state capacity and American technology.

government's ownership and monopoly in the oil industry. Today most gasoline consumed in Mexico is imported, a dismal consequence of the nationalization of the oil industry. Thus geography has been benevolent in providing oil to both Mexico and Venezuela. The oil industry in Venezuela flourished up to 1960, reaching a maximum level of production in 1970, while Mexico's stagnated. Differences in institutional quality are at the heart of the contrasting tale of these two oil-producing countries. Venezuela adopted policies consistent with more economic freedom, while Mexico relied on a socialist model.

As previously indicated, in the 1960s, the democratic government of Romulo Betancourt put an end to the extension of tract lands to oil multinationals to find and extract oil reserves, and founded the OPEC oil cartel.¹⁷ In the first half of the 1970s, Carlos Andres Perez nationalized the oil industry. Revealingly, today, the oil industry suffers from the consequences of excessive governmental intrusion. To illustrate this point: in 1958, Venezuela's oil industry commanded a 15% share of the world's export market, compared to less than 3% today. Once again, adoption of measures that reduced economic freedom is the main cause of this downfall.

Geography has also provided Venezuela with a great potential for developing a profitable tourism sector, owing to the abundance of beautiful beaches, mountains, islands, waterfalls, and other natural resources. However, once again, the economic rules of the game have curbed a fledging and potentially thriving tourism industry. In the 1950s, under the dictatorship of Marcos Perez-Jimenez, several government-owned and managed hotels were opened in different parts of the country, as well as two high cable cars, one in Caracas and the other in Merida, in an attempt to provide an initial impetus to the tourism industry.

In the 1960s, the democratic government decided to boost the industrial sector through various policies of import substitutions, among them raising trade barriers in some cases to prohibitive levels and in other cases implementing outright bans of certain imports as well as the extension of soft loans by government-owned banks to industry owners. Naturally, these industries became highly inefficient, curtailing the welfare of the people and misallocating resources.

Thus, this is a case where geography provided propitious conditions for development of a strong tourist industry. On this occasion, however, adoption of policies that restricted economic freedom crippled development of an economic activity where the country has a potential comparative advantage.

The lesson that can be learned from the above discussion is clear. Geography may provide favorable conditions for development of certain sectors; yet, if the institutional quality is not supportive of economic freedom, those sectors will never realize their economic potential.

17 No more tract lands for oil exploration implied no new discoveries of oil reserves, limiting extraction from existing wells, and contributing to cap maximum production in a country that has more proven reserves than Saudi Arabia according to the OPEC website. Within OPEC, traditionally Venezuela has voted for reductions in oil production to increase prices. Thus both factors have been conducive to reducing oil production. To compensate for revenue losses stemming from lower production the government through OPEC resorts to the expediency of price manipulations, alleviating the pressure to become competitive and efficient. Additionally, the state-owned oil industry is afflicted by the Tragedy of the Commons, a frequent outcome observed among institutional arrangements based on common property. This tragedy is also instrumental in the lower production and market share as well, in spite of an expanding world market for oil.

5.2 Some effects of restricted economic freedom on outcomes explained by Public Choice principles¹⁸

5.2.1 *The socialist-mercantilist alliance*

The commanding heights of the economy of Venezuela have been owned by the government since the mid-1970s, a clear socialist practice inconsistent with economic freedom, as the “subsoil” was owned by the Monarch of Spain during the colonial era and by the government after independence. Commencing in the 1960s, to industrialize the country the government erected high trade barriers—a clear mercantilist practice, incompatible with economic freedom as well. What do socialist politicians and mercantilist entrepreneurs have in common? A profound loathing for markets, the main resource allocation mechanism.

This unholy alliance offers substantial explanatory power for Venezuela’s and Latin America’s predicament of low growth induced by low levels of economic freedom. The alliance has ramifications that extend well beyond affecting adversely only Area 1 and Area 4 of the EFW index. Entrepreneurs benefit from corruption of the judiciary—Area 2—because adjudication of justice is attuned to the interests of the highest bidder. Judges subservient to the executive branch remove important checks and balances on the executive branch, enabling politicians more leeway on the decision-making spectrum.

This alliance also fosters complex business regulations—Area 5—that reduce competition, favoring existing large companies. Complexity also benefits bureaucrats by increasing their power over small businesses seeking a permit. To the extent that obtaining a permit necessitates jumping through various bureaucratic hoops, the potential for greater corruption is ostensible.

The socialist-mercantilist alliance may also affect Area 3: Sound Money. The creation of money may benefit government by allowing the bestowal of government largesse on favored groups of the executive branch. In addition, companies can protect themselves from the ravages of inflation by raising prices. If price controls are in place, a binding ceiling can be raised by virtue of good political connections. Thus, once again, the beneficiaries of the alliance profit at the expense of average citizens, who in Venezuela happen to be poor.

5.2.2 *Largess to uncompetitive sectors*

Systematic implementation of policies favoring agricultural and industrial activities is another consequence of low economic freedom explainable by Public Choice theory. For a better understanding of the *raison d’être* of policies favoring agricultural and industrial activities, even today, we note that the onset of the oil revolution caused the so-called Dutch Disease, which rendered agriculture less competitive—and many political leaders as well as elites from the private sector were farm owners.

Taking into account that the Venezuelan people were and are *de jure*, not *de facto*, owners of the oil wealth, no constituency emerged to counterbalance the manifold inefficient programs and policies aimed at helping farmers and industrialists. Thus, the Venezuelan Dutch Disease can also be construed as a Schumpeterian process of creative destruction, which required adaptation to a new reality in the form of economic activity compatible with oil such as tourism (Faria and Filardo, 2015: 379).

18 We acknowledge that there is a two-way causality between economic freedom and the outcomes analyzed in this subsection.

Viewing the competitive loss in agriculture and industry as emanating from currency overvaluation, induced by a more competitive sector capable of increasing the flow of hard currency, provides the seeds for the mirage to devalue the currency, reducing people's external purchasing power and possibly instigating an inflationary spiral. Indeed, Alberto Adriani, a well-known economist and politician, who became in Venezuela the equivalent of the secretary of the treasury, in the early 1930s suggested the convenience of devaluing the Bolivar to make agricultural exports more competitive and to leave behind the economic policy of *laissez faire* favored by Gomez. Perhaps needless to say, Mr. Adriani's parents owned a farm in the state of Merida in Venezuela (Lahoud, 2015). Thus, instead of focusing on curbing inflation and becoming efficient, efforts even today are directed towards the expedient of devaluation, which as expected did not enhance the competitiveness of companies.

In sum, given the historical facts presented in this chapter, analyses suggesting that the culprit of Venezuela's current predicament stem from 15 years of Venezuela's revolution are simplistic and misleading (O'Grady, 2016, May 8). Venezuela's economy ails from a vicious cycle of deeply rooted exclusionary institutions, dating back to the colonial period, which now operate through the channel embodied by the socialist-mercantilist alliance, empowering and enriching political and economic elites.¹⁹

Revealingly, the perverse institutional arrangements persist over time, although the identity of the favored elites may change. A case in point is Mr. Lorenzo Mendoza, the CEO of Empresas Polar S.A., Venezuela's largest conglomerate of beer, soda pop, and food production, who was recently interviewed by a well-known US newspaper (Forero, 2016, June 3). Mr. Mendoza rightfully decries price controls and the government's decision to exclude Empresas Polar from receiving the government-controlled dollars it needs to import raw materials. Unfortunately, the report fails to mention that beer production in Venezuela is basically a duopoly that has excluded most Venezuelans from buying international beer brands, depriving consumers of the benefits conferred by increased variety of goods.²⁰ Moreover, we have not observed Mr. Mendoza expressing support, privately or publicly, for a dollarization or a monetary-freedom institutional arrangement that allows average citizens, preponderantly poor, to protect the fruits of their labor. In other words, access

19 As aforementioned, inclusive economic institutions enjoyed an interregnum during the Gomez dictatorship. After his death in 1935, inclusive economic institutions persisted until 1957, albeit somewhat deteriorated. With the onset of democracy, economic institutional inclusiveness dissipated rapidly and accelerated with the advent of the Chavez-Maduro government. Today, Venezuela is the country of the world that reliable data shows to have the lowest level of economic freedom.

20 O'Grady correctly denounces the extinction of Venezuela's productive sector by state diktat. However, she fails to mention that Venezuela's industrial and agricultural sectors are generally inefficient, a legacy of the policies implemented prior to Chavez's advent. The survival of these sectors stems from government protection that increased unnecessarily exclusion of poor Venezuelans, let alone an inefficacious allocation of resources. Thus, a more comprehensive analysis of Venezuela's travails clearly reveals that the so-called domestic productive sector is part of the problem. This is one of the elephants in the room that most analyses of Venezuela's predicament decline to see. These partial analyses conceal the real problem, which, as previously stated, is a vicious circle of exclusionary institutions and policies that needs to be broken.

to the dollar, and hard currency in general, in Venezuela is a privilege and the elites loath and disparage its democratization.²¹ Ironically, a conspicuous member of the Venezuelan economic elite is now being excluded from access to dollars.

This instance exemplifies a pervasive syndrome present in Latin America and particularly in Venezuela that Acemoglu and Robinson dub the iron law of oligarchies: “The overthrow of a regime presiding over extractive institutions heralds the arrival of a new set of masters to exploit the same set of extractive institutions ... Extractive institutions then not only pave the way for the next regime change, which will be even more extractive, but they also engender continuous infighting and civil wars” (2012: 366, 367). In other words, social mobility Venezuelan style.

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21 Even in Daniel Ortega’s Nicaragua the dollar circulates freely, suggesting egregious malice among Venezuela’s political and entrepreneurial leaders for opposing an efficient mechanism to protect a basic human right: integrity of the fruits of one’s labor.

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