**Universitat Ramon Llull**

# DOCTORAL THESIS

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| Title | **DECENTRALISATION, CORRUPTION, AND INFLATION: THE CASE OF NEOPOPULISM IN VENEZUELA** |
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# ACKNOWLEDGEMENTS

# TABLE OF CONTENT

# LIST OF FIGURES

# LIST OF TABLES

# ABSTRACT IN ENGLISH

The doctoral thesis based monographic articles presented is a collection of four complementary *papers*: Corruption and Size Decentralisation; Flawed Decentralisation and Corruption in Venezuela; Structural Consolidation of Venezuela's Political Institutions; and Stagflation in Neopopulist Venezuela and the Integration of Latin America's Left. The very brief introduction before the first *paper* and the general conclusions after the fourth *paper* justifies the coherence and unity of the work, mainly by relating the research within some of the larger empirical and theoretical debates of the area. Overall, the research lies at the intersection of economics, public administration, planning and development, and political science. The keywords or primary subfields of interest are: corruption, decentralisation, Venezuela, populism and inflation. Summarising in one short and easy sentence, the main finding strongly supports the argument that the consolidation of unpopulated subnational units into relatively more autonomous and democratic organisations of governance is a viable institutional reform to strengthen accountability and transparency in corrupt countries. The country of study –Venezuela– is an interesting and significant case in view of the broad political and economic changes that have taken place there in recent years.

# RESUM EN CATALÀ

La tesi doctoral monogràfica basada en articles que es presenta és un compendi de quatre *papers* complementaris: Corrupció i Descentralització Administrativa; Descentralització viciada i Corrupció a Veneçuela La Consolidació Estructural de les Institucions Polítiques a Veneçuela, i Estagflació a la Veneçuela neopopulista i la Integració de l'Esquerra en Llatí Amèrica. La introducció que precedeix el primer *paper* i les conclusions generals a partir de la quarta *paper* justifica la coherència i unitat del treball, i relaciona la investigació amb els debats teòrics de l'àrea. En línies generals, la tesi es troba en la intersecció de l'economia, l'administració pública, la planificació i el desenvolupament, i les ciències polítiques. Les paraules claus de la investigació són: corrupció, descentralització, Veneçuela, populisme i inflació. El resultat principal que la investigació ofereix és una sòlida evidència empírica en referència a la reducció de governs subnacionals, sota un context democràtic i autonòmic, com una reforma institucional viable per enfortir la transparència i la responsabilitat en els països corruptes. El país d'anàlisi, Veneçuela, és un cas significatiu a vista dels esdeveniments polítics i econòmics dels últims anys.

# RESUMEN EN CASTELLANO

La tesis doctoral monográfica basada en artículos que se presenta es un compendio de cuatro *papers* complementarios: Corrupción y Descentralización Administrativa; Descentralización Viciada y Corrupción en Venezuela; La Consolidación Estructural de las Instituciones Políticas en Venezuela; y Estanflación en la Venezuela Neopopulista y la Integración de la Izquierda en Latín América. La introducción antes del primer *paper* y las conclusiones generales después del quinto *paper* justifican la coherencia y unidad del trabajo, y relaciona la investigación con los debates teóricos del área. En líneas generales, la tesis se encuentra en la intersección de la economía, la administración pública, la planificación y el desarrollo, y las ciencias políticas. Las palabras claves de la investigación son: corrupción, descentralización, Venezuela, populismo e inflación. El resultado principal que la investigación ofrece es sólida evidencia empírica en referencia a la reducción de gobiernos subnacionales –bajo un contexto democrático y autonómico como una reforma institucional viable para fortalecer la transparencia y la responsabilidad en los países corruptos. El país de análisis –Venezuela es un caso significativo en vista de los acontecimientos políticos y económicos de los últimos años.

# GENERAL INTRODUCTION[1]

This Doctoral thesis studies the relationship between corruption and decentralisation, focussing on the size of the territories in terms of population per regional government and on the lack of revenue autonomy. It is not that decentralisation in general is related to corruption, but that excessive size decentralisation and insufficient fiscal decentralisation is related to corruption. The study is then qualitatively completed with the political-economic analysis of the case of Venezuela, which shows the flaws of decentralisation in that country, as well as the effects of populism on inflation and its impact on the integration phenomenon of Latin America.[2]

It all started with a book recommendation by my tutor Pere Puig Bastard: 'The Elusive Quest for Growth' by William Easterly (2002). The book turned out to be a pivotal event in my life as a researcher. Chapter 12 was my first experience with the theories of corruption. Latter I came across with the seminal works of Klitgaard (1991), Rose-Ackerman (1999), Banerjee (1997), Tanzi (1998), Bardhan (1997), and mainly Shleifer and Vishny (1993) who introduced the logical argument that increasing the quantity of independent subnational governments, could also increase total bribery. This idea led to the second general area of the literary review process: the decentralisation of government. (Second line of Figure 1.1).

The literary review of decentralisation and corruption found a rising theoretical tension present in the literature. For the first time, the debate is no longer a one-sided monograph that supports the association between decentralisation and decreasing corruption (Huther and Shah, 1998; De Mello and Barenstein, 2001; Fisman and Gatti, 2002). To the best of my knowledge, the debate got serious 15 years ago, when two brave authors (Tanzi, 1995; Prud'homme, 1995) convincingly pointed out that in developing countries, decentralisation reforms are generating more harmful consequences than beneficial spill-over

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[1] Since the central chapters of this PhD thesis consists of four journal-type-long *papers*, the introduction is summarised at its maximum expression. For a more in-depth detailed description of the individual contents, refer to the abstracts and introductions of each *paper*. (The same applies to the conclusions).
[2] I appreciate the comments of an anonymous thesis evaluator for helping shape from a different perspective a concise delimitation of the general objectives presented here and the last paragraph of the general introduction, which explains the overall structural and internal organisation of the thesis.

effects. Surprisingly, it took the academic community at least five years to empirically sustain that decentralisation (especially political decentralisation) may well deteriorate the quality of government (Treisman, 2002). Possibly, the most relevant argument to explain this phenomenon is that in weak institutional environments, decentralisation tends to encourage corruption (Bardhan, 2002; Bardhan and Mookherjee, 2006).

Decentralisation is measured in several ways. From the most widely used fiscal decentralisation (the power to collect revenues and execute expenditures), to the equally important decision decentralisation (the power to legislate without central intervention). And all the combinations in between. The first *paper*, 'Corruption and Size Decentralisation', focuses on the interaction between corruption as the dependent variable and a relatively unstudied measure of decentralisation, which I define as 'size decentralisation', as the main independent variable.

Statistical evidence reported in the first *paper* (next chapter) found that countries which have more first-tier subnational governments relative to their population are more corrupt. These findings support the argument that decreasing the quantity of subnational governments by consolidating poor and unpopulated units into relatively more autonomous organisations of governance is a viable institutional reform to improve accountability in already corrupt countries.

The *paper* that follows the general research on corruption and decentralisation starts a sequence of three case studies on Venezuela. As a qualitative progression to this first, the second *paper* is titled 'Flawed Decentralisation and Corruption in Venezuela'. Different from the first *paper*, the second *paper* is based on primary data (mainly group interviews) and uses local governments in Venezuela as the unit of analysis. The specific findings identified four decentralisation factors that increase bureaucratic corruption and mismanagement at local levels of government in Venezuela: municipal atomisation, increasing local bureaucracy, lack of revenue autonomy, and the creation of community councils.

As an answer to these relevant issues, two viable decentralisation-related policies would consolidate poor and unpopulated units into more autonomous governments, and allow more flexible changes to the rate of at least one important local tax. Broadly speaking, the second *paper* ('Flawed Decentralisation and Corruption in Venezuela') supports the growing tendency in the recent literature that links fiscal decentralisation to decreasing corruption, and political decentralisation to increasing corruption (Enikolopov and Zhuravskaya, 2007; Fan, Lin, and Treisman, 2009). The second *paper* also briefly describes the evolution and nature of high corruption in Venezuela.

The third and fourth *papers* came as a necessity to thoroughly comprehend the case of Venezuela from a political and economic perspective. The third *paper* titled 'Structural Consolidation of Venezuela's Political Institutions' mainly focuses on the slow pace of political party institutionalisation. It also describes two relevant issues: (1) the dramatic polarisation of the political landscape beyond reasonable boundaries; (2) and the consolidation of the PSUV (*Partido Socialista Unido de Venezuela*) as a leftwing redistributive political party.

The fourth *paper* titled 'Stagflation in Neopopulist Venezuela and the Integration of Latin America's Left' focuses on two common causes of high inflation and slow economic growth, which is the result of the extreme populist *chavismo* government: exchange rate uncertainty and low private investment. It also challenges the collapsing four-phase classical theory of populism made famous by Sachs (1989), with the main argument that neopopulism can beat hyperinflation by financing the expanding public spending programs with internal oil funds, instead of foreign debt and seigniorage. The case of stagflation in Venezuela is particularly significant, because it has a direct impact on the integration phenomenon of Latin America's plural lefts, which has already started with the one-by-one acceptance of ALBA member countries into MERCOSUR. First in line is Venezuela.

Following the work of Ellner (2010), the third and fourth *papers* clearly emphasize the pragmatic decision-making model over the social-prioritisation model. That is, it supports the importance of state institutionalisation and production efficiency, instead of social national planning targeted at development and social objectives. Similarly, the predominant criteria used to evaluate the political system that has recently emerged in Venezuela is the liberal democracy thesis, which stresses checks and balances and warns against excessive executive power and centralism.[3]

The thesis is organised in two distinct parts. The first two *papers* are about corruption and decentralisation (in general and in Venezuela). The last two *papers* are mainly about politics and economics in Venezuela (inflation, populism, the party system, and the impact of Venezuela on the integration phenomenon of Latin America). The thesis, however, is structured in a way that it is easy to follow, where one issue leads to another. This logical sequence is graphically explained in Figure 1.1.

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[3] The alternative theory to liberal democracy is radical democracy, which highlights the benefits of the majority rule by encouraging the participation of the popular sectors of society (inspired by the formulations of Jean-Jacques Rousseau).

**Figure 1.1** Interdisciplinary Research Projects



| | | | | Social Science Discipline |
|---|---|---|---|---|
| Economics | Public Administration | Political Science | Planning and Development | |

| | | | | | General Interests |
|---|---|---|---|---|---|
| Corruption → | Decentralisation → | Venezuela → | Populism → | Inflation | |

| | | | | Specific Subfields |
|---|---|---|---|---|
| Causes of Corruption ↔ Subnational Institutions | Municipal Atomisation ↔ Lack of Fiscal Autonomy | Consolidation of the PSUV ↔ Extreme Polarisation | Low Private Investment ↔ Exchange Rate Risks | |

| Second Chapter | Third Chapter | Fourth Chapter | Fifth Chapter | Final Papers |
|---|---|---|---|---|
| 'Corruption and Size Decentralization' | 'Flawed Decentralisation and Corruption in Venezuela' | 'Structural Consolidation of Venezuela's Political Institutions | 'Stagflation in Neopopulist Venezuela and the Integration of Latin America's Left' | |

| | | | | Journals |
|---|---|---|---|---|
| Journal of Applied Economics | Public Performance and Management Review | Monthly Review | Latin American Perspectives | |

| | | | | Status (01/04/2012) |
|---|---|---|---|---|
| PUBLICATION: JUNE 2012 | REVISE AND RESUBMIT | Under Review | REVISE AND RESUBMIT | |

# CORRUPTION AND
# SIZE DECENTRALISATION[4]

**ABSTRACT**

Statistical tests based on newly collected cross-sectional data suggest that countries which have more first-tier subnational governments relative to their population are more corrupt. I measure the strength of association between "corruption" and the variables "population per regional government" and "average area of first-tier unit," both individually and combined as the interaction effect "size decentralisation," in 100 randomly selected countries. Two theoretical arguments may explain these associations: (i) the greater the quantity of first-tier subnational units with monopolistic powers, such as legal and regulatory sanctions, the greater the incentives for bribery and extortion; and (ii) elected authorities and public servants of smaller regional governments are more vulnerable to capture by a corrupt private elite, especially when control and accountability mechanisms are weaker than national ones. This *paper* also provides some support for existing corruption theories, namely that wealthy countries with Protestant societies use democratic systems more effectively to control corruption.

*JEL classification codes*: R12, R50

KEYWORDS -- decentralisation · corruption · subnational · regional

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## 2.1   INTRODUCTION

Decentralisation, or the process of devolving powers to regional and local governments by shifting the structure of accountability from the national to the subnational level (Tiebout, 1956; Burki, Perry, and Dillinger, 1999), tends to be associated to encouraging the efficiency and responsiveness of government (Oates, 1972), developing institutional and technological innovations (Beasley and Case, 1995), improving public accountability (Seabright, 1996), and controlling corruption (Huther and Shah, 1998; de Mello and Barenstein, 2001). However, recent evidence also suggests that certain measures of decentralisation such as increasing the quantity and variety of first-tier subnational governments may increase the incentives that drive corruption (Shleifer and Vishny, 1993; Bardhan, 2002).

The plausible link between decentralisation and corruption (defined as "the abuse of entrusted power for private gain" by Transparency International) is a relevant issue that requires further exploration and questioning. Prud'homme (1995) makes an interesting comparison between Western medicine and decentralisation. He argues that Western medicine is highly effective, but only when it is correctly applied to the appropriate illness, at the right time, and in the proper dosage. If these conditions are not met, then secondary harmful effects will probably be worse than the disease itself. Unfortunately, in the majority of cases, decentralisation is prescribed in excess, with the presence of abusive regulations, without the financial or administrative capabilities needed, under inadequate institutional and democratic controls, and with inefficient public servants and bribe-thirsty elected authorities.

Defining decentralisation is a difficult task. This is due mainly because the definition of decentralisation must first discuss the deep relationship between decentralised and federal states. According to Riker (1964), a federal constitution has at least two levels of government affecting the same land and people, each level has at least one area of action in which it is autonomous and there is some guarantee (even though merely a statement in the constitution) regarding each government's autonomy. Lijphart (1984) simplifies this concept by suggestion that federalism is a constitutionally guaranteed division of power between central and regional governments. Incidentally, decentralisation is commonly defined as "the process of devolving political, fiscal, and administrative powers to subnational units of government" (Burki, Perry, and Dillinger, 1999: 3). The similarity between the two concepts is remarkable. Prud'homme (1995: 201) actually defines decentralisation using the definition of the theory of pure fiscal federalism: "that is, a system in which pure local governments raise pure local taxes and undertake pure local expenditures without the benefit of central government transfers."

Separating decentralised and centralised states from federal or unitary constitutions is almost an impossible task; given that there can be both centralised and decentralised federations, and centralised and decentralised unitary states (Lijphart, 1984). Joumard and Kongsrud (2003) demonstrate that the extent of decentralisation is not always encouraged by a federal structure and not always restrained by unitary institutional structure. In their study they found that some unitary countries (e.g., Denmark and Sweden) were more decentralised than the countries identified as federal (e.g., Germany, Mexico, and USA). Italy, for example, "though politically decentralised, is not considered a federation since the article in its constitution that enumerates the matters on which regional legislatures can legislate (Article 117) stipulates that they can legislate only 'within the limits of the fundamental principles established by the laws of the State' and 'provided that such legislation is not in contrast with the interests of the Nation or of other Regions'. Regional laws must not contradict fundamental principles established by national laws, and so regional autonomy is limited." (Treisman, 2000: 432). A similar argument could be made for Mexico, Pakistan, and Malaysia, which are highly centralised bureaucracies with federal constitutions. A converse argument holds for Finland.

Is decentralisation only bad for developing countries? In the majority of cases, the overall extent of decentralisation's rate of success appears to be lower in developing countries. A comprehensive theoretical rationale that explains in part this phenomenon is that designing decentralisation policy "is particularly difficult in developing countries because institutions, information and capacity are all very weak. The cross-cutting nature of decentralisation, the importance of local institutions in influencing the impact of decentralisation and the limited empirical evidence on what works and what does not make the design and implementation of decentralisation a considerable challenge (for example, matching expenditures and revenues at each level of government, providing a regulatory framework that imposes a hard budget constraint on subnational governments, and incorporating local participation and accountability in decentralisation). Evidence suggests that the problems associated with decentralisation in developing countries reflect flaws in design and implementation more than any inherent outcome of decentralisation." (Litvack, Ahmad, and Bird, 1998: 7-8).

On the other side, it is impossible to argue that the specific impact of size decentralisation (positive or negative) on corruption is more significant in developing countries, because the theoretical evidence regarding this relevant issue is limited. Statistically, I ran several regression models controlled by a wide range of factors in two

subset samples of developing and developed countries.[5] I found that the overall fit of the models and the estimated values of the parameters are similar in the three scenarios, including the whole sample of countries. I also found that in all scenarios the correlations do not vary substantially between the dependent variable "corruption" and the two main independent variables "population per regional government" and "average area of first-tier units." From now on I will only make reference to the whole sample of countries.

Figure 2.1 shows dispersion graphs between the dependent variable "corruption" measured by the Corruption Perception Index (CPI) and the two main independent variables. The unconditional analysis of the tendency lines clearly shows upward slopes, especially "population per regional government," which provides some initial support to the specific hypothesis that countries with more population per regional government tend to be less corrupt since their CPI is relatively higher (higher CPI scores imply less corruption). On the other hand, countries which have more regional or first-tier subnational governments relative to their population tend to be more corrupt since their CPI is generally lower.

**Figure 2.1** Corruption and Indicators of Size Decentralisation

### A. Population indicator                        ### B. Area indicator
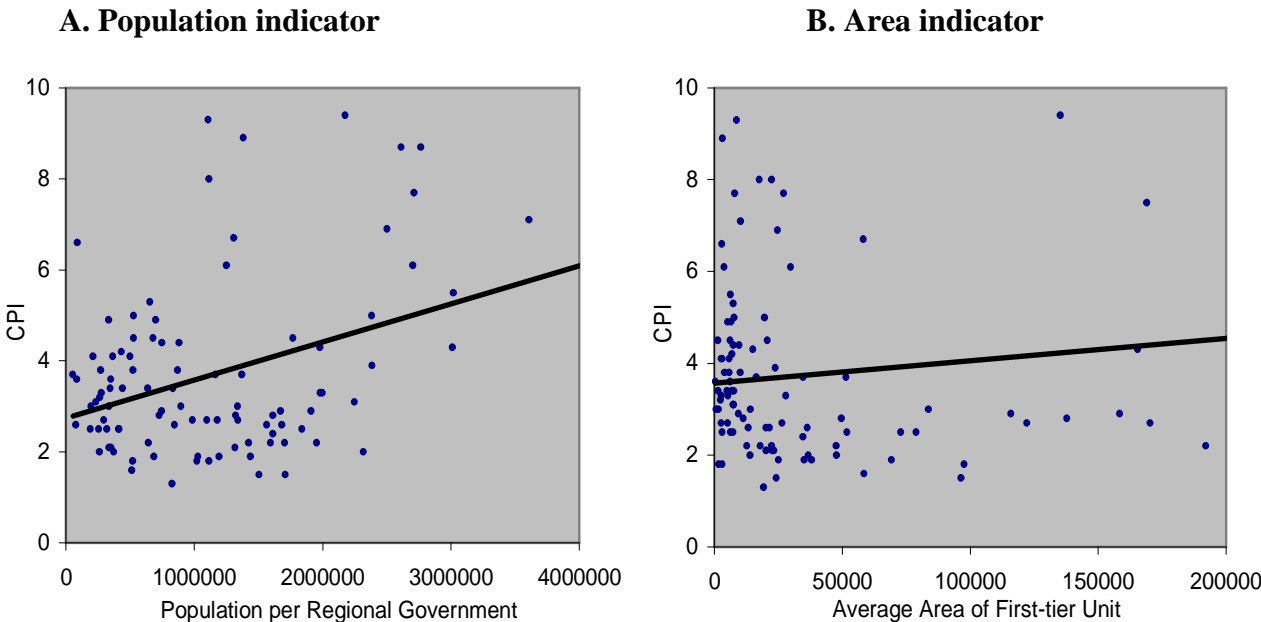


Note: The first graph does not show the three outliers (Germany, UK, and USA). The second graph does not show Australia and Canada. Their effects, however, are computed in the tendency lines.

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[5] The whole sample of 100 countries was divided in two subset samples of 79 developing and 21 developed countries based on the 2009 Human Development Index (HDI) list of developed countries by the UN. The HDI is arguably the most comprehensive mean to distinguish whether the country is developed or not, since it is a comparative measure of life expectancy, literacy, education and standards of living for countries worldwide.

The association between the dependent variable "corruption" measured by the CPI and the two main independent variables "population per regional government" and "average area of first-tier unit" (as well as their interaction effect "size decentralisation") is the analytical focus of the regressions tests.[6] This does not imply that I do not control for other measures of decentralisation (e.g., fiscal, decision, government tiers, and electoral decentralisation. The proposed three hypotheses clarify these points:

**Hypotheses**

| | |
|---|---|
| Hypothesis 1 | Countries which have more first-tier subnational governments relative to their population are more corrupt. |
| Hypothesis 2 | Countries which on average are divided into geographically small first-tier subnational governments are more corrupt. |
| Hypothesis 3 | Countries which on average have geographically large first-tier subnational governments and also have a large population per unit are less corrupt. |

Therefore, based on the proposed three hypothesis, the primary objective of this quantitative study is to support the plausible association between the dependent variable "corruption" and the main independent variables "population per regional government" and "average area of first-tier unit" shown in Figure 2.1, both individually and combined in their interaction effect defined as "size decentralisation." The secondary objective is to examine the classical theories of corruption by testing several explanatory factors, including democracy, education, income inequality, share of Protestant population, GDP per capita, liberty of press, openness to trade, and total population.

The *paper* is organised as follows. The next section describes the data. The third section runs a series of regression tests to examine the relationship between the dependent variable "corruption" and the two main independent variables "population per regional

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[6] In view of the fact that the theoretical relationship between decentralisation and corruption in general terms has been thoroughly analyzed over the last few decades; namely, the institutional benefits of administrative and decision-making autonomy such as the power to tax at a subnational level of government.

government" and "average area of first-tier unit." The quantitative findings are robust to a wide range of controls (including all of those that have been used in the recent cross-country literature on corruption) and provide strong support for the specific hypothesis that countries which have more first-tier subnational governments relative to their population are more corrupt. The fourth section concludes.


## 2.2   DATA


Using recent cross-sectional data on a random sample of 100 countries summarised in Table A2.4 (found in the appendix after the references list), I test various arguments about how increasing the quantity of first-tier subnational governments affects corruption. Specifically, I test the relationship between "corruption" as the dependent variable and two specific sub-measures of "size decentralisation" defined as "population per regional government" and "average area of first-tier unit" as the main independent variables. (First-tier subnational unit and regional government are used interchangeably throughout the study).


### 2.2.1   Dependent Variable


The dependent variable "corruption" is measured with the 2009 Corruption Perception Index (CPI) by Transparency International (TI). The CPI is "the best-known" index available (Tanzi, 1998: 577), and has been used in a number of studies, including Gupta et al., (1998), Alesina and Weder (1999), and Treisman (2000). However, as its name implies, the index measures the perception of corruption (on a scale of 0 to 10, with higher scores corresponding to better corruption ratings), not the actual level of corruption itself. The "corruption" variable and the two main independent variables "population per regional government" and "average area of first-tier unit" are free of endogeneity problems, because it is not plausible that the elements consulted to compile the index were influenced by the countries' administrative divisions.

I tested the validity of the dependent variable with great success against six endogenous government performance variables. Four indexes from the 2008-2009 Global Competitiveness Report (World Economic Forum): "property rights", "strength of auditing

and reporting standards", "judicial independence" and "reliability of police services." And two indicators from the 2008 Worldwide Governance Research Dataset (policy research working paper 4978): "regulatory quality" and "government effectiveness." The unconditional bivariate correlation coefficients ranged anywhere from .75 to .95. These extremely high correlations confirm the dependent variable as an accurate measure of corruption. In fact, it should not come as a surprise that property rights, strength of auditing and reporting standards, judicial independence, reliability of police services, regulatory quality, and government effectiveness, are all highly correlated between themselves and with the CPI, given that they are all just another name for the lack of corruption. Tanzi (1998) best explains this rationale: As a way of life in highly corrupt countries, corruption is hardly ever reported or penalised. Corrupt police officials are by nature not reliable. The legal processes in these countries tend to be rigid and obsolete. Regulations and taxes are generally confusing, some are not public, and they are sometimes modified without previous notification. Laws are so complicated that only trained lawyers can understand them. The social costs for accusers are high. Personal freedom and basic rights such as private property are constantly threatened by corrupt law enforcement officials. And the judges are easily captured by the corrupt private elite.

### 2.2.2   Main Independent Variables

The first main independent variable "population per regional government," shown in Table A2.5, is measured dividing a country's total population (numerator) by its total number of first-tier subnational governments (denominator). A country is commonly divided in two subnational tiers of government: regional and local. A country, however, can be divided in three subnational tiers: provinces or states (regional government), counties (intermediate government), and municipalities (local government). For the purpose of this analysis, when a country is divided in three or more tiers, the information on the first-tier (provinces or states in the previous example) will be used as the denominator. If a country's administrative division includes only one subnational tier, then this information will be used as regional governments (e.g., Kuwait's six Governorates).[7]

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[7] I use the definition of tiers or levels of administration for both governments with or without legislative councils and with or without elected leaders.

The information for total population is the 2009 Population Division of the United Nations Department of Economic and Social Affairs. The total number of regional governents is taken from the International Organisation for Standardisation (ISO) 3166 subdivision codes. Recent versions of the Larousse Atlas of Countries of the World and the National Geographic Atlas were used as corroborating sources of data. From the sample taken, I assume that regional governments of all countries are endowed with a minimal degree of autonomy. Naturally, this autonomy varies from country to country, sometimes tremendously. For example, the delegates chosen by the central government in Russia have considerably less autonomy than elected officials in Spain's autonomous communities.

Consistent with the first hypothesis, "population per regional government" is expected to enter the "corruption" function with a strong positive coefficient, indicating that countries with more population per unit of first-tier subnational government are relatively less corrupt, since their corruption ratings are better (higher). One theoretical rational that explains this association is that "stronger personal links between bureaucrats and their constituents under decentralisation might make it easier for corrupt individuals to collaborate, and smaller jurisdictions may make bribery more affordable and limit the resources available for fighting it. In addition, smaller jurisdictions may encourage more-detailed regulation of economic activity, encouraging corruption." (Arikan, 2004: 182).

The second main independent variable "average area of first-tier unit" is measured dividing the country's total area in square kilometers (land and internal waters) by the total number of first-tier units (regional governments). The information for total area is the 2008 United Nations Statistic Division. Similar to the variable "population per regional government," and consistent with the second hypothesis, the variable "average area of first tier unit" is expected to enter the regression with a positive coefficient, indicating that countries which on average have geographically large first-tier subnational jurisdictions are less corruption. One logical argument that explains this plausible association is that the benefits derived from the economies of scale diminishes in geographically small first-tier subnational governments.

If the hypotheses hold true, then why not ask if large populations decrease corruption? Most academics argue that highly populated countries tend to be less corrupt. This is due not only because "larger countries might adopt more decentralised fiscal systems to better cater to the diverse preferences of their citizens while, at the same time, economies of scale might arise in the fight against corruption" (Fisman and Gatti 2002b: 330); but also because according to an industrial development model by Murphy, Shleifer, and Vishny's (1989),

market size determines the extent to which firms can benefit from positive spillovers, which in part possibly explains the relatively greater economic development (and less corruption) found in large countries (e.g., USA and Japan).

On the other hand, an alternative rationale argues that highly populated countries could actually be more corrupt, since large population emerges from a trade-off between economies of scale in supplying public goods and the greater cultural-ethnic heterogeneity cost present in populated countries. In practice, this trade-off is usually dominated by the heterogeneity factor (e.g., the former Soviet Union), which increases the incentives of corrupt bureaucrats to favor their own reference group (Alesina and Spolaore, 1997), and encourages the armed conflicts and political instabilities that generates corruption (Mauro, 1995). In line with these theoretical arguments, Alesina, Spolaore, and Wacziarg (1997) suggest that large countries, in terms of population, can afford to be closed, while small countries face stronger incentives to liberalise trade. Therefore, based on this reasoning, highly populated countries should have a disadvantage against corruption because openness to trade decreases corruption (Ades and Di Tella, 1999).

### 2.2.3   Different Dimensions of Decentralisation

Orthodox theory assumes that decentralisation encourages competition among subnational governments (Tiebout, 1956; Brennan and Buchanan, 1980), and interjurisdictional competition in turn is associated to improving three relevant factors that disciplines government and decreases the level of corruption: accountability (Tabellini, 2000), bureaucracy (Bahmani and Nasir, 2002), and efficiency (Jin, Qian, and Weingast, 1999). In fact, "the basic model of interjurisdictional competition predicts a negative relationship between decentralisation and corruption" (Fisman and Gatti, 2002a: 26), as subnational populations observe and compare the performance of officials or bureaucrats across jurisdictions the level of corruption decreases (Dincer, Ellis, and Waddell, 2010). The logic is simple. Subnational governments should compete to attract capital from residents and businesses by providing public goods and services more efficiently. For example, if a corrupt subnational government steals and wastes resources or over-regulates businesses in order to extract bribes, taxpayers and firms should exercise their free option of moving to areas with more efficient governments with fewer regulations. The two most well-known measures of

decentralisation are generally associated to improving subnational institutions. These beneficial measures are: (i) fiscal decentralisation, or the constitutional authority to collect taxes and execute public expenditures by subnational governments; and (ii) decision decentralisation, or the scope of issues on which regional and local governments can decide autonomously without being overruled by higher-tier governments.

For the purpose of this study, the information for "fiscal decentralisation" is the most recent estimates of the Government Finance Statistics Yearbook (IMF). It measures regional government revenue and expenditure as a percentage of total revenue and expenditure. To be consistent with the units defined by "size decentralisation," I will only measure information on the first-tier subnational jurisdiction or regional government. The variable "fiscal decentralisation" does not measure any information corresponding to the second or third level of subnational governance, which are commonly referred as intermediate and local governments. The proxy that I propose for "fiscal decentralisation" attributes two-thirds weighting to revenue and one-third weighting to expense. I emphasize the income side because the incentives created by subnational revenue generation encourage a series of beneficial spillover effects on regional economic prosperity (Weingast, 2009). In the regression model, the variable "fiscal decentralisation" is expected to enter the "corruption function" with a strong positive coefficient, indicating that more fiscally decentralised countries have better (higher) corruption ratings. The anticipated findings should support the theory that fiscal decentralisation decreases corruption (Huther and Shah, 1998; De Mello and Barenstein, 2001; Fisman and Gatti, 2002b; Dincer et al., 2010). A commonly used argument that explains the theory is that "bureaucrats in a fiscally decentralised economy" have fewer incentives to engage in rent-seeking behavior (Arikan, 2004: 192).

Decision decentralisation is defined by the dummy variable "federal status." It measure decision-making autonomy at a regional level of government. I use the classification of federal countries by the independent organisation The Forum of Federations to measure the variable "federal status." The information regarding a country's federal status has traditionally been used in the academic literature to measure decision decentralisation, since the primary characteristic of federalism is a constitutionally guaranteed division of power between national and subnational governments (Lijphart, 1984: 170), in which at least one tier of government has at least one autonomous area of action (Riker, 1964: 11). The imperfect dummy that I constructed took the value "2" for federal countries and "1" for unitary states. And since federalism has theoretically been associated to decreasing corruption (Hayek, 1948), as autonomous subnational officials with constitutional powers to legislate have

greater access to relevant local information that enables providing public services more efficiently (Fisman and Gatti, 2002b), the control variable "federal status" is expected to enter the regression with a positive coefficient (indicating that federal countries have better corruption ratings).

In addition to "fiscal decentralisation" and "federal status," I also test "electoral decentralisation." This dimension of decentralisation is defined as the constitutional right to democratically elect subnational authorities. *A priori*, it is possible to constrain corruption with institutions of accountability from below, as democratic forces should punish corruption. "The intuition is that, under decentralisation, politicians are held directly accountable for their actions" (Fisman and Gatti, 2002a: 26). In the regression model, "electoral decentralisation" is expected to share a positive relationship with "corruption," since it is measured by the interaction effect between the variable "federal status" and the variable "democracy" (which I formally define next). This positive relationship implies that countries with more electoral control have better (higher) corruption ratings.

### 2.2.4 Other Explanatory Variables

"Democracy" is measured by the 2008 Economist Intelligence Unit Democracy Index. The index focuses on electoral processes and pluralism, civil liberties, the functioning of government, generalised participation, and political culture. It ranges from full democracies (scores of 8-10) to authoritarian regimes (scores below 4). *A priori*, democracy decreases corruption, since democratic institutions improve economic policies and outcomes (Besley et al., 2005), encourages power of speech (Besley and Burgess, 2002), increases the participation in a generalised interpretation of the rule of law (Bardhan, 2005), "and when it works well, it provides citizens a means to express choices and to hold public officials accountable" (Weingast, 2009: 280). Treisman (2000) quantified the effect of democracy on corruption by sustaining that more than 40 consecutive years of democracy should decrease corruption by about 10%; The variable "democracy" should enter the regression model with a strong and significant positive coefficient, indicating that full democracies (scores of 8-10) have better (higher) corruption ratings.

"Education" is measured by the 2008 United Nations Education Index, which attributes two-thirds weighting to the adult literacy rate and one-third weighting to the combined gross school enrolment ratio. The education index's highest possible score is 1,

implying perfect education attainment. In the analysis, the variable "education" should also enter the regression model with a positive coefficient, since well-educated societies condemn corruption more vigorously (Ades and Di Tella, 1997).

"Inequality" is measured by the 2008 CIA World Factbook Gini Inequality Coefficient. The Gini coefficient is a measure of statistical dispersion of income inequality. It ranges from 0 to 1. Low coefficients refer to equal distributions, with 0 corresponding to complete equality. While higher coefficients represent unequal distributions, with 1 indicating complete inequality. The variable inequality is anticipated to enter the regression model with a negative coefficient, indicating that more equal societies (low Gini coefficients) have better (higher) corruption ratings; given that unequal societies are usually governed by a corrupt elite (Gupta, Davoodi, and Alonso-Terme, 1998),

"Protestantism" is measured by the share of Protestant religion in the country. The information used for Protestantism is the USA State Department's 2004 International Religious Freedom Report. Protestantism includes Evangelical, Quaker, Assembly of God, Anglican, Episcopalian, Baptist, Church of God, Church of the Nazarene, Congregationalist, Church of Christ, Lutheran, Calvinist, Holiness, Mennonite, Methodist, Pentecostal, Presbyterian, and Reformist Churches. Treisman (2000) quantifies the effect of Protestantism on corruption by sustaining that an increase of 5% to 10% in the Protestant population should decrease corruption by about 11%. One plausible argument to explain this phenomenon is that Protestants are generally more responsible for their actions and sins, while Catholics, as a converse example, tend to highlight the sinful weaknesses of the individual and the need for a forgiving and protecting Church. In the regression model, "Protestantism" and "corruption" are expected to share a positive relationship.

"GDP per capita at nominal value and at purchasing power parity (PPP)" is measured by the 2008 IMF World Economic Outlook Database. GDP per capita at nominal value measures the value of all final goods and services produced within a nation in a given year, converted at market exchange rates to current U.S. dollars, divided by the average population for the same year. Alternatively, GDP per capital at PPP estimates are arguably more useful in cross-country analyses because they take into account the countries' relative cost of living and inflation rates, rather than just using exchange rates which may distort the real differences in income. In theory, poor countries are more corrupt (Gould and Amaro-Reyes, 1983). This is due mainly because corruption decreases investment rates (Mauro, 1995), which is an essential determining factor for economic growth (Levine and Renelt, 1992). Wei (1999) quantifies the effect by sustaining that corruption acts like an arbitrary tax equal to 20% of

total business returns. The variable "GDP per Capita at PPP" is expected to enter the regression model with a strong positive coefficient, implying that wealthier countries are less corrupt.

"Press freedom" is measured by the 2009 Reporters Without Borders Press Freedom Index. The index refers to the amount of freedom journalists and the media have in each country, and the efforts made by governments to see that press freedom is respected. (Lower scores correspond to better press freedom ratings). "Press freedom" should enter the regression model with an inverse coefficient, since the freedom to report corrupt individuals is a key factor to prevent future acts of corruption (Brunetti and Weder, 1998).

"Trade freedom" is measured by the 2009 Heritage Foundation and The Wall Street Journal Trade Freedom Index. The index is a composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services. The index uses a scale from 0 to 100, where 100 represent the maximum expression of openness to trade. "Trade freedom" and "corruption" are anticipated to share a positive relationship, given that countries which are more open to foreign trade tend to be less corrupt because exposure to imports disciplines the market (Ades and Di Tella, 1996).

"Tiers of subnational governance" is compiled by the ISO 3166 subdivision codes. Treisman (2002) empirically sustains (using World Bank indicators) that corruption increases from .16 to .21 points in a 3.5 scale for each additional tier of government. One logical rationale that explains this phenomenon is that as vertical divisions of government increases, the waste of public resources resulting from the effects of duplication also increases. In the regression model, "tiers of subnational governance" and the dependent variable "corruption" are likely to share a negative relationship, which implies that countries divided in more tiers of subnational governance have worst (lower) corruption ratings. A commonly used theoretical rationale to sustain this inverse relationship is the "overgrazing" problem of different tiers of government competing to extract bribes from the same economic actor (Treisman, 2000: 433).

**Table 2.1** Summary Statistics (cross-country data)

| Variables | Obser-Vations | Mean | Standard Deviation | Min. | Max. |
|---|---|---|---|---|---|
| MAIN EFFECT | | | | | |
| Corruption | 100 | 3.81 | 1.98 | 1.30 | 9.40 |
| Population per Regional Government | 100 | 1,264,777 | 1,141,554 | 52,000 | 6,893,523 |
| Average Area of First-Tier Units | 100 | 49,515 | 125,694 | 321 | 961,503 |
| Democracy | 100 | 5.54 | 2.17 | 1.52 | 9.53 |
| Education | 98 | 0.79 | 0.20 | 0.27 | 0.99 |
| Inequality | 98 | 41 | 9 | 24 | 62 |
| Protestantism | 100 | 13% | 18% | 0% | 91% |
| GDP per Capita (PPP) | 99 | 11,875 | 12,202 | 400 | 46,381 |
| GDP per Capita (Nominal Value) | 99 | 12,039 | 16,483 | 138 | 62,097 |
| Press Freedom | 100 | 21 | 25 | 0 | 116 |
| Trade Freedom | 97 | 76 | 10 | 50 | 90 |
| MEASURES FOR LACK OF CORRUPTION | | | | | |
| Property Rights | 79 | 4.32 | 1.05 | 2.10 | 6.50 |
| Strength of Auditing and Reporting Standards | 79 | 4.56 | 0.80 | 2.80 | 6.30 |
| Regulatory Quality | 100 | -0.06 | 0.98 | -2.13 | 1.91 |
| Government Effectiveness | 100 | -0.11 | 0.96 | -1.48 | 2.19 |
| Reliability of Police Services | 79 | 4.00 | 1.17 | 2.00 | 6.50 |
| Judicial Independence | 79 | 3.60 | 1.30 | 1.40 | 6.70 |
| DECENTRALISATION MEASURES | | | | | |
| Fiscal Decentralisation | 64 | 16% | 14% | 1.43% | 54% |
| Tiers of Subnational Governance | 100 | 3 | 0,91 | 1 | 4 |
| Federal Status | 100 | 1.1 | 0.30 | 1 | 2 |
| ROBUSTNESS CHECKS | | | | | |
| Total Population | 100 | 23,974,957 | 37,949,640 | 520,000 | 308,493,000 |
| Total Area (km2) | 100 | 885,101 | 229,524 | 5,130 | 17,093,112 |

## 2.3 METHODS AND FINDINGS

Initial estimates of the unconditional bivariate correlation matrix (shown in Table 2.2) is consistent with the hypothetical framework, because the main independent variables "population per regional government" and "average area of first-tier units" generates significant and positive coefficients of .48 and .31, respectively, with the dependent variable "corruption". (Taking into account that extremely high coefficients tend to be more problematic and that "population per regional government" and "average area of first-tier units" have relatively lower correlations with all explanatory variables, which should strengthen the future interpretation of the main independent variables as significant estimators of corruption). Hypotheses 1 and 2 are further marginally reinforced since, on average, the variables "total population" and "total area" per country (not shown Table 2.2) share a

relatively less significant relationship with "corruption," compared to the two main independent variables. Bivariate coefficients of .25 for "total population" compared to .48 for "population per regional government," and .14 for "total area" compared to .31 for "average area of first-tier units." ("Total population" and "total area" are formally controlled in the regression model).

The grouping of the factors, based solely on Table 2.2, also implies that high corruption is mainly present in weak institutional environments of poor countries governed by authoritarian regimes. And that corruption could additionally be linked to other significant indirect determinants. These vary from inheriting a non-Protestant, uneducated and unequal society, or to experience a lack of openness to trade and liberty of press. (The negative correlation of "inequality" with "corruption" implies that lower Gini coefficients refer to more equally distributed countries, while higher CPI refers to less corrupt countries (the same applies to "press freedom," countries with more liberty of press –lower indexes– have better – higher– corruption ratings).

**Table 2.2** Main Effect Correlation Matrix

| | Corruption | Population per Regional Government | Average Area of First-Tier Unit | Democracy | Education | Inequality | Protestant Religion | GDP per Capita (PPP) | Press Freedom | Trade Freedom |
|---|---|---|---|---|---|---|---|---|---|---|
| Corruption | 1 | | | | | | | | | |
| Population per Regional Government | 0.48 | 1 | | | | | | | | |
| Average Area of First-Tier Unit | 0.31 | 0.26 | 1 | | | | | | | |
| Democracy | 0.73 | 0.29 | 0.15 | 1 | | | | | | |
| Education | 0.54 | 0.18 | 0.10 | 0.57 | 1 | | | | | |
| Inequality | -0.44 | -0.18 | -0.05 | -0.25 | -0.44 | 1 | | | | |
| Protestant Religion | 0.39 | 0.24 | 0.15 | 0.37 | 0.07 | 0.04 | 1 | | | |
| GDP per Capita (PPP) | 0.85 | 0.51 | 0.30 | 0.67 | 0.66 | -0.51 | 0.25 | 1 | | |
| Press Freedom | -0.48 | -0.14 | -0.07 | -0.72 | -0.19 | 0.10 | -0.35 | -0.44 | 1 | |
| Trade Freedom | 0.51 | 0.16 | 0.14 | 0.57 | 0.57 | -0.33 | 0.08 | 0.54 | -0.40 | 1 |

## 2.3.1 Regressions Tests

I ran a series of regression tests with "corruption" as the dependent variable. The log is used to normalise the data of "population per regional government", "GDP per capita" (nominal and PPP), "average area of first-tier units", "total population," and "total area." As in numerous other studies, logs are used to avoid giving excessive weight to extremely high observations, which is precisely the case when dealing with population, geographic area, and GDP. (The significance of the estimates are based on White-corrected standard errors).

The first column of Table 2.3 shows the explanatory variables effect on the "corruption" function. It is important to highlight that "democracy", "Protestantism", and "GDP per capita at PPP" have strong positive slope coefficients at less than 1%. (I also tested, without any relevant results to report, the effect of nominal GDP per capita instead of PPP, given that PPP are estimates rather than hard facts and should be used with caution, since its measurements tend to vary substantially depending on the source of data). In general, the overall fit of the model is consistent with existing corruption theories because it explains about 70% of the variation in "corruption." That is, wealthy Protestant societies that rely on democratic institutions are in a better position to report and punish corruption (Mauro, 1995; Gould and Amaro-Reyes, 1983; Wei, 1999; Treisman, 2000). The puzzling inverse relationship between quality of education and decreasing corruption could be somewhat explained because the inherence of excellent public educational systems in former communist countries came along with a highly corrupt bureaucracy. (The direction of "education," the low coefficient of "inequality," and the insignificance of "press and trade freedom" are subject to further investigation beyond the aims of this study).

When the main independent variables "population per regional government" and "average area of first-tier units" entered the regression, the goodness of fit improves .4 percentage points. The direct effect of "population per regional government" is highly significant. (The null hypothesis that the true slope coefficient is zero is clearly rejected, given that "population per regional government" and "corruption" are uncorrelated in only fourteen out of ten thousand occasions). These findings provide strong support for the first hypothesis that countries with more population per regional government have better (higher CPI) corruption ratings. The size of the partial slope coefficient implies that a one standard deviation increase in "population per regional government" will be associated to an improvement in the country's corruption rating by about 100% of a standard deviation,

assuming that all other factors affecting corruption are held constant. (The true value of the coefficient of "population per regional government" lies within the 95% confidence interval between .41 and 1.63). On the other hand, the marginal coefficient of "average area of first-tier units" could indicate that its effect on corruption is partially captured by "population per regional government," which could introduce a host of multicullinearity problems, as both variables measure similar effects on corruption. Consequently, I ran an additional regression (not shown in Table 2.3), excluding "population per regional government," and the parameter of "average area of first-tier unit" dramatically improves to .35 (reinforced at a *p*-value of .05). These results provide some support for the second hypothesis that countries which on average are divided into geographically small first-tier subnational governments are more corrupt.

The fourth column in Table 2.3 reports the direct effect on corruption of three specific measures of decentralisation. However, only "tiers of subnational governance" is significant at less than 5%. The size of the coefficient implies that if a country decreases its tiers of subnational governments by one unit, *ceteris paribus*, the corruption ratings should improve by .44 points (on a scale of 0 to 10). For example, if Venezuela were to decrease its number of subnational governments from four to three, its forecasted mean corruption score would improve from 1.9 to about 2.4. The theoretical rationale for this phenomenon could be that as competition between different autonomous governments to extract bribes from the same economic actor often leads to the problem of "overgrazing" (Treisman, 2000: 433). "Fiscal decentralisation" and "federal status," on the other hand, appear to be insignificantly related to corruption, which contradicts classical theories for reasons that are beyond the scope of this study. I also tested an interaction term defined as "electoral decentralisation" by multiplying "democracy" times "federal status." The interaction term entered the regression with a positive coefficient of .49, with a *p*-value of .06; which provides some support to the theoretical argument that having a democratic government closer to the citizens is easier to control, especially when voters have to pay the bills (Fisman and Gatti, 2002a).

**Table 2.3** The Effect of Size Decentralisation on Corruption (OLS cross-country estimates)

| Variables | (I) Explanatory Effect | (II) Basic Estimators | (III) Main Interaction | (IV) Decentralisation Measures | (V) Robustness Checks |
|---|---|---|---|---|---|
| Population per Regional Government | | 1.02*** (3.30) | 1.30 (0.78) | 1.22** (2.54) | |
| Average Area of First-tier Unit | | 0.02 (0.09) | 0.43 (0.18) | 0.28 (0.90) | |
| Democracy | 0.34*** (3.26) | 0.26** (2.51) | 0.26** (2.50) | 0.31* (1.86) | 0.34* (1.91) |
| Education | -3.06*** (-2.79) | -2.22** (-2.11) | -2.22** (-2.10) | -3.41** (-2.22) | -3.02* (-1.75) |
| Inequality | -0.04*** (-2.83) | -0.04*** (-2.79) | -0.04*** (-2.78) | -0.04** (-2.57) | 0.05** (-2.44) |
| Protestantism | 2.19*** (3.20) | 2.25*** (3.52) | 2.27*** (3.47) | 1.81** (2.35) | 2.08** (2.46) |
| GDP per Capita (PPP) | 2.20*** (5.20) | 1.94*** (4.81) | 1.95*** (4.77) | 2.31*** (3.35) | 2.37*** (3.07) |
| Press Freedom | -0.01 (-0.04) | -0.01 (-0.92) | -0.01 (-0.92) | -0.01 (-0.94) | -0.01 (-0.65) |
| Trade Freedom | 0.02 (0.90) | 0.02 (1.11) | 0.02 (1.11) | 0.03 (1.06) | 0.02 (0.78) |
| Interaction (Pop. per Region & Ave. Area of First-tier Unit) | | | -0.07 (-0.17) | | |
| Fiscal Decentralisation | | | | 0.41 (0.34) | 0.80 (0.58) |
| Tiers of Subnational Governance | | | | -0.44** (-2.45) | -0.35* (1.70) |
| Federal Status | | | | -0.68 (-1.47) | -0.42 (0.80) |
| Total Population | | | | | 0.33 (0.69) |
| Total Area (Km2) | | | | | 0.24 (0.68) |
| Observations | 94 | 94 | 94 | 63 | 63 |
| Adjusted R-squared | 0.70 | 0.74 | 0.74 | 0.77 | 0.72 |

Note: *t*-statistics are in parentheses. Standard errors are corrected for heteroscedasticity. In all cases, the computed *f*-values (between 15 and 40) clearly exceed the critical *f*-values at 1%; hence, the null hypothesis that the collective impact of all explanatory variables is simultaneously equal to zero is rejected. Significance: * $p < 10\%$; ** $p < 5\%$; *** $p < 1\%$.

Additionally, I computed a logarithmic weighted average of six measures and sub-measures of decentralisation defined as the "extent of decentralisation," and tested its effect on the multiple regression model. Given that the proxies for "population per regional government" and "average area of first-tier unit" explain similar effects of the variation in "corruption," each were assigned with a 15% weight. The same applies to "federal status" and "electoral decentralisation". "Fiscal decentralisation" and "tiers of subnational governance," on the other hand, made up for the remaining 40%, evenly distributed with 20% each. In line with the theory that the different measures and sub-measures of decentralisation are somewhat independent of each other and do not move in tandem (Sharma, 2006), the imperfect proxy "extent of decentralisation" entered the regression model with an insignificant coefficient. The logic behind these findings could be that some measures of decentralisation improve corruption ratings such as "electoral decentralisation," and some measures of decentralisation worsen corruption ratings such as "tiers of subnational governance." Hence, it is not plausible to accurately explain the overall effect of decentralisation on corruption, because its individual measurements tend to cancel each other out.

The fifth column reports the direct effect of "total population" and "total area" on the model. I excluded "population per regional government" and "average area of first-tier unit" to avoid severe problems of multicollinearity. The strength of the direct association of "total population" and "total area" with "corruption" turned out to be insignificant. It should be noted that "GDP per capita (PPP)" is highly significant throughout the regressions tests. The size of the coefficients imply that a one standard deviation increase in "GDP per capita (PPP)" will be associated to an improvement in the country's corruption rating by more than 200% of a standard deviation. As a final point, I would like to add that the specific hypothesis that countries which have more first-tier subnational governments relative to their population are more corrupt is also reinforced because the variance inflation factor (VIF) of "population per regional government" is constantly below what is commonly agreed on as the barrier for multicollinearity of 4. (Naturally, the VIF of "population per regional government" dramatically improves when "average area of first-tier unit" and/or "total population" are/is excluded from the "corruption" function).

## 2.4  CONCLUSIONS

It is a complex task to measure the extent of decentralisation. And it is even harder to measure the overall impact of decentralisation on corruption. This is due mainly because decentralisation is defined and measured differently in different studies (Sharma, 2006). For example, some decentralisation-related studies use the Government Finance Statistics of the International Monetary Fund (IMF) as a general measure for the extent of decentralisation and its overall impact on corruption such as the case of Fisman and Gatti (2002a; 2002b). However, in reality this variable is only valid as an imperfect proxy for fiscal decentralisation, since it does not include information on the level of autonomy of subnational governments in terms of their revenues or expenditures, which is important information when analysing decentralisation. Which country is more decentralised? One that has subnational powers to tax and spend (fiscal decentralisation), but the rulers are directly appointed by national headquarters (lack of electoral decentralisation or deconcentration of power), or another country where subnational governments are financed by funds and transfers by the central government (fiscal centralisation) but are endowed with complete autonomy to legislate (decision decentralisation). In addition to the problems of accurately measuring and defining decentralisation, its different measures and sub-measures are somewhat independent of each other and do not move in tandem.

In this *paper* I do not intend to capture the overall effect of decentralisation on corruption. I only intend to capture the effect of two specific sub-measures of size decentralisation. In particular, I found that the association between the dependent variable "corruption" and "population per regional government" is highly significant and is robust to control for a wide range of potential sources of omitted variable bias,[8] which provide strong support for the first hypothesis that countries which have more first-tier subnational governments relative to their population are more corrupt. The channels that rationalise the above-mentioned hypothesis suggest that the benefits of having a  regional government closer to the citizens, which in theory should increase the controls of corruption, is dominated by the argument that in smaller jurisdictions corruption is less costly. It appears to be the case that public servants in small jurisdictions tend to be captured more easily by the corrupt private

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[8] I also found that fully democratic wealthy countries with high share of Protestantism and less tiers of government are less corrupt. On the other hand, the negative sign of "education" is subject to further investigation because it does not support the classical theories of corruption, as is the case with the insignificant effect of three traditionally significant controls of corruption: income inequalities, liberty of press, and openness to trade.

elite (Prud'homme, 1995). This is due mainly because regional control and accountability mechanisms (such as legal and regulatory sanctions, codes of conduct, whistleblowing, and independent watchdogs in the public sector) are weaker compared to national ones (Bardhan and Mookherjee, 2006). And also because, public servants in regional governments are relatively more unreliable, underpaid, uncooperative and unmotivated in comparison to their national level counterparts (Bardhan, 2002). Besides, family and personal ties between the private sector and corrupt officials tend to be closer in smaller jurisdictions (Tanzi, 1995). Another rationale that explains the association between "corruption" and "population per regional government" is that the greater the number of first-tier subnational units with monopolistic regulatory powers to impose independent bribes, the greater the total number of bribes in the country (Shleifer and Vishny, 1993).

The direction of causality presents a significant limitation that is very hard to solve. This is why all decentralisation and corruption studies must rely on the underlying theory. One statistical solution to this endogenous problem is to develop a research design that observes changes in corruption over time and then to relate these changes to decentralisation. For example, it would be feasible, though not entirely accurate, to examine the decentralisation variable a few years before the corruption variable. By doing so it may be plausible to verify the influential causality of decentralisation on corruption (Treisman, 2000).

However, even if a correct research design were to be developed, it is impossible to completely separate decentralisation from corruption, because the interaction between the two variables is the result of an extremely complex and continuously changing phenomenon that involves several economic, political, cultural, and historical factors. In fact, separating corruption from anything related to governance is very difficult because it appears that corruption is an integral part of the government. As Bardhan (2002: 203) correctly points out: "Before being too quick to claim that decentralisation brought about certain outcomes, it is worth considering that decentralisation may have resulted from ongoing political and economic changes that also affected these same outcomes. Separating decentralisation from its political and economic causes, so that decentralisation is not just a proxy for an ill-defined broad package of social and economic reforms, is a delicate task."

# APPENDIX

**Table A2.4** Definition of the Data

| Variable | Interpretation | Source | Year |
|---|---|---|---|
| Corruption | Perception of corruption, not the actual level of corruption. | Transparency International | 2009 |
| Population per Regional Government | Total population divided by total number of regional governments (first-tier subnational unit). | UN Department of Economic & Social Affairs, and ISO 3166 Subdivision Codes. | 2009 |
| Average Area of First-Tier Unit | Total area (km2) divided by total number of regional governments (first-tier subnational unit) | UN Statistic Division, and ISO 3166 Subdivision Codes. | 2008 |
| Democracy | Electoral processes, pluralism, generalised participation, functioning of government, civil liberties, and political culture. | Economist Intelligence Unit index | 2008 |
| Education | Two-thirds weighting to adult literacy rate and one-third to combined gross school enrolment ratio. | United Nations index | 2008 |
| Inequality | Statistical dispersion of income inequality. | CIA World Factbook Gini inequality coefficient | 2008 |
| Protestantism | Share of Protestant Religion in the Country | International Religious Freedom Report (USA State Department) | 2004 |
| GDP per Capita (PPP) | Value of goods and services divided by population (takes into account relative cost of living and inflation rates). | IMF World Economic Outlook Database. | 2008 |
| Press Freedom | Freedom of journalists and media, and efforts made by governments to see that press freedom is respected. | Reporters Without Borders | 2009 |
| Trade Freedom | Measures the absence of tariff and non-tariff barriers. | Heritage Foundation and The Wall Street Journal Trade Freedom index | 2009 |
| Property Rights | Protection of property rights, including financial assets. | Global Competitiveness Report (World Economic Forum) | 2008-2009 |
| Strength of Auditing and Reporting Standards | Financial auditing and reporting standards regarding company financial performance. | Global Competitiveness Report (World Economic Forum) | 2008-2009 |
| Regulatory Quality | Obstacles generated by excessive regulations. | Worldwide Governance Research Dataset (World Bank) | 2008 |
| Government Effectiveness | Quality of public management, credibility in implementation of public policies, and capabilities of public employees. | Worldwide Governance Research Dataset (World Bank) | 2008 |
| Reliability of Police Services | Police services reliability to enforce law and order. | Global Competitiveness Report (World Economic Forum) | 2008-2009 |
| Judicial Independence | Judiciary independency from influences of government, citizens, or firms. | Global Competitiveness Report (World Economic Forum) | 2008-2009 |
| Fiscal Decentralisation | Two-thirds weighting to revenue and one-third to expense (regional level of government). | Government Finance Statistics Yearbook (IMF) | 2002-2008 |
| Tiers of Subnational Governance | Total number of vertical subnational levels of government. | ISO 3166 Subdivision Codes | 2009 |
| Federal Status | Measure decision-making autonomy at a regional level. | The Forum of Federations | 2009 |

**Table A2.5** Main Independent Variables

| Country | Administrative Division<br>First-Tier Subnational Governments<br>(Regional level between central and local) | Nº of<br>First-Tier<br>Units | Total<br>Population<br>(2009 est.) | Total<br>Area<br>(km2) | Population<br>per Regional<br>Government | Average<br>Area of First-<br>Tier Unit |
|---|---|---|---|---|---|---|
| Afghanistan | 34 Provinces | 34 | 28,150,000 | 652,230 | 827,941 | 19,183 |
| Albania | 12 Counties | 12 | 3,170,000 | 28,748 | 264,167 | 2,396 |
| Algeria | 48 Provinces | 48 | 34,895,000 | 2,381,740 | 726,979 | 49,620 |
| Angola | 18 Provinces | 18 | 18,498,000 | 1,246,700 | 1,027,667 | 69,261 |
| Argentina | 23 Provinces, 1 Federal District | 24 | 40,134,425 | 2,780,400 | 1,672,268 | 115,850 |
| Armenia | 10 Regions, 1 City | 11 | 3,230,100 | 29,743 | 293,645 | 2,704 |
| Australia | 6 States, 2 Territories | 8 | 22,117,000 | 7,692,024 | 2,764,625 | 961,503 |
| Belarus | 6 Oblasts | 6 | 9,671,900 | 207,600 | 1,611,983 | 34,600 |
| Belgium | 3 Regions | 3 | 10,827,519 | 30,528 | 3,609,173 | 10,176 |
| Benin | 12 Departments | 12 | 8,935,000 | 112,622 | 744,583 | 9,385 |
| Bolivia | 9 Departments | 9 | 9,879,000 | 1,098,581 | 1,097,667 | 122,065 |
| Bulgaria | 28 Regions | 28 | 7,576,751 | 110,879 | 270,598 | 3,960 |
| Burkina Faso | 45 Provinces | 45 | 15,757,000 | 274,200 | 350,156 | 6,093 |
| Burundi | 16 Provinces | 16 | 8,303,000 | 27,830 | 518,938 | 1,739 |
| Cameroon | 10 Regions | 10 | 19,522,000 | 475,440 | 1,952,200 | 47,544 |
| Canada | 10 Provinces, 3 Territories | 13 | 33,968,000 | 9,984,670 | 2,612,923 | 768,052 |
| Central African Rep. | 16 Prefectures, 1 Capital | 17 | 4,422,000 | 622,984 | 260,118 | 36,646 |
| Chad | 22 Regions | 22 | 11,274,106 | 1,284,000 | 512,459 | 58,364 |
| Chile | 13 Regions | 13 | 17,020,000 | 756,102 | 1,309,231 | 58,162 |
| Colombia | 32 Departments, 1 Capital District | 33 | 45,267,000 | 1,141,748 | 1,371,727 | 34,598 |
| Costa Rica | 7 Provinces | 7 | 4,579,000 | 51,100 | 654,143 | 7,300 |
| Cote d'Ivoire | 16 Regions | 16 | 21,075,000 | 322,463 | 1,317,188 | 20,154 |
| Croatia | 20 Counties, 1 City | 21 | 4,435,056 | 56,594 | 211,193 | 2,695 |
| Cuba | 14 Provinces, 1 Special Municipality | 15 | 11,204,000 | 110,860 | 746,933 | 7,391 |
| Czech Republic | 14 Regions, 1 Municipality | 15 | 10,513,397 | 77,276 | 700,893 | 5,152 |
| Denmark | 5 Regions | 5 | 5,532,531 | 43,094 | 1,106,506 | 8,619 |
| Dominican Republic | 29 Provinces, 1 District | 30 | 10,090,000 | 48,380 | 336,333 | 1,613 |
| Ecuador | 22 Provinces | 22 | 14,113,000 | 276,840 | 641,500 | 12,584 |
| El Salvador | 14 Departments | 14 | 6,163,000 | 20,720 | 440,214 | 1,480 |
| Eritrea | 6 Provinces | 6 | 5,073,000 | 121,320 | 845,500 | 20,220 |
| Estonia | 15 Counties | 15 | 1,340,415 | 43,211 | 89,361 | 2,881 |
| France | 22 Regions, 4 Overseas Departments | 26 | 65,073,482 | 640,053 | 2,502,826 | 24,617 |
| Georgia | 9 Reg., 2 Autonomous Republics, 1 City | 12 | 4,385,400 | 69,700 | 365,450 | 5,808 |
| Germany | 16 Lands | 16 | 81,789,573 | 357,114 | 5,111,848 | 22,320 |
| Ghana | 10 Regions | 10 | 23,837,000 | 238,533 | 2,383,700 | 23,853 |
| Greece | 13 Administrative Regions | 13 | 11,306,183 | 130,800 | 869,706 | 10,062 |
| Guatemala | 22 Departments | 22 | 14,027,000 | 108,430 | 637,591 | 4,929 |
| Guinea | 7 Governorates | 7 | 10,069,000 | 245,857 | 1,438,429 | 35,122 |
| Guyana | 10 Regions | 10 | 762,000 | 214,696 | 76,200 | 21,470 |
| Haiti | 9 Departments | 9 | 10,033,000 | 27,560 | 1,114,778 | 3,062 |
| Honduras | 18 Departments | 18 | 7,466,000 | 111,890 | 414,778 | 6,216 |
| Iraq | 18 Governorates | 18 | 30,747,000 | 435,244 | 1,708,167 | 24,180 |
| Ireland | 4 Provinces | 4 | 4,459,300 | 70,273 | 1,114,825 | 17,568 |
| Israel | 6 Districts | 6 | 7,509,000 | 22,072 | 1,251,500 | 3,679 |
| Italy | 20 Regions | 20 | 60,231,214 | 301,336 | 3,011,561 | 15,067 |
| Jamaica | 14 Parishes | 14 | 2,719,000 | 10,831 | 194,214 | 774 |
| Japan | 47 Prefectures | 47 | 127,530,000 | 374,744 | 2,713,404 | 7,973 |
| Jordan | 12 Governorates | 12 | 6,316,000 | 91,971 | 526,333 | 7,664 |
| Kazakhstan | 14 Regions, 2 Cities | 16 | 15,776,492 | 2,724,900 | 986,031 | 170,306 |
| Kuwait | 6 Governorates | 6 | 2,985,000 | 17,820 | 497,500 | 2,970 |
| Kyrgyzstan | 7 Regions, 1 City | 8 | 5,482,000 | 199,951 | 685,250 | 24,994 |
| Laos | 16 Provinces, 1 Capital City | 17 | 6,320,000 | 236,800 | 371,765 | 13,929 |
| Lebanon | 8 Governorates | 8 | 4,224,000 | 10,452 | 528,000 | 1,307 |
| Liberia | 15 Counties | 15 | 3,476,608 | 111,355 | 231,774 | 7,424 |
| Libya | 34 Municipalities | 34 | 6,420,000 | 1,759,540 | 188,824 | 51,751 |
| Lithuania | 10 Counties | 10 | 3,329,227 | 65,300 | 332,923 | 6,530 |
| Malaysia | 13 States, 3 Federal Territories | 16 | 28,306,700 | 330,803 | 1,769,169 | 20,675 |
| Mali | 8 Regions, 1 District | 9 | 14,517,176 | 1,240,000 | 1,613,020 | 137,778 |
| Mauritania | 12 Regions, 1 District | 13 | 3,291,000 | 1,025,520 | 253,154 | 78,886 |

| Moldova | 10 Districts, 2 Territories, 1 City | 13 | 3,567,500 | 33,846 | 274,423 | 2,604 |
|---|---|---|---|---|---|---|
| Morocco | 16 Economic Regions | 16 | 31,698,000 | 446,550 | 1,981,125 | 27,909 |
| Mozambique | 10 Provinces, 1 City | 11 | 20,226,296 | 801,590 | 1,838,754 | 72,872 |
| Netherlands | 12 Provinces | 12 | 16,582,600 | 37,354 | 1,381,883 | 3,113 |
| New Zealand | 2 Islands | 2 | 4,350,600 | 270,467 | 2,175,300 | 135,234 |
| Nicaragua | 16 Departments, 2 Autonomous Regions | 18 | 5,743,000 | 130,373 | 319,056 | 7,243 |
| Niger | 7 Departments, 1 Urban Community | 8 | 15,290,000 | 1,267,000 | 1,911,250 | 158,375 |
| Panama | 9 Provinces, 5 Districts | 10 | 3,454,000 | 75,417 | 345,400 | 7,542 |
| Papua New Guinea | 1 District, 19 Provinces | 20 | 6,732,000 | 462,840 | 336,600 | 23,142 |
| Paraguay | 17 Departments, 1 Capital City | 18 | 6,349,000 | 406,752 | 352,722 | 22,597 |
| Peru | 24 Departments, 1 Constitutional Province | 25 | 29,132,013 | 1,285,216 | 1,165,281 | 51,409 |
| Poland | 16 Provinces | 16 | 38,100,700 | 312,685 | 2,381,294 | 19,543 |
| Romania | 40 Departments, 1 Municipality | 41 | 21,466,174 | 238,391 | 523,565 | 5,814 |
| Russia | 21 Rep, 6 Terr., 50 Reg., 10 Dist., 2 Cities | 89 | 141,915,979 | 17,098,242 | 1,594,562 | 192,115 |
| Rwanda | 4 Provinces, 1 Town Council | 5 | 9,998,000 | 26,338 | 1,999,600 | 5,268 |
| Saudi Arabia | 13 Provinces | 13 | 25,721,000 | 2,149,690 | 1,978,538 | 165,361 |
| Senegal | 14 Regions | 14 | 12,534,000 | 196,722 | 895,286 | 14,052 |
| Sierra Leone | 1 Area, 3 Provinces | 4 | 5,696,000 | 71,740 | 1,424,000 | 17,935 |
| Slovakia | 8 Regions | 8 | 5,421,937 | 49,037 | 677,742 | 6,130 |
| South Korea | 9 Provi., 6 Metropolitan Cities, 1 Capital | 16 | 48,333,000 | 99,828 | 3,020,813 | 6,239 |
| Spain | 17 Autonomous Communities | 17 | 45,967,632 | 505,992 | 2,703,978 | 29,764 |
| Sri Lanka | 9 Provinces | 9 | 20,238,000 | 65,610 | 2,248,667 | 7,290 |
| Sudan | 26 States | 26 | 39,154,490 | 2,505,813 | 1,505,942 | 96,377 |
| Suriname | 10 Districts | 10 | 520,000 | 163,820 | 52,000 | 16,382 |
| Syria | 14 Provinces | 14 | 21,906,000 | 185,180 | 1,564,714 | 13,227 |
| Tajikistan | 1 Autonomous Region, 2 Regions | 3 | 6,952,000 | 143,100 | 2,317,333 | 47,700 |
| Tanzania | 26 Regions | 26 | 43,739,000 | 945,087 | 1,682,269 | 36,350 |
| Thailand | 75 Prov., 1 Metropolitan Administration | 76 | 63,389,730 | 513,120 | 834,075 | 6,752 |
| Togo | 5 Regions | 5 | 6,619,000 | 56,785 | 1,323,800 | 11,357 |
| Trinidad and Tobago | 11 Regions, 5 Municipalities | 16 | 1,339,000 | 5,130 | 83,688 | 321 |
| Tunisia | 24 Governorates | 24 | 10,327,800 | 163,610 | 430,325 | 6,817 |
| Turkey | 81 Provinces | 81 | 71,517,100 | 783,562 | 882,927 | 9,674 |
| Turkmenistan | 5 Regions | 5 | 5,110,000 | 488,100 | 1,022,000 | 97,620 |
| Uganda | 80 Districts | 80 | 32,710,000 | 241,550 | 408,875 | 3,019 |
| Ukraine | 24 Regions, 1 Republic, 2 Cities | 27 | 46,011,345 | 603,500 | 1,704,124 | 22,352 |
| United Kingdom | 9 Regions | 9 | 62,041,708 | 242,900 | 6,893,523 | 26,989 |
| USA | 50 Sates, 1 District, 6 Outlying Areas | 57 | 308,493,000 | 9,629,091 | 5,412,158 | 168,931 |
| Venezuela | 23 States, 1 Federal District | 24 | 28,627,000 | 912,050 | 1,192,792 | 38,002 |
| Vietnam | 64 Provinces | 64 | 85,789,573 | 331,212 | 1,340,462 | 5,175 |
| Yemen | 19 Governorates, 1 City | 20 | 23,580,000 | 527,968 | 1,179,000 | 26,398 |
| Zambia | 9 Provinces | 9 | 12,027,000 | 752,612 | 1,336,333 | 83,624 |

Note: The total sample is constituted by 100 randomly selected countries. The sample, however, makes no clear distinction between federal and unitary States.

# FLAWED DECENTRALISATION AND CORRUPTION IN VENEZUELA[9]

## ABSTRACT

This multiple case study focuses on the following four factors, which are all related to flawed decentralisation, that increase bureaucratic corruption at local levels of government in Venezuela: (1) municipal atomisation, i.e., newly created local units of government in relatively poor and scarcely populated small territories; (2) increasing local bureaucracy as measured by public salaries and number of bureaucrats; (3) vertical fiscal imbalances due to the absence of revenue autonomy; and (4) the creation of community councils, which introduce new tiers of undemocratic, dependent governments. A viable government measure that would address these salient factors would be to consolidate small units and allow more flexible changes to the rate of at least one important local tax.

KEYWORDS -- decentralisation · corruption · Venezuela · bureaucratic mismanagement · ethics

## 3.1 INTRODUCTION

Why has flawed decentralisation worsened corruption in Venezuela? This inductive research question is addressed as part of an ongoing project that began in 2005. The aim of the research is to show that some specific components of decentralisation in Venezuela have aggravated corruption through four causal mechanisms: increasing the number of municipalities, increasing the size of the local public sector work force, forcing municipalities to rely heavily on central government money transfers, and giving rise to a third subnational tier of government. The country examined in the study, Venezuela, poses issues that are interesting to the empirical literature by virtue of the broad political changes that have taken place there in recent years.

In this *paper* I demonstrate these points through a descriptive account based on group and individual interviews, as well as on published texts available in Venezuela. I also use this account to support an analytical claim that a viable government initiative to reduce the number of subnational units and increase revenue autonomy would decrease corruption. The focus groups took place in Margarita Island, Nueva Esparta State, and the personal semi-structured interviews were conducted on site at two municipalities, central government offices, and one community council. The research process separated and treated these locations as independent sub-cases of the general case study on flawed decentralisation and corruption in Venezuela.

The research developed around two conceptual links: (1) that corruption leads to flawed decentralisation and (2) that flawed decentralisation may increase corruption in an already corrupt environment, especially when local mechanisms of control and accountability (e.g., independent whistleblowers and regulatory sanctions) are weaker than their counterparts at the central or national level. Throughout the *paper*, corruption is defined as the misuse of power for personal gain, while decentralisation is defined as the devolution of power to subnational governments.

The *paper* advances the literature in several ways. While some academics trained in the deductive methodology may question the validity of qualitative research, hard data at the micro-level are unique, necessary, and very challenging to gather in developing countries. Additionally, we do not adequately understand the causative factors that are generating local government corruption and mismanagement in developing countries. Therefore, more

evidence from case studies is needed before we can discern the direction of future research. As Fan, Lin, and Treisman (2009: 33) acknowledge, "the direction of causation is open to question for all the dimensions of decentralisation examined."

The *paper* is organised in seven short sections. The next section examines theories regarding corruption and decentralisation and describes the unit of analysis (local governance in Venezuela). The third section explains the methodology and defines the dependent variable of the case study (i.e., high corruption in Venezuela). The fourth section introduces an approximation of the findings (i.e., indirect causes of high corruption in Venezuela). The fifth section analyses the four explanatory factors of interest (municipal atomisation, increasing local bureaucracy, lack of revenue autonomy, and creation of community councils). The sixth section offers specific guidance to practitioners by formulating three viable government measures. The final section concludes.

## 3.2   REVIEW OF THE LITERATURE

### 3.2.1   Corruption and Decentralisation Theories

Corruption is the misuse of public power for personal gain. This definition has been widely used by Transparency International (TI), although TI now uses "abuse" instead of "misuse," "entrusted" instead of "public," and "private" instead of "personal." According to Tanzi (1998), the harmful effects of corruption on the quality of government are significant because corruption undermines the essential government obligations to respect contracts, protect private property, and deliver impartial justice.[10]

Previous studies have shown that corruption increases consumer price inflation (Cukierman et al., 1992), raises real interest rates (Bahmani and Nasir, 2002), consolidates socioeconomic inequalities (Alonso-Terme et al., 1998), encourages unproductive public policy choices such as less spending on education and more spending on defense (Mauro, 1998), diminishes the legitimacy of governments to the point of instigating civil wars

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[10] Some well-known corrupt activities are pay-offs, bribery, collection of charge fees, illegal gifts, illicit contributions, tax evasion or fraud, nepotism or patronage, unlawful appropriation of public funds or state property, abuse of public authority, traffic of influences, acceptance of compensation and gifts, use of privileged information, and any other activity that influences the political and public system with the objective of obtaining either direct or indirect benefits (Harch, 1993).

(Klitgaard, 1990), and functions as an arbitrary tax (amounting to 20% of total business returns) that significantly inhibits the rate of investment (Wei, 1999) and that decreases economic growth by approximately 0.5% annually (Mauro, 1995).

Decentralisation is the transfer of decision-making powers, including real control over local revenues, to democratically elected subnational tiers of government. Decentralisation is commonly associated with improving public accountability (Seabright, 1996), strengthening institutional and technological innovations (Besley and Case, 1995), increasing the responsiveness of government (Maskin et al., 2000), and encouraging economic growth (Qian and Roland, 1998; Jin et al., 1999; Akai and Sakata, 2002).

Decentralisation programs involve a division of powers (subnational units and government tiers) in the fiscal, legislative, electoral, personnel, control, and administrative domains. Fiscal decentralisation is the capacity to autonomously collect taxes and execute subnational expenditures. Legislative decentralisation is decision-making autonomy at subnational levels of government. Electoral decentralisation is the constitutional right to democratically elect subnational government authorities. Personnel decentralisation is the proportion of public servants belonging to subnational governments in relation to their national level counterparts. Control decentralisation is the right to veto national public policies by subnational governments. Subnational-unit decentralisation relates to the number of government units at a horizontal level, whereas government-tiers decentralisation relates to the number of government units at different vertical levels.[11]

The relationship between corruption and decentralisation deserves special attention because it has become an unsettled question in the literature. Classical theory tends to suggest that public expenditure at subnational levels of government and perceived corruption are inversely related (Huther and Shah, 1998; de Mello and Barenstein, 2001; Fisman and Gatti, 2002a). These groundbreaking *papers*, however, only define fiscal decentralisation from the expenditure side and do not include the devolution-of-revenue effect. Further, Huther and Shah (1998) do not perform any statistical controls, whereas de Mello and Barenstein (2001) only control for population and per capita GDP. Although Fisman and Gatti's (2002a) research includes a wide range of controls (including per capita GDP, civil liberty, population density, ethnic diversity, openness to trade, government size, and colonial history), the effect

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[11] This paper focuses on four components of decentralization as listed below with the specific feature in parentheses: fiscal (lack of revenue autonomy), electoral (creation of community councils), subnational units (municipal atomization), and personnel (increased local bureaucracy).

of the Protestant tradition was omitted. According to Treisman (2002), the inclusion of this variable decreases the significance of the regressions.

### 3.2.2 Weak Assumptions Regarding Decentralisation

Dating back to Tiebout's (1956) seminal work, the majority of empirical studies have exaggerated the theoretical merits of decentralisation. This exaggeration is based mainly on the shaky assumption that decentralisation increases competition among subnational governments and that inter-jurisdictional competition generates a long list of beneficial spillover effects on governance.

The subnational competition assumption takes for granted the proposition that government responsibilities are perfectly defined. In reality, "if decentralisation creates multiple tiers of government, it could weaken accountability, since voters would have greater difficulty attributing blame for failures and credit for successes" (Fisman and Gatti, 2002a: 328). Classical theories of decentralisation also assume that subnational information is relatively more accessible to local officials (Inman and Rubinfeld, 1996, 1997). This assumption is also unsustainable for several reasons. The majority of national-level agents are residents of subnational governments; thus, they have exactly the same capacities as local officials to perceive and understand heterogeneous regional and local information (Bardhan and Mookherjee, 2006). Furthermore, national governments' economies of scale are likely to produce institutional advantages in obtaining and comprehending all types of information (Prud'homme, 1995).

The theories of decentralisation are also based on the unrealistic assumption that subnational governments are divided and organised according to the needs and preferences of their constituents. In reality, the regional and local governments of developing countries are divided mainly on the basis of their potential income rather than on the basis of qualitative differences such as ethno-linguistic or geographical differences (Prud'homme, 1995). In the specific case of Venezuela, the first-tier division of government could ideally be organised into nine administrative regions corresponding to climatic and bio-geographical regions, but the nation has actually been divided into twenty-three states plus the capital district. More than four decades ago, the nine regions were already divided by a 1969 decree on regionalisation that institutionalised a process of regional development; however, in practice, this decree has never been put into effect. The nine regions that should have been

institutionalised by the 1969 regionalisation decree are far more internally homogeneous than the actual 24 first-tier subnational division. (The hypothetical nine regions are shown in Table A1 after the reference list).

Fifty years after the publication of Tiebout's piece, its theoretical assumptions about decentralisation are starting to generate more doubts than answers. The first real challenge to orthodox theory was Tanzi's (1995) suggestion that institutional imperfections might exist in the production, administration, and distribution of public goods and services at subnational levels of government. In accordance with these arguments, Bardhan (1997) and Shleifer and Vishny (1993) suggested that an increase in the number of local governments with a monopoly of regulatory power increases the total number of bribes. Bardhan (2002) later added that subnational governments of developing countries usually do not fulfill government objectives. Even if they harbor good intentions and are staffed by the appropriate public personnel, subnational governments of developing countries usually do not have sufficient income, constitutional authority, or administrative capacity to finance their responsibilities (Bardhan and Mookherjee, 2006).

### 3.2.3 Unit of Analysis: Decentralisation of Local Governance in Venezuela

Modern local governance in Venezuelan started in 1958 with the birth of the current democracy, and with the promulgation of its basic law, the Constitution of 1961. In the following years, no major modifications arose in the processes of reforming local governments. However, in the mid-eighties the falling prices of oil and the economic programs promoted by the International Monetary Fund (IMF), called the "Economic Package," led to a severe political, economic, and democratic crisis associated with a massive popular revolt called "El Caracazo." As a partial response to the severe institutional and democratic crisis in Venezuela, a decree calling for local elections was first introduced on June 15, 1989, and the first democratic election at a local level was carried out in 1992. Prior to that date, the President of the Republic designated the municipal mayors, and these mayors, in turn, named the members of the legislative councils according to regional constitutions.

In the Presidential elections of 1998, six years after the first democratic elections at the local level, a popular movement of the Marxist left-wing group, led by Army Lieutenant Colonel Hugo Chávez Frías, succeeded in taking national office for the first time after more than four decades of bipartidism dominated by rightwing politicians. This situation brought

forth a total rupture of the traditional political structure. Subsequently, the process of drafting a new constitution was initiated in 1999, and the current Constitution was approved in December of the same year by a public referendum.

Based on this new legal framework, a group of laws was subsequently introduced to regulate public administration in Venezuela. Among these laws, two are particularly notable: the Organic Law of Public Administration (official gazette number 37,305; 17 October 2001), which establishes the principles and bases for regulating the organisation and functioning of Venezuela's public administration, and the Organic Law of Planning (official gazette number 5,554; 13 November 2001), which establishes the parameters for the organisation and planning of subnational governments.

## 3.3 METHODOLOGY

### 3.3.1 Research Philosophy

The research developed through several rounds of original fieldwork during which new local hard data were collected at the local level of government. The primary data collection techniques were semi-structured interviews and focus groups. The decision to rely on semi-structured interviews rather than questionnaires was necessary, not only because busy politicians and bureaucrats often prefer to be interviewed rather than to fill in a questionnaire; but also because public officials, who are deluged with paperwork, tend to treat a questionnaire as just another low priority piece of paperwork. In contrast, an in-depth interview can be a pleasant and informative interlude in a day otherwise dominated by paperwork. In total, 71 individuals from all sectors of society were interviewed or participated in the focus group exercises. The study scored high in validity tests because the data reflect reality in Venezuela. However, the study scored low in reliability tests because the methodology does not allow the findings to be replicated in other regions of the world.

Despite the problems of access resulting from the sensitivity of the topic (corruption) to the gatekeepers (public officials and political authorities), the pool of respondents was well balanced: approximately 45% from the PSUV (Partido Socialista Unido de Venezuela), approximately 30% from the opposition, and approximately 25% from the community. Some of the more frequent elite respondents include the following: Alejandro Feo, opposition

municipality mayor of Naguanagua; Ibrain Velásquez, *chavista* municipality mayor of Gaspar-Marcano; David Baez, community leader and Justice of the Peace; Ricardo Gutierrez, former Vice-President of the National Assembly; and José Khan, Director of the Central Bank and Minister of Basic Industries and Mining.

Access to the elite respondents was made possible through an anonymous common acquaintance. The introductions provided by this common acquaintance established familiarity and increased the willingness of the respondents to express their ideas and differences freely; moreover, this situation allowed the researcher to get close enough to the respondents to obtain valid data. Furthermore, according to Morgan (1993), a familiar environment is crucial to understand the intrinsic meaning of a specific phenomenon. For the purpose of this research, the interviews were conducted on site, and the focus groups occurred at two specific locations in Porlamar and Juan Griego, state of Nueva Esparta.[12]

The research identified the following consequences related to flawed decentralisation that contribute to bureaucratic corruption at local levels of government in Venezuela: municipal atomisation, increasing local bureaucracy, lack of revenue autonomy, and the creation of community councils. The independent sub-cases used to identify and explore these relevant issues are the municipalities of Gaspar-Marcano and Naguanagua, a sample from the national government, and a community council in Nueva Esparta state. Particular emphasis is given to the two municipalities because local governments are the first and most important locus of interaction between citizens and the public sector (Holden et al., 2003).

The cases are considered to be sensible units of observations because they resemble the political landscape in Venezuela. The municipality of Gaspar-Marcano has a predominately poor total population of 31,959, most of whom are dedicated to traditional fishing, and it is run by Ibrain Velásquez, a veteran leftwing *chavista* leader. Naguanagua, with a total population of 168,000, consists primarily of rich neighborhoods in the industrial state of Carabobo and is run by a newcomer, Alejandro Feo, who is backed up by a centre-right political party in the opposition bloc called Project Venezuela, which is not linked to the traditional parties AD (Acción Democrática) and COPEI (Comité de Organización Política Electoral Independiente). Approximately two-thirds of the sample taken from the central government consists of PSUV members, which is the *chavistas* united political party, while the remaining one-third are mostly bureaucrat old-timers who profess no political affiliation but are known to be the remaining survivors of a four-decade unchecked bipartidism.

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[12] The author appreciates the staff of the restaurants formerly called Margaritaville and Bongo Beach (where the focus groups took place) for setting up a comfortable and relaxed atmosphere.

It is hard to estimate the political affiliation of the individuals interviewed from the community council. The first impression would indicate that most community councils are deconcentrated organisations of PSUV headquarters, since the financial bottom-line must be approved by the central administration. In summary, the sub-cases are comparable units of observation that behave similarly to the political consequences of flawed decentralisation.

### 3.3.2 Dependent Variable: High Corruption in Venezuela

Venezuela's corruption perception index (CPI), as reported by Transparency International, has worsened from a very low starting point of 2.7 in 1995, to 2.6 in 1999, 2.5 in 2002, 2.3 in 2004, 2.0 in 2007, 1.9 in 2009, and slightly up to 2.0 in 2010. (The CPI ranges from zero to ten, with lower scores corresponding to worsening corruption ratings.) The World Bank Worldwide Governance Research Dataset and the Global Competitiveness Report by the World Economic Forum both corroborate that notion that corruption in Venezuela has become a generalised problem.

According to Tanzi (1998), high corruption and weak public institutions are strongly associated. Tanzi (1998) argues that institutional weaknesses can be summarised as inefficient penalty and tax systems, poor bureaucratic quality, lack of checks and balances, rigid and obsolete regulations and authorisations, and lack of transparency in rules and processes. These institutional weaknesses are all present in Venezuela. Therefore, it should not come as a surprise that the high rate of corruption in Venezuela is associated with weak public institutions. In the specific case of Venezuela, the following problems are evident: an unstable legal framework, price controls on basic goods and services, over-reliance on oil for public revenues, severe market distortions through dual exchange rate, repeated attacks against press freedom, lack of judicial autonomy, nationalisation of the economy's strongest industries, substantial trade barriers, constant threats to personal security, rigid labor laws, complex rules and regulations, crumbling infrastructure, and an increasingly powerful *chavismo* administration that resembles an unprecedented mix of Bolivar's nationalism, Peron's populism, Allende's socialism, and Castro's communism.

The 2010-2011 Global Competitiveness Report by the World Economic Forum (Almunia et al., 2010) ranks Venezuela dead-last out of 139 countries in judicial independence, property rights, favoritism in decisions of government officials, burden of regulations, and efficiency of legal framework in settling disputes and challenging

regulations. These sub-indicators are also essential components of the general indicator "Public Institutions," in which Venezuela also ranks last. Venezuela's "voice and accountability" scores on the 1996-2008 Governance Indicators by the World Bank (Kaufmann et al., 2009), which are scaled between -2.5 and 2.5 with higher values corresponding to better governance outcomes, also decreased from a low starting point of 0.08 in 1996 to -0.62 in 2008. "Regulatory quality" also significantly worsened from -0.10 in 1996 to -1.44 in 2008. "Rule of law" took an even larger drop over the same period from 0.60 to -1.59.

## 3.4   INDIRECT CAUSES OF HIGH CORRUPTION IN VENEZUELA

In addition to the weakness of public institutions, high corruption in Venezuela can also be explained by eight indirect factors. The first five factors come from the literature, while the remaining three were derived from the interviews. (It should be noted that some of the causes presented next are controversial hypotheses which in many cases have not been proven and might even be offensive to some cultures):

i) Tropical location: Venezuela is geographically located in a tropical poverty trap, and poverty drives corruption (Mauro, 1995; Glaeser and Saks, 2006). Sachs (1997) reports that annual growth rates of tropical countries between 1965 and 1990 were 1.3% lower than the growth rates in nations further away from the Equator. An argument that explains this phenomenon is that the equator region has historically witnessed a series of tropical disease outbreaks, which tend to lethally infect healthy, productive males who work in the countryside.

ii) Spanish colonisation: Venezuela was colonised by Spain rather than by Great Britain. The logic behind the Spanish colonisation hypothesis is that the British common law system encouraged watchful societies because it more efficiently protected the private property held by the aristocrats against expropriation or regulation by the monarchy (Treisman, 2000).

iii) Oil dependency: Venezuela's economy is highly dependent on oil, which accounts for at least 90% of total exports and more than half of federal income. Easterly (2001) argues that economic dependence on natural resources generates corruption mainly because of the corrupt incentives associated with the distribution of exploration rights.

iv) Lack of democracy: Venezuela's form of democracy undermines key mechanisms of control and accountability such as independent whistleblowers and watchdogs. According to the Economist Intelligence Unit's 2008 Democracy Index, Venezuela is somewhere between a "flawed democracy" and an "authoritarian regime," with a score of 5.34 on a scale from zero to ten.

v) Low Protestant religious background: Venezuela has a relatively low Protestant population of less than 30% according to the 2004 US State Department's International Religious Freedom Report. Treisman (2000) quantified the effect of the Protestant religion on corruption, revealing an increase of 5% to 10% in the Protestant population decreases the level of corruption by approximately 11%. The reasons for this phenomenon are beyond the scope of this study.

vi) Cultural/traditional injustices: In all interviews, at least half of my interviewees spent several minutes at the beginning of our conversations (always related to the general causes of high corruption in Venezuela), giving unsolicited descriptions of the injustices suffered by the bulk of the population. For example, Justice of the Peace and community council treasurer David Baez was quick to note another root cause of corruption in Venezuela: "After winning the election, they [political officials] are socially expected to repay their supporters, become a big man in their town, and recover the personal costs of running an expensive political campaign." (Interview with David Baez, No 10.1, August 7, 2007).[13]

vii) Corrupt idiosyncrasies: Ricardo Martinez (personal assistant to the Mayor of Gaspar-Marcano), added that from an "idiosyncratic" perspective the incoming Mayor has no choice but to hire his own supporters if the previous Mayor came from the opposition. Further, because the law prohibits the firing of bureaucrats, it should not come as a surprise that the bureaucracy is over-saturated. In Mr. Martinez's own words: "We immediately had to bring in our own people at first because we had problems even in printing daily memos due to the constant sabotage by the opposing bureaucracy that had governed here (municipality of Garspar-Marcano) for 16 straight years (four consecutive terms)." (Interview with Ricardo Martinez, No 15.1, January 9, 2009).[14]

viii) Low public salaries: Low-level employees of the two municipalities interviewed tend to agree that a significant institutional root cause of corruption in Venezuela is that "the

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[13] Transcripts or copies of notes of the author's interviews are available on request by referring to the interview number.

[14] The current "Ley Orgánica del Trabajo" (Organic Law of Work, or LOT) of 1997, which is fundamentally the same as the original Law of 1936, practically prohibits (namely through articles 8, 105, 116, 127, 450, 449, 655, and 656) the firing of bureaucrats without strong and irrefutable justification, citing employees' immobility and stability as two keystones of long-term public life careers.

salaries paid here are eaten up by inflation and never cover employees' basic needs; this is why at the end of the month (for example) traffic police officers find creative ways to increase their income" (Interview No 13.2, 2008). When questioned about salary in subsequent open-ended interview sessions, over 90% of low-level personnel believed that corruption is morally acceptable if an official's salary is not commensurate with his or her responsibility.

One significant problem with public salaries in Venezuela is that increases are not evenly distributed. As a result, low-level public employees end up underpaid. In Venezuela from 2008 to 2009, salaries paid to government directors increased 42% and salaries paid to deputies in the National Assembly increased 44%, but the salaries of low-level workers increased only 17% for the same period (Tejero, 2010a). Thus, salary increases for low-level workers were below the 2009 inflation rate of 25%.

Mookherjee and Png (1995) explain how higher public salaries can control corruption, applying an economic cost-benefit analysis to a case in which a public official monitors a polluting private firm. Let us suppose that an inspector from the environmental ministry visits the polluting private firm and that the firm has exceeded the legal levels of pollution. In this case, the public inspector will receive a reward in the form of a high salary as a work incentive, and the polluting firm will receive a fine as punishment. However, if the public inspector accepts a bribe and is discovered, then the public inspector and the corrupt firm will both suffer a penalty. Facing this typical case of corruption, only one of the following three possibilities will occur: First, if the fine is less than the bribe, then the firm prefers to pollute and pay the fine instead of paying an illegal and costly bribe. Second, if the penalty for the public inspector exceeds the bribe, then the public inspector will likely comply inefficiently with his/her functions to avoid unnecessary risks. Third, if the salary reward for the public inspector is greater than the costs associated with receiving a bribe, then the public inspector will probably reject future bribes and the environment will not suffer.

### 3.5  FINDINGS REGARDING FLAWED DECENTRALISATION

On top of the direct cause (weak public institutions) and the eight indirect causes mentioned in the previous section, high corruption in Venezuela could also be triggered by the following four interlinked factors related to flawed decentralisation: (1) an excessive number of municipalities; (2) an excessive number of local public personnel; (3) a lack of local revenue

autonomy; and (4) a lack of subnational democracy. In all cases, the common pattern when any of these factors is present is a weakening of accountability and, ultimately, an increase in incentives for corruption. Refer to Figure 3.1. (Figures and tables are found at the end of this *paper*, after the references list).

**Figure 3.1** Flawed Decentralisation Rhombus
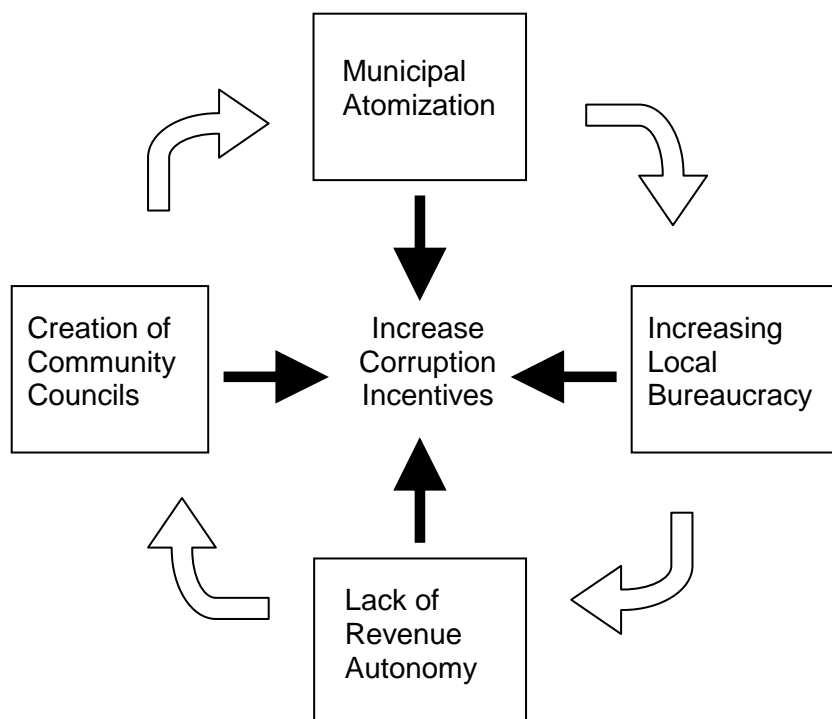


The four flawed decentralisation factors identified in this case study are all interlinked among themselves in such a way that one issue leads to another. Focusing on one or two factors, and not looking at the whole picture, would be insufficient to fully understand the research question: Why has flawed decentralisation worsened corruption in Venezuela? For example, the first key concept discussed is the atomisation of local governments into small, non-viable units that are corrupt and ineffective. More municipalities lead, in turn, to increase the total amount of local bureaucracy, which increases the prevalence of rigid and obsolete municipal processes. In addition to the bureaucratic burden, efficiency is severely handicapped due to a lack of revenue autonomy. "As a way to bypass an inefficient

bureaucracy and complete tasks once and for all," one respondent nicely explained, "new forms of political participation had to be created" (Interview with community council secretary, No 9.2, August 4, 2007). The creation of new forms of political participation, in turn, raises the question: Are community councils a further atomisation of local government?

### 3.5.1 Municipal Atomisation

The first scenario in which decentralisation can fail involves the atomisation of local government. As the term is used here, atomisation of local government refers to newly created local units of government in relatively poor and scarcely populated small territories. Throughout Latin America, atomisation of local government appears to be the rule and not the exception. For example, in Bolivia more than half of all municipalities have populations of less than 10,000 inhabitants, but such small municipalities account for only 9% of total population. In Ecuador, approximately two-thirds of local governments or cantons have populations of less than 50,000 inhabitants, and the vast majority of them are less than 25 years old. The number of cantons in Ecuador has almost doubled during the last few decades from 113 to 219. In northwestern Europe, by contrast, the tendency is to reduce the number of local governments. For example, in Great Britain, the number of local governments has been reduced from 2,000 to approximately 500; in Germany, the number has been reduced from 24,000 to 3,500; in Austria, the number has been reduced from 4,000 to 2,300; and in Sweden, the number has been reduced from 2,500 to 270. This trend is also common in France, Belgium, Holland, Switzerland, Finland, Norway, Sweden, and Denmark.

      The findings from the focus group discussions indicate that local government atomisation is linked to increasing corruption. Naguanagua municipality Mayor Alejandro Feo nicely described this phenomenon in one of my interviews with him: "Only a few municipalities are rich and powerful; but the remaining vast majority is relatively poor, geographically small, newly created, and scarcely populated." (Interview with Alejandro Feo, No 12.0, January 17, 2008). In Venezuela, one municipality in particular (Maracaibo) has a population of 1.5 million inhabitants. Three municipalities have populations of approximately 800,000 inhabitants. Seven municipalities have populations of approximately 300,000 inhabitants. However, the remaining 324 municipalities are remarkably poor and have relatively small populations. In fact, quite a few municipalities have populations of less than 5,000 inhabitants. The mean population of the 335 municipalities in Venezuela is

approximately 87,000 inhabitants. This observation is in line to the findings by Fan, Lin, and Treisman (2009: 33), which strongly argue that smaller local units are associated with more frequent and costly corruption; hence, "reducing the size of the lowest-level local units may also be a bad idea."

The main concern is that poor and unpopulated municipalities increase all types of incentives for corruption due to their disadvantages in economies of scale, which in turn cause elected officials and public personnel of relatively small jurisdictions to be more vulnerable to capture by corrupt, local, private elites. This problem is particularly severe when local mechanisms of control and accountability are weaker than the corresponding mechanisms in the national government. Aside from the fact that smaller subnational governments tend to lack the capacity to coordinate central public policies effectively, in cases where vertical divisions of government increase, there is a tendency for the waste of public resources to also increase due to duplication. When respondents in this study were cued about municipal atomisation, this last point was strongly emphasized in all of my personal interviews and focus group discussions.


### 3.5.2   Increasing Local Bureaucracy

Midway into the research, the attention shifted from municipal atomisation to increasing local bureaucracy. When asked why municipal atomisation generates corruption and mismanagement, the most frequently repeated answer (over 74%) to this pivotal question was that municipal atomisation indirectly drives corruption by increasing the total number of public personnel at subnational levels of government. In fact, every knowledgeable person interviewed strongly agreed on one particular point: municipal atomisation creates more patronage positions that are sold to local interests for funding associated with re-election purposes.

These arguments help to understand the quantitative findings by Fan, Lin, and Treisman (2009), who documented the proposition that larger subnational bureaucracies are associated with more frequent and costly bribery. The relationship between higher government employment and increasing corruption was particularly strong among bureaucracies at the subnational level. On the other hand, the relationship does not necessary apply to higher employment by the central government or to total public employment, particularly if the findings relating to different developing countries are evaluated separately.

In Latin America, Chile is the only country to set limits on the size of the local-level public workforce relative to the size of the population (Nickson, 1998). This limit is 1 local government employee per 500 citizens. The 5 municipalities in the Caracas Metropolitan Area, on the other hand, average 1 local government employee for every 145 citizens. In Baruta, the ratio is 1 local government employee for every 312 citizens; in Libertador, the ratio is 1 public employee for 206 citizens; in El Hatillo, the ratio is 1 public employee for 147 citizens; in Sucre, the ratio is 1 public employee for 89 citizens; and in Chacao, the ratio is 1 public employee for 59 citizens (Rodríguez, 2003). The number of citizens per public employee in these municipalities is, on average, lower than the 280 citizens per public employee observed in the Buenos Aires Metropolitan Zone and well below the 500 citizens per employee limit that was set by law in Chile (Nickson, 1998). In a similar study of municipalities in less developed states, the citizens per public employee ratios were even worse: 127 citizens in Amazonas, 124 citizens in Delta Amacuro, and 102 citizens in Nueva Esparta (González, 1998).

In addition to the exceedingly large local bureaucracy, the raw number of national level public personnel in Venezuela has almost doubled during the last decade; from 1,293,227 employees in 2000, to 2,730,185 in 2008, and to 2,317,822 in 2010 (Caripa, 2008; Tejero, 2010b). In 2007, national level public personnel in Venezuela constituted 17% of the total labor force, and public employee salaries alone represented 19% of the total public budget (Tejero, 2007). In 2008, this share fell back to 17%; however, in 2009, this share rebounded to well over 23% of the total public budget (Tejero, 2009a). The greatest increase, in terms of number of workers, came from the oil company PDVSA (Petróleos de Venezuela S.A), whose workforce almost doubled from a total number of 49,180 workers in 2005 to 91,949 workers in 2009 (Armas, 2010). By the end of 2010, PDVSA estimated that it had 123,177 employees.

It is important to note that local bureaucracy, as the term is being used here, refers to an excessive number of corrupt bureaucrats performing unnecessary governmental tasks that reflect rigid and obsolete rules and regulations at local levels of government. This definition, however, does not correspond to the classical definition of bureaucracy. Max Weber (1978) defined bureaucracy as an organisation with a hierarchical structure designed to coordinate many individuals in the pursuit of large-scale administrative tasks and organisational goals. "Weber was not simply an advocate of bureaucracy and its efficiency but also fundamentally critical and fearful of it" (Swedberg, 2005: 20). In reality, a bureaucracy is comprised of many departments and hierarchies that are structured in such a way that the ruler or elected official

is the principal, while the bureaucrat is the agent. Bureaucrats usually have their own personal objectives that are distinct from those of the ruler, and these distinct objectives give rise to agency problems. Like employees in any other organisation, government agents are also interested in their own welfare.

### 3.5.3   Lack of Local Revenue Autonomy

Local governments have assumed greater responsibilities that require the expenditure of funds, but they have experienced very little financial autonomy. Most expenditures are still financed by constitutional funds and transfers from the national administration. In most cases, as much as 80% of the total local budget is financed by funds and transfers. The link between a lack of tax revenue autonomy and corruption has been well documented. More specifically, some models predict that the level of decentralisation relating to expenditure and revenue generation influences the extent of bureaucratic corruption (Fisman and Gatti, 2002b: 25-26). According to Fan, Lin, and Treisman (2009: 32), "giving local governments a larger stake in locally generated income can reduce their bribe extraction. Other things equal, in a country (such as Finland) in which subnational revenues came to 15% of GDP, the probability that firms would say they "never" had to make unofficial payments to get things performed was .14 higher than in countries (such as Luxembourg) where subnational revenues were only 5% of GDP."

The reason that the lack of local revenue autonomy in developing countries such as Venezuela increases corruption is because it tends to distort the optimal efficiency equilibrium between marginal costs and marginal profits, which is achieved through a gradual process of adjusting expenditures to benefits at the margin. That is, funds and transfers from the national administration significantly disrupt the government-enhancing decentralisation effects that result from a balance between effort and performance (Persson and Tabellini, 2000) and thus undermine a key mechanism for controlling corruption (Fisman and Gatti, 2002b). Fisman and Gatti (2002a: 329) explain this phenomenon very well: "fiscal decentralisation, particularly to the extent that devolution of revenue raising and expenditure power corrects vertical fiscal imbalances across levels of government, is often quoted as an important ingredient for accountability and, ultimately, good governance."

The academic literature reveals a strong consensus on this matter. In an already corrupt political environment (such as Venezuela's local governments) fiscal decentralisation

tends to have a significant negative relationship with corruption (de Mello and Berenstein, 2001; Fisman and Gatti, 2002a; Arikan, 2004), but this positive effect occurs only when expenditure decentralisation (i.e., the power to spend) is accompanied by the devolution of subnational revenue generation (i.e., the power to tax) (Bardhan and Mookherjee, 2006).

In relation to the specific case of Venezuela, the consensus that emerged in most of the focus group discussions (namely the focus groups in two municipalities) was that funds and transfers from the central government are not a source of corruption in themselves even though such funds and transfers generally constitute more than 80% of local budgets that are reported in Venezuela. This level of transfer actually exists in most European countries. Interestingly, the analysts who conducted the focus groups and explained the results to me suggested that Venezuela's governmental transfers do not comply with a series of conditions that are generally present in countries that already have a well-developed political environment with strong independent public institutions. The interviewees claimed that government transfers do not necessarily increase corruption because the transfers are (1) transparent, (2) stable over time, (3) contract-based, (4) disbursed pursuant to allocation formulas that do not discourage local fiscal effort, and (5) disbursed automatically pursuant to objective indicators and not on an ad hoc or case-by-case negotiable basis.

In effect, if the five conditions are satisfied, there is nothing wrong with consistent inter-governmental transfers. However, meeting all of these five conditions is impossible in an already highly corrupt political system with precarious public institutions, which is the case in Venezuela. Recently, the decrease in checks and balances that has occurred in the Chávez era is making it more difficult to efficiently comply with any of the conditional terms. In fact, every person interviewed, including members of the sample drawn from the central government, concur that government transfers in Venezuela do not efficiently comply with any of the five conditions.

### 3.5.4   Creation of Community Councils

The last decentralisation-related cause of corruption is the creation of a third subnational tier of government below the regional (state) and local (municipality) levels of government. Community councils are unelected, bottom-up institutions in which small groups of people (usually 200 to 400 families in the cities and 100 to 200 families in the rural areas) can exercise a united voice and obtain direct financial access to public decisions and resources.

A distinctive characteristic of community councils is that all members are on equal footing and are called "spokespeople" (Ellner, 2010: 90-91). Ellner adds that the wide-range of activities promoted by community councils demonstrates their ability to assume diverse responsibilities. To date, after approval in community assemblies, much of the money received and expended by community councils has been used to construct priority public works projects such as community centers, roads, sidewalks, family housing, and loans for small local businessmen.

Community councils do have the potential to become a pivotal tool in Latin American politics. In reference to community councils, Petras (2007: 2) suggested that "the most important political change is the creation of new locally based forms of political representation in which elected community and communal institutions will be allocated state revenues rather than the corrupt, patronage-infested municipal and state governments." In theory, to encourage decentralised decision-making with community participation regarding public affairs is a relevant issue and requires more academic attention because the performance of citizen participation (Behn, 2002) and evaluation measures (Swindell and Kelly, 2000) have traditionally been neglected. However, the dark side of community councils is that these councils can be manipulated from above and may be detrimental to the proper democratic process.

The data from the focus group interviews demonstrates that the main problems with community councils in Venezuela are straightforward. In the first place, community councils weaken established subnational institutions such as local and regional governments by introducing a third, semi-deconcentrated tier of government that is actually subject to the approval and discretion of an increasingly powerful national government. In the second place, a priori, democracy at any level should always be considered the best option for selecting officials because democracy improves economic policies and outcomes (Besley et al., 2005), encourages power of speech (Besley and Burgess, 2002), and fosters participation in a generalised interpretation of the rule of law (Bardhan, 2005). In the third place, the creation of dependent new tiers of government encourages collusion between agencies in the vertical bureaucratic hierarchy and overgrazing by different autonomous governments that all compete to extract bribes from the same economic actors.

Approximately two thirds of the answers I obtained from the focus groups in response to a cue about mismanagement problems in community councils involved some combination of the three arguments mentioned above. (The specific question was: In what sense do community councils generate mismanagement?) The latter two arguments, which are

discussed below, comprised 18% of all coded answers: 11% for the fourth argument and 7% for the fifth argument. The fourth argument suggests that community councils could work but only in a developed environment with solid institutions, which is not the case in Venezuela. The fifth argument suggests that the creation of communal councils represents an attempt by Chávez and other national politician to weaken opposition-controlled subnational governments.

Surprisingly, based solely on the group interview results, mismanagement problems generated by the creation of community councils were not recognised as a significant contributing factor for the increase in corruption until I specifically asked: "Do you think that corruption will increase with the creation of community councils?" Naturally, interview respondents from the community council and from the national government sample did not considered corruption to be a significant problem, but approximately half of the *chavista* municipality respondents and a vast majority of the respondents from the opposition municipality believed that the creation of community councils will end up increasing incentives for corruption.

The scope of these arguments matches the theories of decentralisation and corruption. Treisman (2002) reports (on the basis of World Bank indicators) that GNP decreases approximately 27% and corruption increases (by between 0.16 and 0.21 points on a 3.5 scale) for each additional tier of government. Fan, Lin, and Treisman (2009: 32) also argued that "in countries with a larger number of administrative or governmental tiers, reported bribery was both more frequent and more costly to firms." The effect was more significant in developing countries with weak institutions, which is precisely the case in Venezuela. (Table 3.1 shows the general questioning map used to find the results, divided by the sub-cases.)

**Table 3.1** General Map of Questions and Responses

| | Municipality of Naguanagua | Municipality of Gaspar-Marcano | Community Council in Nueva Esparta | Sample from the National Government |
|---|---|---|---|---|
| *Three most repeated answers* | | | | |
| What are the general causes of high corruption in Venezuela? | Weak public institutions | Relatively low public salaries | Cultural/Traditional injustices | Economic dependency on oil |
| | Relatively low public salaries | Weak public institutions | Flawed decentralisation | Weak public Institutions |
| | Flawed decentralisation | Corrupt idiosyncrasies | Weak public Institutions | Flawed decentralisation |
| How has flawed decentralisation worsened corruption in Venezuela? | Lack of revenue autonomy | Lack of revenue autonomy | Unrepresentative democratic system | Municipal atomisation |
| | Creation of community councils | Increasing local bureaucracy | Increasing local bureaucracy | Excessive veto powers |
| | Municipal atomisation | Creation of community councils | Municipal atomisation | Increasing local bureaucracy |
| *Most significant argument* | | | | |
| Why does municipal atomisation generate corruption? | Increases the waste of public resources resulting from duplication | Increases the waste of public resources resulting from duplication | Generates disadvantages in the economies of scale | Decreases the capacity to coordinate central public policies effectively |
| How are excessive local bureaucracies increasing corruption? | Creates more patronage positions for re-election purposes | Creates more patronage positions for re-election purposes | Increases the rigidity of bureaucratic processes | Increases the vulnerability to be capture by the local private elites |
| Why is the lack of revenue autonomy generating corruption? | Transfers are negotiable case by case, instead of contract-based | The allocation formulas discourages local fiscal effort | Transfers are not transparent, stable in time, and contract-based | Transfers are not automatically based on objective indicators |
| In what sense do community councils encourage corruption? | Weakens subnational democratic institutions | Generates collusion between the vertical bureaucratic hierarchy | Lack of democracy to select authorities and autonomy to execute | Increases overgrazing to extract bribes from the same person |

## 3.6  GUIDANCE FOR PRACTITIONERS

Questions regarding specific guidance to practitioners were asked near the end of every interview session and focus group discussion. The following three viable government measures emerged as the most frequently repeated suggestions to reverse the weakening of subnational institutions (which ultimately leads to more incentives for corruption) generated by flawed decentralisation:

(i) The first measure is to decrease the number of subnational governments by consolidating poor and unpopulated units into governance organisations that would be relatively more accountable. Fortunately, decreasing the number of subnational governments seems to fit perfectly in the *chavismo* nationalistic agenda. During his third presidential mandate speech to the National Assembly on January 10, 2007, the inflammatory and confrontational President of Venezuela raised the following questions: "Does Venezuela need to be divided politically and territorially as it is now? Is it necessary to have so many municipalities?" The fact that the President posed these questions indicates that it might be politically feasible to decrease the number of subnational governments in Venezuela despite the significant social cost that would result from laying off many public employees. According to unofficial data, at least 100,000 subnational public servants will be laid off (El Nacional, 2007: A2) and 200 municipalities will eventually disappear (Acosta-Ramírez, 2007: A2) if President Chávez's promised structural reforms to reorganise Venezuela's geopolitical administration are ultimately institutionalised. Thus far, these proposals already have a theoretical name: "la nueva geometría del poder" (the new geometry of power).

(ii) Parallel to the decrease in the number of subnational governments, a straightforward government measure to indirectly control corruption would be to empower the newly consolidated regional and local units to change sales and property tax rates. Together, these two taxes account for approximately 13% of total municipal revenues. It should be noted, however, that the respondents were divided in their opinions about fiscal revenue autonomy. Naturally, the *chavistas* municipality personnel interviewed strongly argued in favor of "not changing the status quo," but the anti-*chavistas* municipality personnel complained that the national government

was arbitrarily withdrawing access to locally generated revenue to build dependence on the largesse of the national government.

(iii) In reference to community councils, it should be noted that two characteristics will definitely not change in the near future. First, community councils will never become democratic and autonomous subnational units of governance because community councils were founded as a deconcentrated agency of an increasingly powerful central government. Second, community councils are "here to stay," as mentioned by every interviewee and emphasized by President Chávez on repeated occasions.[15] Taking these issues into consideration, community councils will at least need to work side by side with elected local officials and municipal staff in a way that is consistent with the citizen-initiated performance assessment model proposed by Ho and Coates (2004). Not working side by side with elected officials and municipal staff was most likely the main reason for the failure of the community councils' predecessor, *consejos locales de planificación* (local public planning councils). As Wilpert (2005: 22) correctly notes in reference to local public planning councils: "This is something that never existed before and was badly needed because local government was one of the main areas of corruption—and still is because the Planning Councils have so far not been able to live up to their potential."

### 3.7   CONCLUSION

Evidently, an appropriate balance of decentralisation is necessary for the efficient functioning of the government. In developed countries with independent and strong institutions (such as the case of Switzerland), devolving subnational powers to local democratic institutions tends to improve the quality of government. This is due mainly because (simply through sheer proximity) local officials can be held more accountable by their constituents for their performance (Oates, 1972); and also because, in a mobile society competition among subnational governments may encourage the incentives to be more responsive (Tiebout 1956).

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[15] At his third inauguration Presidential mandate speech in 2007, President Chávez said: "Progressively, the constituted national power must decentralise the political, social, economic, and administrative authority to community councils."

The problem is that in an already highly corrupt environment with weak institutions (such as the case of Venezuela), decentralisation programs could be generating more harmful consequences than beneficial spill-over effects; namely by increasing the incentives that drive corruption. The issue is that highly corrupt countries like Venezuela do not comply with a series of basic prerequisites to realising the potential benefits of decentralisation. Among these prerequisites are strong institutions, such as horizontal accountability; low levels of informality in society; no major policy distortions; clarity in the distribution of attributions for each tier of government (who does what and is accountable for that); a reasonable match between responsibilities and resources; clear and enforceable contracts between the central and local tiers of government; and depoliticised public administration. Clearly meeting these conditions is impossible in highly corrupt and developing countries such as Venezuela

Therefore, this *paper* contributes to a better understanding of the sources of corruption in developing countries (which is an important research topic in Venezuela and elsewhere) and suggests that flawed decentralisation may well contribute to the problem. Specifically, the *paper* examines the interaction between decentralisation and corruption in Venezuela, with a clear focus on four explanatory factors: (1) municipal atomisation, which refers to newly created local units of government in relatively poor and scarcely populated small territories; (2) increasing local bureaucracy as measured by public salaries and number of bureaucrats; (3) lack of local revenue autonomy; and (4) the creation of community councils, which introduce new tiers of undemocratic, dependent governments.

As mentioned in the previous section, a viable government measure relating to decentralisation that could be initiated to control corruption would be to decrease the number of local governments by consolidating poor and unpopulated units into organisations of governance that would be relatively more accountable. More specifically, this policy, as applied to Venezuela in particular and possibly in other Latin American countries, would reverse the harmful consequences that are produced by municipal atomisation, and it would enhance local bureaucratic efficiency. Another practical and straightforward fiscal policy to reduce corruption would be to empower regional and local units to change the rates of at least one important tax. Changing the sales or property tax rate in Venezuela should be enough to correct vertical fiscal imbalances and encourage institutional innovations such as income tax initiatives.

The specific findings in this *paper* about contemporary Venezuela support the strong empirical findings of Enikolopov and Zhuravskaya (2007) and Fan, Lin and Treisman (2009), which indicate that fiscal decentralisation reduces corruption while political decentralisation

tends to increase corruption. The main argument used by those authors to support these conclusions is that uncoordinated rent-seeking behavior increases when government structures become more complex. That is, increases in the number of governmental units and in the number of public sector employees with pockets to fill increases the risk that the rents of office will be overgrazed. The purpose of this *paper* is to contribute to a better understanding of these arguments and to elaborate on a few other potential arguments.

One way to understand the lack of revenue autonomy argument is to apply the microeconomic efficiency principle of optimising fiscal accounts to the point of equilibrium, which is found somewhere between marginal profits and marginal costs. This efficient equilibrium can only be achieved when the benefits of public programs are adjusted in accordance with the necessary expenditure of resources; however, making this type of determination requires information that the national government often lacks or obtains only after a delay. In theory, increasing subnational revenue collection "encourages citizens to keep government officials in check and therefore decreases corruption" (Fisman and Gatti, 2002a: 334).

The *paper* also introduces several valid reasons for the high incidence of corruption in Venezuela. Each of the reasons involves a powerful explanation of the impact of flawed decentralisation, which includes weak public and democratic institutions, cultural and idiosyncratic factors, and the low pay structure of municipal employees. The aim of this inductive *paper*, however, is not to separate and test the explanatory power of these factors from those attributed to flaws in decentralisation. Instead, the aim and scope of this research is to investigate less obvious factors of corruption by understanding the meaning to the question: Why has flawed decentralisation worsened corruption in Venezuela?

As a final point, a fundamental question remains: Can Hugo Chávez decentralise subnational revenue autonomy in a way that makes regional and local units in Venezuela more efficient and possibly less corrupt without succumbing to the temptation to make his own power greater in the process? The answer to this question is highly uncertain because, thus far, the caudillo-type authoritarian and nationalistic personality of Mr. Chavéz has sent the wrong signals. Another uncertainty that Venezuela faces is whether Hugo Chávez and other national politicians will benefit by reversing municipal atomisation, in which case, this *paper* might be deemed just another sham discussion. (The research findings are summarised in Table 3.2).

**Table 3.2** Summary of Results

| Research Question | Why has flawed decentralisation contributed to the generalisation of corruption in Venezuela? | | | |
|---|---|---|---|---|
| Research Philosophy | Epistemology: Interpretivist | Strategy: Case Study | Time Horizon: Cross-sectional | Purpose: Exploratory |
| Independent Cases | Municipality of Gaspar-Marcano in Nueva Esparta State<br><br>Municipality of Naguanagua in Carabobo State<br><br>Community council in Nueva Esparta State<br><br>Sample from the national government | | | |
| Explanatory Factors | Municipal Atomisation | Increasing Local Bureaucracy | Lack of Local Revenue Autonomy | Community Councils |
| Conditions for Success | Subnational units are divided according to the qualitative differences of its citizens, such as ethno-linguistic and geographic differences. | Increase salaries, opportunities for job promotion, rotation of responsibilities, diversity of work, innovation incentives, training and coaching. | Government transfers are stable in time, contract-based, and transparent and the allocation of funds do not discourage local fiscal effort | The councils are democratic and accountable, and the distribution of tasks and responsibilities are based on clear and enforceable contracts. |
| Practical Implications | Decrease the number of local governments by consolidating poor and unpopulated units into relatively more accountable organisations. | Limit the number of local level public personnel in relation to the size of the population to 500 citizens per local government employee. | Empower the newly consolidated local governments to change sales and property tax rates and to respond automatically to objective indicators. | In addition to the conditions of success, especially democracy, community councils must work with local elected officials and municipal staff. |

**APPENDIX**

**Table A3** 'Ideal' First-tier Division

| Administrative Region | Population (2005) | Area | States |
|---|---|---|---|
| Andean Region | 2,210,194 | 53,900 km² | Barinas, Mérida, Trujillo |
| Capital Region | 4,687,002 | 9,879 km² | Miranda, Vargas, Capital District (Caracas) |
| Central Region | 3,851,290 | 26,464 km² | Aragua, Carabobo, Cojedes |
| Central-Western Region | 3,703,675 | 66,900 km² | Falcón, Lara, Portuguesa, Yaracuy |
| Guayana Region | 1,776,545 | 458,344 km² | Bolívar, Amazonas, Delta Amacuro |
| Insular-Eastern Region | 3,165,657 | 85,522 km² | Nueva Esparta, Federal Dependencies, Anzoátegui, Monagas, Sucre |
| Llanos Region | 1,181,650 | 141,486 km² | Apure (excluding Páez Municipality), Guárico |
| South-Western Region | 2,000,000 (est.) | N/A | Táchira and Páez (Municipality of Apure) |
| Zulian Region | 3,520,376 | 63,100 km² | Zulia |

# STRUCTURAL CONSOLIDATION OF VENEZUELA'S POLITICAL INSTITUTIONS[16]

## ABSTRACT

Venezuela's political institutions have mutated from a subsidised coalition that almost privatised the oil industry, to a populist nationalism that is polarising society to the brink of civil war. In this *paper*, I briefly examine *chavismo* in Venezuela as a new and unusual revelatory phenomenon and the most extreme case of leftwing populism in Latin America. The within-case analysis addresses the extreme polarisation of the political landscape and the consolidation of the *Partido Socialista Unido de Venezuela* (United Socialist Political Party of Venezuela, or PSUV) as the united leftwing redistributive party. The specific findings suggest that despite the polarisation drawback, Venezuela's political institutions have finally taken the first out of four steps towards a constructive democracy. The next three steps or phases are equally relevant: (1) the PSUV needs to evolve into an institutionalised phenomenon –beyond the nominal leader– with clear division of power and strong internal debate; (2) the multi-diverse opposition needs to unite behind a fresh new leader –under one political organisation– with a defined ideology more relevant than the single bonding effect of removing Chávez; (3) and in time, democratic institutions would need to consolidate through the elected transfer of power. The focus of the *paper* is on the first phase.

KEYWORDS -- Venezuela · *chavismo* · polarisation · PSUV · *puntofijismo*

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[16] An earlier version titled 'Public Sector Reforms in Latin America' was presented at the '6th International Conference on Accounting, Auditing and Management in Public Sector Reforms' in Copenhagen 2010.

4**.1  INTRODUCTION**

How is the *chavismo* popular movement in Venezuela reforming orthodox political institutions? Few articles have addressed this question. The majority of which, including academic pieces, regularly criticise the harmful consequences of a big populist government. On the other hand, a handful of authors have been more constructive by focusing on the slow pace of institutionalisation; while some independent and alternative publications tend to highlight the significant social improvements of slashing poverty in half and improving socioeconomic inequalities all the way to becoming the most equalitarian country in Latin America. But none, or at least to the best of my knowledge, explores the conflicting forces between a highly polarised political landscape and the structural consolidation of the *Partido Socialista Unido de Venezuela* (United Socialist Political Party of Venezuela, or PSUV).

Over the turn of the century, Venezuela's political institutions have in fact experienced structural transformations of revolutionary magnitude, to the point of dividing the last half-century in two democratic periods. The Chávez era is called *chavismo*. And the pre-Chávez era is called *puntofijismo*, which was a profit sharing democratisation pact between the two dominant political parties *Acción Democrática* (Democratic Action, or AD) and *Comité de Organización Política Electoral Independente: Partido Social Cristiano* (Committee of Independent Electoral Political Organisation: Social Christian Party, or COPEI). AD was supposedly the redistributive political option.

*Chavismo* offered real redistribution; and more. *Chavismo* captivated the poor and excluded left with the Bolivarian ideology, which is inspired on the writings and actions of independence hero Simón Bolívar, civil war leader Ezequiel Zamora, and Bolívar's tutor Simón Rodríguez (Sanoja, 2009: 401). The combination of the three was too much for the opposition to handle. Bolívar contributed with nationalism and independence from imperial dominance; Zamora chipped in with social justice and the unity of the peasants with the army; and Rodríguez was responsible for education of the masses and the search for a unique identity.

On the contrary, the opposition offered a handshake agreement between Henrique Salas Römer (governor of industrial Carabobo state) and Irene Sáez (mayor of upper class Chacao municipality and former Miss Universe). Fourteen years after the 1998 Presidential election, which marked the end of *puntofijismo* and the beginning of *chavismo*, the opposition is still offering more of the same in a slightly improved version. Old-timers like Henrique Salas Römer is now replaced by the tandem of elite-poster boys Henrique Capriles Radonsky

(Miranda state governor) and Leopold Lopez (former Chacao municipality mayor). Based on all recent polls, more likely than not, the greater part of the middle class and almost the totality of the upper class will buy whoever steps in; but not the majority of the poor.

The rise of class politics in Venezuela is to some extent an explanatory factor for the democratic success of Chávez. Before the 1998 Presidential election, the poor did not vote in mass; given that the few available voting centers were too far away from the barrios in order to accommodate the middle and higher classes, and also because the lack of political interest was generalised to the extreme of not even been registered to vote. Another explanation of the rise of *chavismo* is the general discontent with the decaying *puntofijismo's* institutions, the socioeconomic crisis, and the *chavismo* ability to recycle and adapt to existing ideas (Sanoja, 2009: 405).

I expand on these accounts by suggesting that for the 2012 upcoming Presidential election, the opposition is two steps behind the *chavismo*. As a matter of fact, the political opposition to the government in Venezuela –recently renamed to *Mesa de la Unidad Democrática* (Coalition for Democratic Unity, or MUD)– would first need to unite behind a new and undisputed leadership with a clearly defined ideology. Something that Chávez offered more than ten years ago with the Bolivarian ideology of social justice, regional integration, USA independence, and equality. The next step for the opposition, after the extremely difficult task of uniting 28 political parties (including the Marxist-Leninist Red Flag), is to consolidate under one political rightwing organisation that could balance the impact of the PSUV in the political equation. There are no easy choices here, because democracy is dependent on constructive competition. The opposition in Venezuela needs to unite beyond the common bounding hate to Chávez.

This *paper* also advances Buxton's (2005) the arguments that the *puntofijismo* profit-sharing succession of governments was equally authoritarian and illegitimate compared to the *chavismo* administration. And that all public institutions at the end of the century were in a sclerotic state of decay due to the colonisation of the dominant political parties AD and COPEI. This *paper* matches these assertions and updates the data by describing the consolidation of the PSUV during the November 2008 subnational election. I also argue that through the consolidation of the PSUV, Venezuela's political institutions have taken a gigantic leap forward. The focus of the analysis is that the "structural" consolidation of the PSUV is dependent on three factors. First, PSUV's internal voices have to be harnessed rather than suppressed. Second, PSUV's headquarters has to enforce a clear division of power between the central government, the state, and the public administration. And third, the PSUV

political party has to institutionalise into an independent phenomenon beyond its founding leader bonding effect.

The *paper* is structured as the typical case study; where the case description precedes the theory (Siggelkow, 2007: 20). The following section evaluates the consequences of the *chavismo* administration, without demonising the failures or portraying a rosy depiction of the successes. After the general case description, the aim is to contribute with the unsettled *chavismo* debate, going beyond the specifics of government performance by pinpointing the clash between polarisation and institutionalisation. The last section summarises the findings.

## 4.2   ASSESSING THE *CHAVISMO* GOVERNMENT

Between 1958 and 1998, only the second administration of legendary AD leader Carlos Andrés Pérez (1988–1992) pitched itself as neoliberal (Buxton, 2005: 340).  Although none of the *puntofijismo* governments could be considered socialist/redistributive. The end result of Pérez's second administration of extreme policy adjustment was a massacre called *Caracazo* in 1989, and two failed coups in 1992, which ultimately led to the impeachment of the President. In reality, only the Presidencies of Rómulo Betancourt (1959-1964) and Raúl Leoni (1964-1969) had a centrist position; but after that, Venezuela became increasingly more market oriented. From a practical perspective, it is hard not to label a government as neoliberal, if its economic policies are clearly monopolised by the business elite. In the case of Venezuela, it is a fact that during the *puntofijismo* alternation of governments the media and food industries openly appointed and dismissed executive ministers at their discretion.

However, at the 1998 Presidential election, everything changed when the *chavismo* popular movement rose to political power with a young Hugo Chávez leading the way. To some, the godlike presence of President Chávez presents the only hope of a desperate poor, and the shining champion of a left that refuses to die in Latin America. To others, Chávez is a Marxist-communist totalitarian with no intention of stepping down from power, nor releasing the institutional control over the oil rich revenues of Venezuela. Chávez has been called the new Bolivar, Castro's successor, an authoritarian dictator, a charismatic leader, a crafty politician, a buffoon, and most of all a ranting populist (Sylvia and Danopoulos, 2003: 63).

The *chavismo* phenomenon in Venezuela is without a doubt of the populist variety, because it "relies on a charismatic mode of linkage between voters and politicians, a

relationship largely unmediated by any institutionalised party, and that it bases itself on a powerful, Manichaean discourse of 'the people versus the elite' that encourages an 'anything goes' attitude among Chávez's supporters" (Hawkins, 2003: 1137). However, different from previous popular movements rise to political power in the region, such as Salvador Allende in Chile, Lázaro Cárdenas in Mexico, Getulio Vargas in Brazil, or Juan Perón in Argentina; the *chavismo* ideology is firmly rooted on the "leftist-nationalist" writings of independence hero Simón Bolívar (Hawkins, 2003: 1153).

Wood (2009: 145) argues that the *chavismo* phenomenon is not a mere historical regression to the caudillos of the 19th century or the charismatic figures of the 20th, but rather represents a new and genuinely radical mass movement based on state intervention by way of nationalising the economy's commanding heights and increasing *el poder del pueblo* through community councils and small-scale cooperatives. Aggressive nationalisations and power to the people combined pose a more direct challenge to existing oligopolies than Perón would ever have considered mounting.

### 4.2.1  Good *Chavismo*

The first half of the decade-long *chavismo* government was by no means a walk in the park. A new Constitution, an oil executive sabotage, one coup d'état, two bosses' lockouts, and eight democratic elections are the political highlights from 1998 to 2005. The second half of the chavismo administration was a complete different story, despite the costly long-term effects of the destabilising coups, strikes, and oil sabotage. Since the oil strike seven years ago, GDP in Venezuela doubled. Low oil prices and a 10% production cut decreased GDP 3.3% in 2009 and 1.9% in 2010. So far, parallel to the rebound in oil prices, year 2011 has experienced a 4.5% annualised growth for the first trimester.[17]

More relevant than growth, poverty decreased from 54% in 2003 to 26% in 2008, extreme poverty rate plunged from 43% in 1996 to 7% in 2008, and unemployment fell from 17% in 1998 to about 7% in 2008 (Petras, 2008: 1). According to the *Instituto Nacional de Estadística* (National Institute of Statistics, or INE), in 2011 poverty decreased to a remarkable 23% and extreme poverty to 6%. Even more impressive, on 24 October 2008, in the middle of the worst worldwide financial crisis since the Great Depression, foreign

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[17] For a thorough assessment on Venezuela's socioeconomic indicators, refer to Weisbrot, Ray and Sandoval (2009).

reserves in Venezuela surpassed for the first time US$40 billion (Venezuelan Central Bank, or BCV).

Poverty reduction is mainly attributed to the fact that real social spending per person has increased 314% since 1998, to reach a striking 21% of total GDP in 2006 (Weisbrot and Sandoval, 2008: 11). In 2009, social spending constituted about one-fourth of federal budget (INE). The highlight of Venezuela's social spending is without a doubt on education, as it has grown from 1.5% of total GDP in 1998, to 7% in 2008 (INE). Education spending increase has in fact multiplied school matriculations from 668,109 students in 1998 to 2,135,146 in 2007 (Páez, 2008: 2), and improved literacy rate from 90% in 1999 to 93% in 2008 (INE). In support of these statistics, an April 2008 Gallup survey places Venezuela on top of the Latin American region in children's opportunities to learn and grow. And the 2008 UNESCO Education for All Global Monitoring Report titled "Education for All by 2015: Will we make it?" held on the premises of the BCV and presented by Edouard Matoko affirms that access to education in Venezuela is nearly 100%.

The beneficial spill-over effects of increasing social spending are also reflected on technology and health. Technology spending increased from 0.29% of GDP in 2005, to 1.74% in 2006, and to 2.69% in 2007 (Chacón, 2009). Two specific examples from the area of technology are: (1) on 10 January 2009, when Venezuela officially entered the space race by assuming total control of its first orbiting satellite; (2) and on 8 May 2009, when the first 600 Venezuelan cars came out of the assembly line ready to hit the streets (González, 2009: 16).

From a health related perspective, the flagship *chavismo* social program, *Missión Barrio Adentro*, institutionalised a network of health clinics in low-income neighborhoods, where Cuban doctors treat the poor for free (Brouwer, 2009). The official estimate of health related Cuban personnel working in Venezuela totals 29,996. Divided in 13,020 doctors, 2,938 dentists, 4,170 nurses, and 9,868 other health related personnel (Díaz-Rangel, 2008: 15). *Misión Barrio Adentro* has in fact had a tremendous impact on reducing infant mortality rates –one year of age or younger per 1,000 live births– from 23 in 1998, to 15 in 2008 (INE).

The inequalities decrease in Venezuela also deserves special recognition. Official data –audited by the United Nations Economic Commission for Latin America and the Caribbean– sustain that the Gini coefficient inequalities indicator improved from 51 in 2002, to 41 in 2009. To grasp the magnitude of the decrease in inequalities, consider a similar movement but in the opposite direction for the USA during a period of significant upward redistribution of income from 40 in 1980 to 47 in 2005 (Weisbrot, 2008: 4). Equally important, the *chavismo* administration pegged for the first time social security pensions, which by the way has tripled

the number of recipients (Ellner, 2010: 92). The United Nations Human Development Index (HDI) also dramatically improved from 0.66 –medium range– in 2000, to 0.74 –high range– in 2011. As a matter of fact, for the past five years (2006-2011), Venezuela's HDI country ranking has jumped seven places.

Undeniably, the socioeconomic beneficial effects of the *chavismo* administration are not only based on favorable oil prices over the turn of the century; but also, to recapture sovereignty over oil –which constitutes for more than 90% of total exports (INE)– by charging higher royalties and nationalising strategic oil-related firms. The combination of worldwide high oil prices between 2000 and 2006 and the recapture of oil sovereignty fuelled a public budget bonanza that increased fiscal expenses at an average annual rate of 73% between 2004 and 2008 (Figueroa, 2008: 8).

Parallel to the steep increase in oil revenues, for the first time in history, Venezuela also broadened its client base beyond USA; pulling off gigantic joint exploration deals with heavyweight countries such as China, Brazil, and Russia. China alone, accounts for roughly 17 of Venezuela's total oil exports (INE), which represents about 4% of energy-hungry China's total oil imports. The significance of broadening the client base has nothing to do with the economic principal of diversifying the market. It is more related to minimising the threat of foreign invasion. Venezuela owns the largest proven crude oil reserves with 297 billions of barrels; second is Saudi Arabia with 265; third and fourth are Iran and Iraq with about 150 each (*Últimas Noticias*, 2011: 19). In addition to oil, Venezuela also owns the eighth largest proven natural gas reserve. Fiscal gas revenues in Venezuela have in fact skyrocketed from just above US$23 million in 1998, to a remarkable US$1.2 billion in 2008 (BCV).

### 4.2.2  Bad *Chavismo*

Unfortunately, the "bad" consequences of the *chavismo* administration on governance are even more impressive. When asked by reporter Patricia Janiot of CNN on 3 February 2009; what grade would Simón Bolívar give to the decade long *chavismo* government rule? Chávez answered that Bolívar would probably mark him with 55 out of 100. If the undisputed leader barely approves his term in office based on his own standards –assuming that a fail score is below 50– one could imagine what the real grade is.

The astonishing increasing rates of crime and corruption are two distinctive characteristics of the Chávez administration, and are slowly becoming the downfall of the *chavismo* popular movement astronomical rise to power. According to data by the *Cuerpo de Investigaciones Científicas, Penales y Criminalísticas* (Criminal and Penal Scientific Body of Investigation, or CICPC); during the last decade 101,141 people were killed, a rate of 842 per month or 28 per day (Escalona, 2009a: 44); and 2,003 people were kidnapped, a rate of 200 per year or 17 per month (Escalona, 2009b: 32). And according to the 2010 *Observatorio Venezolano de Violencia* (Venezuelan Observatory of Violence, or OVV) Report –on data from the Interior and Justice Ministry, the National Statistic Institute, the Central University of Venezuela, and the Center for Peace– the amount of homicides in Venezuela spiraled from 19 per 100.000 in 1997, to 48 per 100.000 in 2007, and to 75 per 100.000 in 2009.

The main cause of the homicides increase directly points to the free traffic of guns in the street, estimated between nine and 15 million pieces or a rate between two and three per home; and to homicide impunity, estimated to be at an outrageous 94% in 2008 (Isoliett, 2010: 13). In absolute terms, homicides have increased from 6,583 in 1999, to 11,313 in 2005, to 14,735 in 2007, and to 19,133 in 2009 (OVV). These statistics catapults Venezuela alongside civil war drug infested nations such as Guatemala, Colombia, El Salvador, and Mexico, as the most dangerous Latin American countries. Recent data by the World Health Organisation presented on the 2012 *Seguridad, Justicia y Paz* Report supports this statement. According to the mentioned report, Venezuela is the fifth most dangerous country in the world in terms of total homicides per populations, just below Colombia, which is number six, and slightly above Guatemala and El Salvador (Seguridad, Justicia y Paz; 2012: 23).[18]

Parallel to the crime increase, the Venezuelan government was hammered on the 2008 Human Rights Watch (HRW) Report, and on the 2009 Report by the autonomous body of the Organisation of American States (OAS) for the protection of human rights called the Inter American Commission on Human Rights (IACHR). Even though the HRW report fails to meet the most basic standards of academic rigor, some of its conclusions are meaningful; namely that judicial power has lost independence and that key institutions have weakened. The second –IACHR– report also draws attention to the grave institutional crisis in Venezuela, which prevents the proper application of the rule of law and the adoption of the necessary measures that would provide for the effective exercise of fundamental rights.

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[18] Available at: http://www.seguridadjusticiaypaz.org.mx/biblioteca/summary/5-prensa/145-san-pedro-sula-honduras-la-ciudad-mas-violenta-del-mundo-juarez-la-segunda

Rising inflation is an additional factor that has significantly undermined the performance of the *chavismo* administration. Consumer price inflation has steadily increased from 14% in 2005, to 17 % in 2006, 23% in 2007, 31% in 2008, 25% in 2009, 26% in 2010, and to an eye-popping 28% for 2011 in times of strong worldwide deflationary pressure (INE). And since the exchange rate has remained fixed most of the time, national production has become increasingly uncompetitive, which puts incredible pressure to devalue the "unofficial" exchange rate. The devastating high rates of inflation in Venezuela are in fact flushing down the toilette the recent economic improvements; measured by GDP increase, unemployment decline, poverty reduction, and inequalities decrease.

And last but not least, according to the reliable anti-corruption international organisation Transparency International (TI), the Venezuelan Corruption Perception Index (CPI) has worsened from a very low starting point of 2.7 in 1995, to 2.6 in 1999, 2.5 in 2002, 2.3 in 2004, 2.0 in 2007, 1.9 in 2009, and slightly up to 2.0 in 2010. (The CPI ranges from zero to ten, with lower scores corresponding to worsening corruption ratings.). The World Bank Worldwide Governance Research Dataset and the Global Competitiveness Report by the World Economic Forum corroborate the fact that corruption in Venezuela has become a generalised problem that is tearing down the moral values of society. Shockingly, based on TI, only the exceedingly poor Haiti separates the oil-rich Venezuela from the dishonourable title of the most corrupt country in America.

Generalised corruption, homicide impunity, unstable legal framework, galloping inflation, crumbling infrastructure, insufficient housing, price and exchange rates controls, and a nationalistic discourse that resembles Mussolini's fascism, are the most well-known shortcomings of the Chávez administration. However, at least to the best of my knowledge, a significant harmful effect of the *chavismo* popular movement rise to power that deserves more academic attention is the increasing polarisation of the political landscape, which could eventually open the door to another coup d'état.

The polarisation virus in Venezuela appears to be a direct consequence to four factors: (1) the inflammatory and confrontational *chavismo* rhetoric; (2) an anything-goes government style that bends the law to their own will; (3) hysterical reactions by an irrational opposition that creates a zero sum political framework; (4) and weak political parties institutions.

### 4.3  VENEZUELAN POLITICAL LANDSCAPE

It is nearly impossible to make sense of the Venezuelan government, because mainstream media and academic publications tend to publish contradictory accounts on the subject (Wilpert, 2005: 21). The polarisation of information in Venezuela has in fact stretched reality to the brink of civil war. According to the 2009 Index of Political Instability by The Economist Intelligence Unit, Venezuela is the 29th country with the greatest political instability in the world. The 2009 Global Peace Index (GPI) by the Institute for Economics and Peace, also downgrades Venezuela as the 120th least peaceful nation.

The November 2008 subnational election in Venezuela is a perfect example of the polarised political forces stretching the truth in opposite directions beyond reconcilable boundaries. One extreme of the relative truth exaggerated the landslide nationwide victory and understated the stunning defeats in the capital region of three *chavistas* top subnational leaders: Jesse Chacón in the predominately poor municipality of Sucre, Aristóbulo Istúriz in capital city Caracas, and Diosdado Cabello in the populous Miranda state. In normal circumstances, the electoral outcome at a local, city, and regional level of government in the capital region should had been enough to inspire a complete renovation of top rank officials in the PSUV organisational structure.

Unfortunately, the needed renovation of PSUV subnational leadership will not happen in the near future. The main reason why the needed renovation will not happen in the near future is that Chávez's massive grassroots popularity support is an impressive phenomenon rarely seen in democratic history. Twelve years after his meteoric rise to political power, at no point in time, has any political leader –internal or external– come close to Chávez in terms of popularity in opinion poll surveys. Poll surveys by *Datanálisis* supports this statement by sustaining that Hugo Chávez is by far the undisputed leader of PSUV with 51%; followed in the distance by Diosdado Cabello with 13%, Jesse Chacón with 7%, Jorge Rodríguez with 6%, and Aristóbulo Istúriz with 5% (Díaz-Rangel, 2009: 13).

Anti-*chavistas*, on the other side, distort what really happened on Election Day. Some used misleading titles: "Chavez Supporters Suffer Defeat in State and Municipal Races" (*The New York Times*, 24 November 2008). Others even published twisted data: "Nationwide, the opposition won 52% of the popular vote against the government's 48%" (Vargas Llosa, 2008: 1). Official results –conceded by both sides, corroborated by exit polls, and confirmed by international observers– portray another story. At a regional level of government, Chávez supporters won 17 out of 22 states up for grabs, including the vast majority of legislating state

councils. At a local or municipal level, *chavismo* won 263 out of 326 offices in play. This accounts for thirteen more than the record breaking previous subnational election in 2004. In total, more than five million or 53% of the electoral base elected *chavistas* candidates. And less than four million or 42% voted for an opposition alliance; which is made up mostly of political parties *Un Nuevo Tiempo* (A New Time, or UNT), *Primero Justicia* (Justice First, or PJ), *Partido Social Cristiano de Venezuela* (Christian Democratic Party, or COPEI), *Acción Democrática* (Social Democrats, or AD), and *Podemos* (former left wing faction of Movement Towards Socialism, or MAS). The remaining 5% –the difference between 53% and 42%– is accounted to an independent third sector; constituted at that time mainly by *chavismo* dissidents, such as *Patria Para Todos* (Fatherland for Everyone, or PPT) and *Partido Comunista de Venezuela* (Communist Venezuelan Party, or PCV). Refer to Table 4.1 for a summary of the results.

**Table 4.1**   2008 Subnational Election Results

| Political Party | Total Votes | % | State Governors | Metropolitan Mayors | Municipality Mayors |
|---|---|---|---|---|---|
| PSUV | 5.016.539 | 45,39 | 17 | 1 | 263 |
| UNT | 1.214.406 | 10,99 | 1 | | 8 |
| AD | 798.674 | 7,23 | 1 | | 16 |
| PJ | 618.832 | 5,6 | 1 | | 4 |
| COPEI | 471.163 | 4,26 | 1 | | 11 |
| PV | 331.410 | 3 | 1 | | 1 |
| PPT | 196.790 | 1,78 | | | 5 |
| Podemos | 194.842 | 1,76 | | | 2 |
| ABP | 59.853 | 0,54 | | 1 | |
| Others | 2.150.165 | 19,45 | | | 16 |
| Total | 11.052.674 | 100 | 22 | 2 | 326 |

Critics of the *chavismo* government also argue that the wealthiest and most populated states Zulia, Miranda, and Carabobo, are now in hands of the opposition. They claim that Chávez supporters lost three states compared to the 2004 election. From two, Nueva Esparta and Zulia; to five states, Carabobo, Miranda, Nueva Esparta, Táchira, and Zulia. "It is quite clear that the opposition, which is not represented in Congress and was until last week confined to two states, will now have something of an institutional power base" (Vargas Llosa, 2008: 1). The first argument, however, tends to forget that the opposition governs less than a third of Venezuela's 26 million people, including the vast minority of state capitals. And the second argument overlooks the five *chavistas* dissident governors in Aragua, Carabobo, Sucre, Trujillo, and Guárico. If these states are factored in the equation, *chavismo* actually gained political control over two more states on Election Day.

## 4.4   CONSOLIDATION OF THE PSUV

Who won or lost the 2008 subnational election in Venezuela is irrelevant to the fact that for the first time in ten elections, the *chavismo* phenomenon was united as a single revolutionary political party to overcome the problems generated by a rigid bureaucracy and to articulate popular support with the *chavistas* base. Before 2008, the *chavismo* movement was made up of a conglomerate of leftwing political parties led by *Movimiento Quinta República* (Fifth Republic Movement, or MVR). After 2008, former *chavistas* who did not belong to the PSUV were either outcast into an independent third sector or operate with little voice in the opposition alliance, such as the cases of PPT and Podemos.

The consolidation of the PSUV, however, is just a hint of what a healthy democracy should taste like. Based on liberal democratic standards, the real test will come when institutional checks on power are enforced by separating key positions from political ties, such as the attorney general and the national controller (Ellner, 2010: 79). More often than not, when the judiciary, congress or electoral administration raises objections to government policy, the President threatens reprisal and dismissal (Buxton, 2005: 330). As mentioned before, an unconditional factor for the continuity and "structural" consolidation of the *chavismo* phenomenon is that PSUV's internal voices should be harnessed rather than repressed.

Ten years after the *puntofijismo* debacle, the PSUV is slightly ahead in the quest to become an institutionalised political party. Not only because the PSUV has one recognizable leader and a clearly defined ideology called Socialism of the Twenty First Century, which is primarily based on three Bolivarian principals: equality, nationalism, and regional integration. But also because, the PSUV has institutionalised a bottom-up method of selecting political candidates; in sharp contrast to the opposition's marked top-down approach (Ellner, 2010: 81). It is also fair to say that the opposition organised a successful Presidential primary election on February 2012

Another relevant shortcoming of the PSUV is that the only factor that keeps the organisation together is the common allegiance to Chávez (Hawkins, 2003: 1139). To evolve into an institutionalised political party –beyond structural consolidation– the PSUV must rely on a set of rules rather than the whim of its leader for governing itself. However, this scenario is hypothetical at best; because Chávez appears to be immune to the typical popularity decline. The latest demonstration of popular support for the undisputed party leader was on February 2009, with a commanding 55% approval in a referendum to include the unpopular possibility to run for consecutive Presidential terms. Compared to the previous similar Constitutional reform on December 2007; the February 2009 election represented a 44% increase in total votes for *chavismo*; from 4,370,392 to 6,130,482. The opposition alliance, on the other hand, increased only 15%; from 4,504,353 to 5,193,839. Although for the first time in twelve elections during the last decade, the political opposition in Venezuela surpassed the five million vote's barrier. Naturally, the 2012 Presidential primary elections had a smaller showing, but it is worth mentioning that it surpassed the three million votes.

The road ahead for the opposition is longer and fill with more batches compared to the PSUV. This is due mainly because the opposition is a complex organisational mixture made up mostly of rightwing political parties with contradictory ideologies –except to remove Chávez from power– and antagonist leaderships of wide generational gaps, old-school AD and COPEI versus new- school UNT and PJ. It is widely believed that the opposition alliance is also sponsored by private NGOs such as Súmate, heavyweight players in the media business such as CNN and The New York Times, and some-say foreign intelligent agencies of unfriendly governments. To survive, the opposition in Venezuela would need to converge under one political party with a defined ideology beyond the glue-effect irrational singular objective of removing Chávez.

Furthermore, in a constructive democracy, left and right political forces would eventually have to alternate power. In Spain, for example, the *Partido Socialista Obrero*

*Español* (Spanish Socialist Workers' Party, or PSOE) and the *Partido Popular* (People's Party, or PP) have alternated political power since the end of Franco's military rightwing dictatorship nearly four decades ago. And this alternation of Presidential office has encouraged a series of beneficial spillover effects on governance based on a constructive competitive cycle. In the case of Venezuela, the alternation of power will only become a reality when an opposing leader backed up by united political party defeats the PSUV in a nationwide Presidential democratic election. So far, this scenario is only hypothetical at best.

Despite the fact that Venezuela's political institutions are decades behind compared to Spain, the consolidation of the PSUV and the first step to unite the opposition is a gigantic institutional leap forward compared to the non-aggression democratisation pact –based on sharing oil rent and state appointments– of the past called *Punto Fijo* (in reference to the city where it was signed). The *Punto Fijo* pact turned out to be a powerful subsidised coalition between the two dominant parties, which governed without competition through compromise and shared spoils (Sylvia and Danapoulos, 2003: 64-65). Naturally, to govern without opposition diverted oil riches from trickling down to the bottom of Venezuelan society, driving poverty and inequalities to unbearable limits.

The collapse of *puntofifismo* came as a consequence to the institutional decay, the excessive bureaucratisation, and the massive corruption (Buxton, 2005: 337). It should be noted, however, that the origins of *puntofijismo* was very promising since, at the beginning, *puntofijismo* was grounded on deep ideological differences between the parties (Heath, 2009: 188). AD represented the workers and peasants, advocating state intervention and land redistribution. COPEI represented the interests of the church, the businesses, and the social elite. However, somewhere down the line, in 1979 with the government of Luis Herrera Campins, the two parties succumbed to the corrupting powers of unlimited Petrodollars (Sanoja, 2009: 400).

## 4.5   CONCLUSION

From 1958 to 1998, Venezuela experienced a succession of governments controlled by the economic and social elites that followed a laissez-faire capitalist agenda. In fact, the rightwing democratic subsidised coalition that governed Venezuela for nearly four decades, was a strong supporter of the Washington consensus; to the extreme of almost privatising the oil industry

(PDVSA) by the end of the century in times of triple-digit inflation, devastating poverty, high unemployment, and a profound socioeconomic division between the rich and the poor (Heath, 2009: 190). The legal instrument for the privatisation of PDVSA was an IMF sponsored program called *Apertura Petrolera* (Oil Opening) –in effect from 1996 to 1998– which was designed by planning Minister Teodoro Petkoff and approved by President Rafael Caldera.

In 1998, at the epicentre of a complete lack of authority and legitimacy, Venezuela's 40-year flirt with a market-oriented economy ended abruptly when Chávez swept the Presidential elections. Regrettably, so far, the new *chavismo* political era is generally repeating the institutional shortcomings of the *puntofijismo* governments. Twelve years of *chavismo* administration and more than half of that of complete institutional control, the bottom line is still the same: political institutions are increasingly weak and party leadership (*cogollos*) is responsible for all strategic decisions.

How democracy and institutions are to be reformed in the best interest of all Venezuelan citizens? (Buxton, 2005: 346). The answer to this question is appears to be easy: the consolidation of the PSUV has to become a structural and institutional phenomenon. That is, the PSUV has to encourage internal voices mainly by enforcing the badly needed division of power, and after that, the PSUV has to evolve beyond the nominal leader unmatched skill to galvanise popular support and preserve cohesion. The next frontier to conquer for the PSUV, after taking the colossal step of the structural institutionalisation, would be to consolidate a constructive democracy by handing over in a democratic election Presidential office to a united centre-right political party with a clearly defined ideology and an undisputed leader. For the specific case of Venezuela, in two or three Presidential elections from now – assuming that Chávez will defeat cancer and fulfil survey polls expectations by sweeping the 2012 Presidential elections– one of today's rising star in the opposition alliance, maybe Henrique Capriles, Leopoldo López or María Corina Machado, would have to defeat in a democratic election the best the PSUV has to offer, maybe today's pragmatic managers José Vielma Mora or Rodrigo Cabezas. Once again, there are no easy choices here. Machiavelli once said (1950: 21): "It must be considered that there is nothing more difficult to carry out, nor more doubtful of success, nor more dangerous to handle, than to initiate a new order of things. For the reformer has enemies in all those who profit by the old order, and only lukewarm defenders in all those who would profit by the new order".

# STAGFLATION IN NEOPOPULIST VENEZUELA AND THE INTEGRATION OF LATIN AMERICA'S LEFT[19]

## ABSTRACT

The defining principals of Latin American leftwing governments are regional integration, redistribution, community participation, anti-neoliberalism, and a nationalistic ideology to dictate its own political and economic agenda, or at least to be free from the onerous terms set by international organisations. However, starting with *chavismo* in Venezuela, leftwing governments in the region have so far not lived up to their potential. In spite of this inevitable bumpy start, the unprecedented simultaneous rise to power of Chávez, Lula- Rousseff, Kirchner-Fernández, Evo, Correa, Tabaré-Pepe, Lugo, Ortega, Humala, Funes, and Zelaya, could end up playing a pivotal role in political history; but only if Latin America's plural lefts converge on the path to a united post free trade agreement world. This study argues that Venezuela holds the key to overcome the sharp differences between the moderate Latin American left and the radical left. Namely by proposing that before the acceptance of Venezuela into MERCOSUR or the implementation of the SUCRE as a hard currency among ALBA members, the Venezuelan government would need to moderate its inflationary economy towards the encouragement of private investments and the stabilisation of the highly uncertain exchange rate system.

KEYWORDS -- regional integration · leftwing governments · Bolivarianism · Venezuela · populism · inflation.

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[19] A preliminary version was presented at 'The First Global Dialogue on Ethical and Effective Governance' general conference in Amsterdam 2009. Comments from Susan Rose-Ackerman and Leo Huberts have been incorporated into this final version; though the views and content expressed are the sole responsibility of the author.

## 5.1  INTRODUCTION

"Es una idea grandiosa pretender formar de todo el Mundo Nuevo en una sola nación con un solo vinculo que ligue sus partes entre sí y con el todo. Ya que tiene un origen, una lengua, unas costumbres y una religión, debería, por consiguiente, tener un solo gobierno que confederase los diferentes estados que hayan de formarse." (Carta de Jamaica, Simón Bolívar, 1815). [Actual words]

"It is a grandiose idea to form one nation out of the New World with one link that binds the parts together and to the whole. Since it has a common origin, language, customs and religion, should therefore have only one government to confederate the different states to be formed." (Letter from Jamaica, Simón Bolívar, 1815). [Author's translation]

The Congress of Panamá, organised by Venezuelan independence hero Simón Bolívar in 1826, is the starting point of a Latin American unity. Almost two hundred years later, December 2011 in Caracas witnessed the comeback of Bolívar's dream with the constitutional summit of the Community of Latin American and Caribbean States (*Comunidad de Estados Latinoamericanos y Caribeños*, or CELAC). The CELAC has become the converging forum of political dialogue for 33 countries in the Americas, excluding the US and Canada. And is perceived as an alternative to the US dominated Organisation of American States (OAS). CELAC's first institutional steps were taken during the XX and XI "Rio Group" summits of Santo Domingo in 2008 and Playa del Carmen, Mexico, in 2010.[20]

However, the CELAC cannot be considered a fundamental far-reaching plan, because similar to other integration attempts such as the *Sistema Económico Latinoamericano y del Caribe* in 1975 and the *Asociación Latinoamericana de Integración* in 1980, the CELAC is basically a forum of dialogue. In sharp contrast, the *Mercado Común del Sur* (Southern Common Market, or MERCOSUR) is in effect an institutionalised up-and-running regional trade arrangement. The general objective of this *paper* is to explore the prospect of integrating the member nations from the *Alianza Bolivariana para los Pueblos de Nuestra América*

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[20] Conservative President Felipe Calderón of Mexico was the head of State who proposed the creation of the CELAC at the Santo Domingo summit in 2008.

(Bolivarian Alliance for the Peoples of Our America, or ALBA) into MERCOSUR. That is, the central consistent statement throughout the manuscript is that an economic union independent of US hegemony has to be the principal goal of a unified Latin American movement taking in the moderate left (MERCOSUR) and the more radical left (ALBA).

Brazil, Argentina, Uruguay, and Paraguay have member status at MERCOSUR. Venezuela signed a membership agreement in 2006, that was soon approved by national governments and parliaments all member nations, except the slightly rightwing dominated Paraguayan parliament. ALBA is constituted by Venezuela, Ecuador, Bolivia, Nicaragua, Cuba, Saint Vincent and the Grenadines, Antigua and Barbuda, Dominica, and Honduras before the 2009 coup d'état. ALBA's observer states are Uruguay, Paraguay, Haiti, Surinam, Santa Lucia, and Grenada. The integration of MERCOSUR and ALBA would in fact create a supergiant block of about 350 million consumers distributed in a natural-resource-rich total area of more than 14 million km2.

The integration of Latin America's plural lefts is a feasible phenomenon due to the unprecedented simultaneous democratic rise to political power of ten leftwing governments in the region. (Table 5.1 maps the Latin American governments by ideology in 2011). On top of these unprecedented and remarkable coincidences, the historical heritage of Bolivarianism is also playing a key role as a converging factor, more relevant than the goodwill of the governments in power.

The integration of Latin America's plural lefts is also a feasible phenomenon because contrary to the general coverage in mainstream media, high social spending governments in Latin America have earned the popular support to undertake unprecedented structural reforms aimed at regional integration. This is due mainly because those countries that are governed by leftwing governments in the region tend to perform better on inequality and democratic indicators, which are considered crucial to government stability (Latinobarómetro Report, 2011: 34). In fact, eight out of the first ten countries ranked in the following key indicators are governed by leftwing governments: justice in income distribution; country governed for the common well of all; trust in the government; and satisfaction with democracy.

**Table 5.1** Governments by Ideology, 2011

| Country | 21st-Century Socialism | Center-Left | Center-Right | Right |
|---|---|---|---|---|
| **Argentina** | | Cristina Kirchner (Partido Justicialista) | | |
| **Bolivia** | Evo Morales (Movimiento al Socialismo) | | | |
| **Brazil** | | Dilma Rousseff (Partido dos Trabalhadores) | | |
| **Chile** | | | Sebastián Piñera (Renovación Nacional) | |
| **Colombia** | | | Juan Manuel Santos (Partido Social de Unidad Nacional) | |
| **Costa Rica** | | | Laura Chinchilla (Partido Liberación Nacional) | |
| **Cuba** | Raúl Castro (Partido Comunista de Cuba) | | | |
| **Dominican Republic** | | | Leonel Fernández (Partido de la Liberación Dominicana) | |
| **Ecuador** | Rafael Correa (Alianza PAIS) | | | |
| **El Salvador** | | Mauricio Funes (Frente Farabundo Martí para la Liberación Nacional) | | |
| **Guatemala** | | | Otto Pérez Molina (Partido Patriota) | |
| **Honduras** | | | Porfirio Lobo (Partido Nacional de Honduras) | |
| **Mexico** | | | Felipe Calderón (Partido Acción Nacional) | |
| **Nicaragua** | Daniel Ortega (Frente Sandinista de Liberación Nacional) | | | |
| **Panamá** | | | | Ricardo Martinelli (Cambio Democrático) |
| **Paraguay** | | Fernando Lugo (Alianza Patriótica para el Cambio) | | |
| **Perú** | | Ollanta Humala (Partido Nacionalista Peruano) | | |
| **Uruguay** | | José Mujica (Frente Amplio) | | |
| **Venezuela** | Hugo Chávez (Partido Socialista Unido de Venezuela) | | | |

Source: Prepared by the author based on the 2011 Latinobarómetro Report (page 13).
Notes: Political parties' affiliation in parenthesis. (Sebastián Piñera ran for Presidential elections as an independent candidate due to party statutes).

The study also discusses how the implementation of the *Sistema Único de Compensación Regional* (SUCRE) as a hard currency among ALBA members would help control inflation in Venezuela, mainly by stabilising the highly uncertain exchange rate system. The SUCRE is extremely important to the integration phenomenon of Latin America's leftwing governments because it could be used as a platform for ALBA to enter MERCOSUR as a bloc and not country by country starting with Venezuela. The assertions about the specific case of Venezuela are applicable to all Latin American nations, both expansionary and disciplinary governments, which have suffered from past episodes of high inflation.

Methodologically, the integration of Latin America's plural lefts is explored in this descriptive case study using secondary sources of longitudinal data collection techniques such as surveys, archival and documentary data, semi-structured interviews, and discourses. The choice of using a classic single case study approach is to examine a contemporary phenomenon in its real-life context with unclear boundaries between phenomenon and context (Yin, 1981: 59). This situation is clearly the case with the leftwing writings of Bolívar –which are mainly based on the unification of Latin America– and the unstoppable regional integration phenomenon that is sweeping the region by surprise. Furthermore, classic single case studies are used to gain a deep understanding of a particular social setting (Dyer and Wilkins, 1991: 614), such as the simultaneous rise to political power of several leftwing governments in the region, from the strident populist *chavismo* movement in Venezuela to the institutionalised political party system in Brazil. Many classic single case studies, however, are fundamentally multiple case studies that employ the comparative multiple-case logic or replication and extension to develop theoretical insight (Eisenhardt, 1991: 626).

The *paper* is organised in six sections. Section II reviews neoliberalism and populism as two conflicting but sometimes complementary extreme ideologies. The review of the literary adopts a historical realist assumption that the construction of reality is shaped by sociopolitical and economic values. Section II explores the case of stagflation –namely high inflation– in populist Venezuela. The case of Venezuela argues that high inflation can be beaten by encouraging private investments and stabilising the exchange rate system. Section III describes the feasibility arguments, with a focus on MERCOSUR and ALBA, the heritage of bolivarianism, and survey information from the 2011 Latinobarómetro Report. Section IV provides a theoretical framework, based mainly on Rodrik's (2002) political trilemma, to critically asses the practical implications of institutionalising a regional trade arrangement

between ALBA and MERCOSUR. This section also reveals the implicit debates based on the interpretation of an evaluation model matrix. Section V concludes.


## 5.2 THE EXTREMES: NEOLIBERALISM AND POPULISM

Neoliberalism is explained in three words: liberalisation, privatisation, and stabilisation (Wood, 2009: 139). Liberalisation opens the door to free trade by dismantling protectionist barriers. Privatisation ensures that goods and services are efficiently allocated through market mechanisms. And stabilisation tames the hyperinflation plague that infected many Latin American economies during the 1980s through the strict enforcement of austerity measures such as slashing social spending.

Neoliberalism brightest moment in Latin America came during the 1980s with the invasion of foreign debt just before the US decided to increase interest rates as a government measure to slow down domestic inflationary pressures. Naturally, the refinancing of debt that followed the interest rates hike was conditioned to a series of orthodox policies championed by the IMF and the World Bank –the primary architects of neoliberalism– known as the Washington Consensus, which were targeted to the expansion of commodity exports (Fridel, 2006: 16). Not by chance, the 1980s is considered "the lost decade" in Latin America. Average per capita income declined by 0.9% per year, and more importantly, between 1983 and 1992 the overall number of people living in poverty increased from 78 million to 150 million (Cole, 2010: 318-319).

In fact, the harmful consequences of the neoliberal experiment in Latin America are just short of catastrophic. (Chile is possibly the lonely economic exception). From a political perspective, the initial bursts of the neoliberal model made no secret of their readiness to liquidate any leftwing redistributive movement –such as Salvador Allende in 1973– and install cruel military dictatorships –such as Augusto Pinochet from 1973 to 1990– for the sake of a commodity export-oriented economy by way of intense labor exploitation (Sader, 2008: 7).

From an economic perspective, Sader (2008: 7-8) points out that the largest Latin American economies were the theatre for the most dramatic crises: Mexico in 1994, Brazil in 1999, and Argentina in 2002. Hyperinflation was checked, but this was achieved at tremendous cost. For more than a decade, economic development was paralyzed, public

deficits spiraled, the mass of the population had their rights expropriated, and worst of all the concentration of wealth grew greater than ever before. In the 1990s the share in national income of the bottom decile declined across much of the region. In Brazil, it decreased from an already minuscule 0.7% to 0.6%, and in Peru and Mexico it remained stuck at 1% and 1.4% respectively (Wood, 2009: 142).

At the turn of the century, the neoliberal movement played its game-winning card at the 2001 Third Summit of the Americas of the OAS in Miami, with the Free Trade Area of the Americas (FTAA). It should be noted at this point that the ultimate objective of the FTAA is to consolidate US hegemony across the region and to increase corporate profits within a neoliberal strategy of exogenous development based on trade and deregulation of competitive markets (Cole, 2010: 324). In other words, to guarantee business control of a territory that stretches from the Arctic to the Antarctic, with the free access, without difficulties, of products, services, technology, and capital for the US and Canada. In reference to the North American Free Trade Agreement (NAFTA), Cole (2010: 324) adds that while trade between the US and Mexico increased in 1995 by 23%, total output in Mexico fell by 7% that same year.

Some brave authors have gone a step further by proposing that FTAs with the US is "the fundamental issue that divides Latin America today: the line that separates countries such as Chile, Mexico, Peru or Costa Rica, which have signed deals of this kind, from others such as Argentina, Brazil, Uruguay, Paraguay, Venezuela, Bolivia, Ecuador, Nicaragua or Cuba, that are more interested in regional integration. This is a completely different distinction to that between a 'good' or 'moderate' centre-left, and a 'bad' or radical left, cultivated by the Western media and formulated by figures such as Jorge Castañeda, spokesman of the Latin American right, in order to divide the left, co-opting the moderates and isolating the radicals." (Sader 2008: 19).

FTA with the US is in fact the most reasonable cutting point for the left and the right in Latin America. But Sader's (2008) proposition is incomplete, because leftwing governments in Latin America are sub-divided based on populism in two distinctive fronts and some grey area in between: the radical left or the social populism found in ALBA countries lead by Venezuela, the moderate center-left or the social democracy found in most MERCOSUR countries lead by the tandem Lula-Rousseff in Brazil, and Argentina somewhere in between. Rightwing governments of the present, on the other side, unanimously embrace a more moderate approach to neoliberalism as a common center-right

economic agenda, which is many times associated to liberal democracy, (Panama is possibly the lonely political exception).

Populism is defined as a charismatic mode of linkage between voters and politicians, unmediated by any institutionalised political party and based on a powerful Manichaean discourse of "the people versus the elite" that encourages an "anything goes" attitude among supporters (Hawkins, 2003: 1137). Throughout history, leftwing populism has been particularly strong in Latin America, where many charismatic leaders have emerged in different countries since the beginning of the last century. The list includes the three largest economies in the region: Getulio Vargas in Brazil, Juan Perón in Argentina, and Lázaro Cárdenas in Mexico. Smaller countries in the region have also witnessed how their history has been shaped by the assassination of legendary populist leaders such as Jorge Eliécer Gaitán in Colombia more than six decades ago, which sparked the continent's longest-running armed conflict.

As a socio-political movement that confronts the people against the elite, populism addresses and represents the wellbeing and interests of the poor and repressed, including low level workers and indigenous groups (Kaufman and Stallings, 1991; Haggard and Kaufman, 1991). As an economic movement, populism embodies the struggle to reduce inequality through expansionary social policies financed with foreign debt and seigniorage that often lead to hyperinflation (Sachs, 1989; Fernández, 1991). Dornbusch and Edwards (1991: 11-12) argue that populism has four phases. At the initial phase, real wages and demand increase, while inflation is suffocated with strict price controls and by preventing shortages with subsidised imports. At the second phase, real wages continue to rise, but the strong domestic demand and subsidies on wage goods generates a foreign exchange constraint. At this stage, inflationary pressures build up. At the third phase, inflation is soaring, shortages and strict controls are now a real threat to stability, and fiscal indiscipline deteriorates the deficit at an accelerated pace. At the final collapsing fourth phase of populism, real wages and private investments dramatically decline, and brain drain catches up to a financially unsustainable capital flight. More often than not, an IMF neoliberal program protected by a rightwing military regime will be enacted.

Populism, however, surprisingly holds the key to overcome the sharp differences between the moderate Latin American left and the radical left. This is due mainly because populism is opportunistic by nature, and hence not necessarily has to constantly follow expansionary macroeconomic policies which often lead to high inflation. Weyland (2003: 1098) actually claims that populism and neoliberalism are compatible and even have some

unexpected affinities. Perhaps, the hard populist socialism found in oil-rich Venezuela can also learn from past populist mistakes and find a way to control runaway inflation. In this ideal scenario, the leading financer of the 21<sup>st</sup> Century Socialism movement would need to moderate its economic agenda, not political or social agenda, towards the encouragement of private investments and the stabilisation of a highly uncertain exchange rate system.

## 5.3  STAGFLATION IN POPULIST VENEZUELA

The rise of leftwing populism in Venezuela and its impact on integrating the plural lefts in Latin America is an exceptional case to study. This unprecedented and unstudied phenomenon is grounded on two arguments. In the first place, according to the Latinobarómetro Report (2011: 101), Venezuela has ranked in the second place behind Brazil as the most influential country in Latin America for the past three years with a total response score of 11%, 9%, and 10% to the specific open-ended question: "which Latin American country has most leadership in the region?" Naturally, the supergiant Brazil scored 18%, 19%, and 20% for the same period.[21] This valuable information implies that Venezuela is the undisputed leader of the hard left in the region, which should not come as a surprise taking into consideration that oil revenues for the period 1998-2008 are estimated to be in the neighborhood of US$850 Billion (Lugo, 2009: 20). Part of the huge oil revenues has been well invested in exporting the Bolivarian ideology throughout Latin America and the Caribbean.

The extreme case of populist Venezuela is also significant because it could convincingly falsify the classical four phase theory of populism and even rewrite a fifth phase highlighted by poverty reduction as its main characteristic, instead of high inflation and slow economic growth. Sachs (1989: 14-15) argues that at the collapsing fourth phase of populism, governments implement exchange controls to ration the scarce foreign exchange that leads to a black-market premium. This situation in turn tends to raise the domestic price of imported goods that are paid mostly for on the margin with black-market dollars. The short-term result is a further anti-export bias, and the incentive for export under-invoicing and smuggling. Eventually these distortions prompt an official devaluation and a reunification of the

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[21] As a curious note, although the question specifically states "Latin American country," one of the answers has always been the US, which indicates that the respondents answer to leadership in general.

exchange rate for current account transactions. At the end, the economy is left with an expansionary monetary policy under floating exchange rates, leading to a sustained rise in inflation.

Orthodox theory already assumes the association between populist policies and high inflation while defining the term populism as an approach that deemphasizes the risks of high inflation and deficit finance (Dornbusch and Edwards, 1991: 9). This view is also supported by Haggard (2003: 417-418), who suggests that developing countries with soaring inflation have been those featuring urban labor movements mobilised into populist parties. Monetarists also consider inflation as a problem caused by the surplus of money supply and the excess demand of goods and services, which is typical in populist regimes. While Keynesians argue that inflation is the result of three pressures in the economy: (1) demand-pull inflation that comes from the increase in demand such as extensive government spending; (2) cost-push inflation that comes from the rise in production costs such as higher minimum wages; (3) and build-in inflation that comes as part of a vicious circle created by people's expectations concerning higher prices and by the inertia of high inflation in the recent past. In all three Keynesian pressures, inflation is likely to rise with populist economic policies.

In line with the theory, high inflation in Venezuela is mainly caused by two intrinsic factors: the oil rentier state effect and inflationary expectations. The logic behind rentier states is that oil revenues, which accounts to more than 90% of total exports, are captured by the government. This situation in turn fuels government consumption, which increase domestic inflation as an autonomous spending multiplier. In a useless attempt to control inflation, the Bolívar is artificially overvalued. The artificially overvalued Bolívar leads to a profit squeeze in the corporate sector and to a decline in the non-oil export production. At the end, uncompetitive national industries encourage greater dependence on the oil revenues that caused the rentier effect. The harmful cycle of oil dependency is reinforced by a wide spread between the official and black market rate, which further fuels inflation and strangles the development of other domestic sectors that would permit Venezuela to diversify its economy (Wood, 2009: 145).

The second intrinsic cause is the expectation of high inflation or build-in inflation from a Keynesian perspective. In Venezuela, the economy has settled into a situation in which people expect inflation to persist, perhaps only because it has persisted in the past. The problem with expectation is that it is self-fulfilling, since the expectation that inflation will stay high causes it to stay high (Ball, 1993: 10). For example, if the majority of the people in Venezuela expect –with the aid of an openly anti-government private media– a 30% inflation

to continue in the future, not only firms will end up raising prices about 30% to compensate the 30% increase they expect from their competitors; but also, workers will demand a 30% wage increases to keep up with expected inflation. Ultimately, inflation will probably end up at 30%, fulfilling expectations. This pervasive cycle is aggravated because the persistence of high inflation creates the expectation of persistence, which in turn generates more persistence (Ball, 1993: 11).

The key concern with high inflation is that it is particularly hard on the poor. Mainly because poor families do not own rent producing assets to fight against galloping inflation, and also because, poor families are required to use most of their income to buy inflationary food products, which tends to be higher than overall inflation. According to ex-Central Bank of Venezuela (BCV) Director, José Guerra, poor families use about half of their income to buy food products (Armas, 2011). High income families, on the other hand, use less than 15% of their income (Salmerón, 2010). In line with this arguments, the *Centro de Documentación y Análisis para los Trabajador*es (Documentation and Analysis Centre for the Workers, Cenda), reports that the minimum salary can only buy about half of the food basket, which implies that two minimum salaries are required to cover household food costs (El Universal, 2010).

As mentioned before, in Venezuela theory and data converge nicely. Parallel to the rise of the *chavismo* phenomenon, which is without a doubt of the populist variety (Stahler-Sholk, Vanden, and Kruecker, 2007: 6), inflation rates in recent years have reached an unsustainable 23% in 2007, 31% in 2008, 25% in 2009, 26% in 2010, and 28% in 2011. Venezuela's inflation rate is in fact the highest in Latin America and the second highest in the world behind Belarus.[22] Despite a worldwide economic environment of strong deflationary pressures. (Last column of Table 5.2). High inflation, however, is not the only problem. The economy contracted -3.3% in 2009 and -1.9% in 2010, which represents seven consecutive trimesters of negative growth. (For the time being, the slow economic growth part of stagflation is no longer a problem, since the economy grew 4.2% in 2011 backed-up by the rebound of oil prices invested in construction).

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[22] Data from the CIA Worldfactbook (accessed on 07 March 2012). Available at
https://www.cia.gov/library/publications/the-world-factbook/rankorder/2092rank.html

**Table 5.2**  Socioeconomic Indicators in Latin America

| | Education Index | | | | Poverty | | | | Extreme Poverty | | | | GINI Index | | | | Unemployment | | | | Inflation | | | |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| | UNDP Human Development Report | | | | ECLAC Statistical Yearbook | | | | ECLAC Statistical Yearbook | | | | CIA World Factbook | | | | UNDP International Human Development Indicators | | | | IMF World Economic Outlook Database | | | |
| | PAST | | PRESENT | | PAST | | PRESENT | | PAST | | PRESENT | | PAST | | PRESENT | | PAST | | PRESENT | | PAST | | PRESENT | |
| | Index | Year | Index | Year | % | Year | % | Year | % | Year | % | Year | Index | Year | Index | Year | % | Year | % | Year | % | Year | % | Year |
| **Argentina** | 0,86 | 2000 | 0,88 | 2010 | N/A | | N/A | | N/A | | N/A | | N/A | | 45,7 | 2009 | 15,0 | 2000 | 9,5 | 2006 | -0,9 | 2000 | 6,3 | 2009 |
| **Bolivia** | 0,79 | 2000 | 0,81 | 2010 | 60,6 | 1999 | 54,0 | 2007 | 36,4 | 1999 | 31,2 | 2007 | 44,7 | 1999 | 58,2 | 2009 | 19,0 | 1990 | 4,8 | 2000 | 4,6 | 2000 | 3,4 | 2009 |
| **Brazil** | 0,82 | 2000 | 0,82 | 2010 | 37,5 | 2001 | 24,9 | 2009 | 13,2 | 2001 | 7,0 | 2009 | 60,7 | 1998 | 56,7 | 2005 | 9,3 | 2005 | 7,9 | 2008 | 7,1 | 2000 | 4,9 | 2009 |
| **Chile** | 0,80 | 2000 | 0,84 | 2010 | 20,2 | 2000 | 11,5 | 2009 | 5,6 | 2000 | 3,6 | 2009 | 57,1 | 2000 | 54,9 | 2003 | 8,3 | 2000 | 7,8 | 2008 | 3,8 | 2000 | 1,7 | 2009 |
| **Colombia** | 0,77 | 2000 | 0,82 | 2010 | 54,2 | 2002 | 45,7 | 2009 | 19,9 | 2002 | 16,5 | 2009 | 53,8 | 1996 | 58,5 | 2009 | 11,5 | 2005 | 11,7 | 2008 | 9,2 | 2000 | 4,2 | 2009 |
| **Costa Rica** | 0,74 | 2000 | 0,78 | 2010 | 20,3 | 2002 | 18,9 | 2009 | 8,2 | 2002 | 6,9 | 2009 | 45,9 | 1997 | 48,0 | 2008 | 5,2 | 2000 | 4,6 | 2007 | 11,0 | 2000 | 7,8 | 2009 |
| **Cuba** | 0,70 | 2000 | 0,85 | 2010 | N/A | | N/A | | N/A | | N/A | | N/A | | N/A | | 5,4 | 2000 | 1,8 | 2007 | N/A | | N/A | |
| **Dominican R** | 0,74 | 2000 | 0,75 | 2010 | 47,1 | 2002 | 41,1 | 2009 | 20,7 | 2002 | 21,0 | 2009 | 47,4 | 1998 | 49,9 | 2005 | 14,2 | 2000 | 15,6 | 2007 | 7,7 | 2000 | 1,5 | 2009 |
| **Ecuador** | 0,76 | 2000 | 0,80 | 2010 | N/A | 2002 | 42,2 | 2009 | N/A | 2002 | 18,1 | 2009 | 50,5 | 2006 | 47,9 | 2009 | 9,0 | 2000 | 6,9 | 2008 | 96,1 | 2000 | 5,2 | 2009 |
| **El Salvador** | 0,69 | 2000 | 0,73 | 2010 | 48,9 | 2001 | 47,9 | 2009 | 22,1 | 2001 | 17,3 | 2009 | 52,5 | 2001 | 52,4 | 2002 | 7,0 | 2000 | 6,6 | 2006 | 2,3 | 2000 | 0,4 | 2009 |
| **Guatemala** | 0,59 | 2000 | 0,68 | 2010 | 60,2 | 2002 | 54,8 | 2006 | 30,9 | 2002 | 29,1 | 2006 | 55,8 | 1998 | 55,1 | 2007 | 1,4 | 2000 | 1,8 | 2006 | 6,0 | 2000 | 1,9 | 2009 |
| **Honduras** | 0,68 | 2000 | 0,73 | 2010 | 79,7 | 1999 | 68,9 | 2007 | 56,8 | 1999 | 45,6 | 2007 | 56,3 | 1998 | 53,8 | 2003 | 4,2 | 2005 | 3,1 | 2006 | 11,0 | 2000 | 8,7 | 2009 |
| **Mexico** | 0,76 | 2000 | 0,81 | 2010 | 41,1 | 2000 | 34,8 | 2008 | 15,2 | 2000 | 11,2 | 2008 | 53,1 | 1998 | 48,2 | 2008 | 2,6 | 2000 | 4,0 | 2008 | 9,5 | 2000 | 5,3 | 2009 |
| **Nicaragua** | 0,65 | 2000 | 0,70 | 2010 | 69,3 | 2001 | 61,9 | 2005 | 42,4 | 2001 | 31,9 | 2005 | 60,3 | 1998 | 43,1 | 2001 | 9,8 | 2000 | 5,2 | 2006 | 7,1 | 2000 | 3,7 | 2009 |
| **Panamá** | 0,78 | 2000 | 0,81 | 2010 | 36,9 | 2002 | 26,4 | 2009 | 18,6 | 2002 | 11,1 | 2009 | 48,5 | 1997 | 56,1 | 2003 | 13,8 | 2000 | 6,8 | 2007 | 1,4 | 2000 | 2,4 | 2009 |
| **Paraguay** | 0,76 | 2000 | 0,77 | 2010 | 61,0 | 2001 | 56,0 | 2009 | 33,2 | 2001 | 30,4 | 2009 | 57,7 | 1998 | 53,2 | 2009 | 7,6 | 2000 | 5,6 | 2007 | 9,0 | 2000 | 2,6 | 2009 |
| **Perú** | 0,81 | 2000 | 0,83 | 2010 | 54,8 | 2001 | 34,8 | 2009 | 24,4 | 2001 | 11,5 | 2009 | 57,7 | 1998 | 49,6 | 2009 | 5,2 | 2000 | 7,0 | 2007 | 3,9 | 2000 | 3,0 | 2009 |
| **Puerto Rico** | N/A | | N/A | | N/A | | N/A | | N/A | | N/A | | N/A | | N/A | | N/A | | N/A | | N/A | | N/A | |
| **Uruguay** | 0,84 | 2000 | 0,89 | 2010 | N/A | 2002 | 10,4 | 2009 | N/A | 2002 | 1,9 | 2009 | 44,8 | 1999 | 45,2 | 2006 | 13,6 | 2000 | 7,6 | 2008 | 4,8 | 2000 | 7,1 | 2010 |
| **Venezuela** | 0,74 | 2000 | 0,86 | 2010 | 49,4 | 1999 | 27,6 | 2008 | 21,7 | 1999 | 9,9 | 2008 | 49,5 | 1998 | 41,0 | 2009 | 13,2 | 2000 | 7,4 | 2008 | 16,2 | 2000 | 27,0 | 2010 |
| **AVERAGE** | 0,75 | 2000 | 0,80 | 2010 | 49,4 | 2001 | 38,9 | 2008 | 24,6 | 2001 | 17,9 | 2008 | 52,7 | 1999 | 51,0 | 2006 | 9,2 | 2000 | 6,6 | 2007 | 11,7 | 2000 | 5,4 | 2009 |

Source: specific sources can be found underneath the corresponding demarcation criteria's subtitles.

It is fair to note that Table 5.2 also shows the populist beneficial spillover effects of increasing real social spending per person 314% from 1998 to 2006, to reach a striking 21% of total GDP (Weisbrot and Sandoval, 2008: 11). For example, the first column in Table 2 shows that the Venezuelan Education Index by the UN Human Development Program improved tremendously during the Chávez years, from .74 in 2000 to .86 in 2010.[23] However, improving education is not the greatest achievement of the *chavismo* government. Neither is cutting poverty, extreme poverty, and unemployment to about half. The greatest improvement of the *chavismo* era is decreasing the Gini inequalities coefficient from a mediocre score of 50 in 1998 to becoming the undisputed leader in equality with a score of 41 in 2009.[24]

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[23] The "Education Index" is the adult literacy rate with two-thirds weighting and the gross enrolment ratio with one-third weighting; the value of one is the highest possible theoretical score.
[24] The "GINI Index" measures the degree of inequality in the distribution of family income in a country; the more nearly equal a country's income distribution, the lower its GINI index.

The Venezuelan populist government has desperately tried to defeat high inflation, but with the wrong measures: price controls and increasing the supply of food imports. (Figure 5.1 illustrates this line of thought). The problem with the short-term-fix of price controls on basic products is that it often leads to food scarcity. And food scarcity in turn, will eventually become a threat to stability, exactly as it happened with dairy products not so long ago (Salmerón, 2011a). According to a Datanálisis report, food scarcity in Venezuela has averaged 17% since the radicalisation of price controls set back in 2003 (Caripa, 2011). In reference to food imports, Commerce Minister Edmée Betancourt justifies the 50% budget increase needed to import food with the argument that it is an essential ingredient to stop inflation (Deniz and Barreiro, 2011).

**Figure 5.1** Main Causes of Stagflation in Populist Venezuela
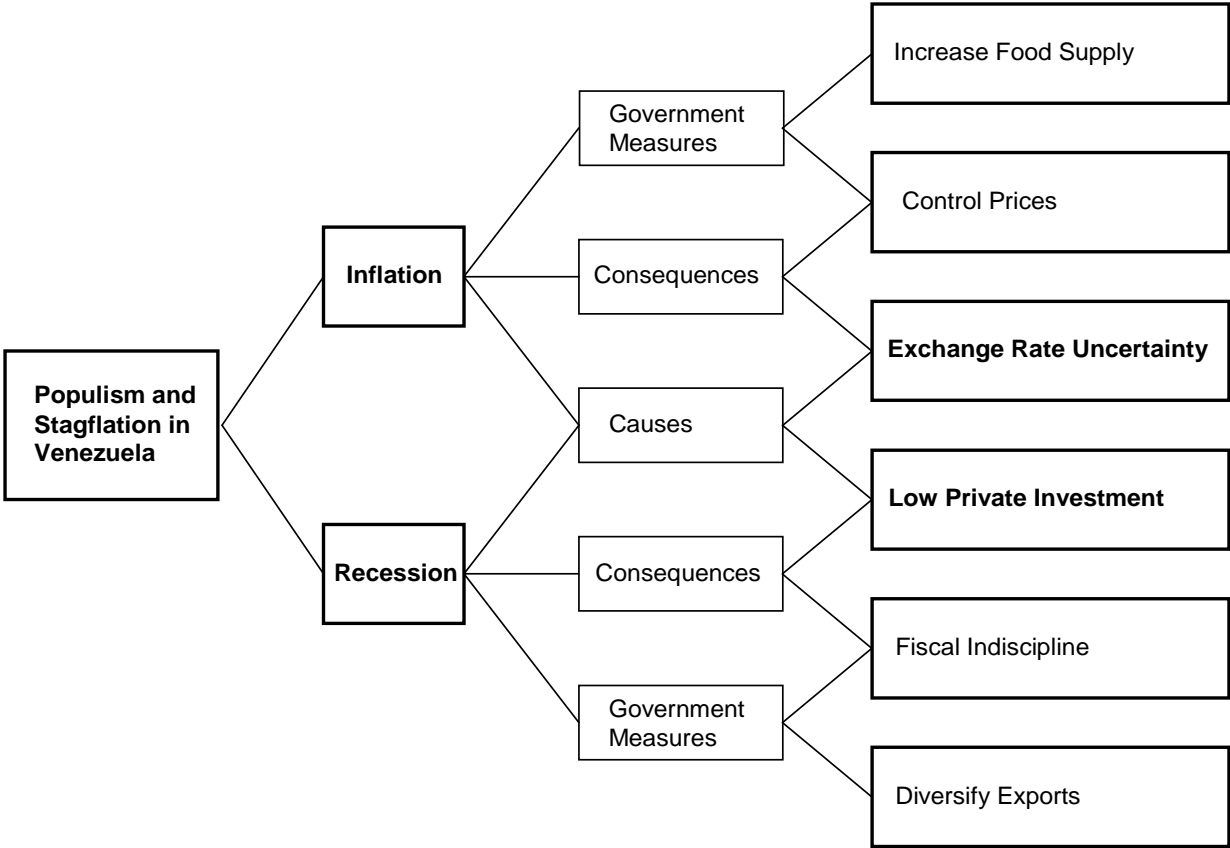
Based on recent poll data, the current government in Venezuela will probably not change in the near future. (Unless Chávez dies from cancer). Furthermore, the public spending frenzy will probably never slow down. Taking these assumptions into consideration, the government in Venezuela will need to concentrate all of its efforts on stabilising the exchange rate system and encouraging private investment. It is a matter of simple logic, if inflation continues to flirt around the 30% barrier; the economy will collapse in an endless cycle of monetary devaluations, since all trading partners have single digit inflation rates. Oil revenues can prolong and even balance payment crisis, but eventually the *chavismo* administration is heavily dependent on decreasing inflation. The far-reaching consequence of the *chavismo* downfall is that it will threaten the survival of ALBA, and more importantly, it will have a devastating impact on the integration of ALBA into MERCOSUR.

Sceptics of the Venezuelan government argue that the strict exchange rate controls fall short of adding monetary stability. The most logical argument of attack is that the monthly limits set by the *Sistema de Transacciones en Moneda Extranjera* (Foreign Currency Transaction System, or SITME) are usually not enough to keep open the lines of credit. According to Jorge Botti, ex-President of CONSECOMERCIO and Director of CEDICE, the SITME is slow and highly bureaucratic, which eliminates any possibility of following a sound financial plan (Deniz, 2010a). Roberto León Parilli, President of the *Alianza Nacional de Usuarios y Consumidores* (ANAUCO), adds that the SITME is discriminatory only to those who have foreign accounts, which is a condition very difficult to satisfy after seven years of exchange rate controls (Deniz, 2010a). Deniz (2010b) also cites the following interview to Fernando Morgado, President of CONSECOMERCIO: "The rebound of oil prices has allowed the government to revitalise public spending and liquidity; but if retailers cannot import on time, it is impossible to react to the eventual increase in demand. In other words, freezing the access to Dollars and throwing money in the street is like putting out a fire with gasoline, which reintroduces the nightmare of hyperinflation in our vocabulary."

In reference to low investments, ECLAC data sustain that out of the US$92 billion of foreign direct investment injected in the region for the period 2004-2008, which accounts to an extra 33% compared to the period 1999-2003, Venezuela only received US$6 billion, well below Chile's US$53 billion, Colombia's US$39 billion, and Peru's US$17 billion (Salmerón, 2009). Private investments have in fact decreased tremendously in Venezuela since the *chavismo* administration took over in 1999. According to the Central Bank of Venezuela (BCV), from 1999 to 2008, real private investments decreased 40% (Tejero

Puntes, 2009b). For the first trimester of 2011, real private investment was 21% less compared to the same period of 2009, and 13% less compared to 2008 (Salmerón, 2011b).

The exceedingly low private investment in Venezuela is partially mitigated thanks to increasing bilateral agreements –based on debt financing in exchange for oil– with China. According to Finance and Planning Minister Jorge Giordani, commercial trade between China and Venezuela has skyrocketed from a very low starting point of US$175 million in 1999 to a remarkable US$8 billion in 2009 (El Universal, 2011). According to the Venezuelan national oil company (*Petróleos de Venezuela*, or PDVSA), oil shipments to energy-hungry China has steadily increased in recent years, from 86 thousand barrels per day in 2008, to 188 thousand in 2009, and to 244 thousand in 2010 (Tovar, 2011a).

To sum it up, bilateral agreements between governments are not enough. Inflation rate in Venezuelan will never reach single digits unless private investment is encouraged well beyond the current level. Mainly because production has to increase if there is any hope to transform the economy from demand-driven to supply-driven, which can only be achieved with the help of private investments. Statistics from the BCV show that industrial output in Venezuela decreased in the last five years. By the end of 2010, industrial output was at its lowest level since 2005. In fact, production was below in ten out of sixteen areas in which the BCV divides private industries, comparing 1997 to 2010. Salmerón (2011c) highlights these relevant pieces of information and even provides the following list of causes from well-known analysts: exchange rate controls and limitations, subsidies to foreign competition caused by an artificially overvalued Bolívar, and an overall hostile environment that scares off private investments. Economist Asdrúbal Oliveros adds that uncertainty and mistrust are two factors that will prevent the Venezuelan economy to reach its full development (Tovar, 2011b).

Perhaps, the eventual acceptance of Venezuela as a full member of the South American trade bloc MERCOSUR would add some confidence to foreign and domestic private investors. Logic and empirical evidence holds a strong consensus on the subject. The inclusion of Venezuela into MERCOSUR's massive trading block would increase the ratio of international trade to GDP. Increasing international trade in turn, would significantly improve the share of investment in GDP. In other words, private investment is linked to economic integration (Leamer, 1988; Romer, 1990), economic integration to economic growth (Romer, 1986; Rivera-Batiz and Romer, 1991), and economic growth to decreasing inflation (Kormendi and Meguire, 1985). The arguments have not changed much since Adam Smith.

That is, productivity and efficiency are encouraged by the increasing competition of a larger market and the specialisation that would be unprofitable in smaller markets.

Another phenomenon that would increase investment rates and help stabilise the exchange rate in Venezuela is the implementation of the SUCRE as a hard currency among ALBA members. Named in honour of Venezuelan-born independence hero Antonio José de Sucre, the SUCRE is currently a virtual regional currency used in commercial transactions among ALBA countries. The SUCRE, born in Bolivia on 2009, was conceived as a measure to decrease the dependence on the US$. The value derives from a basket of currencies from the member countries, weighted accordingly to the relative size of the economies. The core operation of the SUCRE is a central payments clearinghouse managed by an agent bank selected by the Regional Monetary Council. The terms of payments through the clearinghouse are determined by agreements between the agent bank and the Central Banks of the member countries.

## 5.4  FEASIBILITY ARGUMENTS

### 5.4.1  ALBA and MERCOSUR

Regional trade arrangements can be organised in five distinctive types: (1) free trade agreement, (2) customs union, (3) common market, (4) monetary union, (5) and economic union. Starting from the less beneficial type, free trade agreement, the subsequent type builds upon the socioeconomic integration policies of the previous one. That is, the US for example, will benefit from a single fiscal policy of an economic union. Plus the benefits of a single currency that comes from a single monetary policy, such as the EU. Plus free restrictions on labor or capital movement of a common market, such as the former European Economic Community. Plus the common external tariffs and the harmonisation of regulations of a custom union, such as MERCOSUR. Plus the non-tariff barriers between member nations of a free trade agreement, such as NAFTA.

From the previous list, MERCOSUR fits as a custom union, while NAFTA fits perfectly as a free trade agreement. ALBA, however, is different from anything we have seen so far. This is due mainly because ALBA is based on bartering rather than free trade. In ALBA, each country gives according to what it has and receives according to its needs. For example, ALBA's two founding countries, Venezuela and Cuba, exchanged oil for expertise

in education and public health, in line with their respective wants and possibilities (Sader, 2008: 20). Fortunately, as its name implies, ALBA is also based on the Bolivarian ideology. And Bolivarianism is basically based on Latin American unity.

The key to the integration of ALBA into MERCOSUR, however, is that both blocs share a common leftwing ideology rooted on four principals. The first and foremost is Bolívar's utopian dream of the social, economic, and military union of Latin America. As the region undisputed leader, Brazil was very clear about this last issue by proposing a national defence council during the constituting summit of the *Unión de Naciones Suramericanas* (South American United Nations, or UNASUR) held in Brasília on May 2008, and later approved on December 2008. It should be noted that UNASUR did not pass its first real tests by failing to vigorously condemn the 2009 coup d'état in Honduras and the seven US military bases recently installed in Colombian soil.

The remaining four encompassing leftwing principals are: (2) to increase social spending, especially in education for the poor, such as the Bolivian literacy program that according to UN criteria claims to have almost eliminated illiteracy; (3) to forcefully reject IMF and Washington sponsored neoliberal policies, such as the Argentinean fiery opposition to the FTAA during the Fourth Summit of the Americas at Mar del Plata in November 2005; (4) to encourage socialised properties and political participation of the masses, such as small cooperatives and community councils in Venezuela; (5) to increase government intervention in the economy by nationalising natural resources and strategic businesses, such as the Venezuelan nationalisations at of key players in the phone (Cantv), electric (Elecar), and banking (*Banco de Venezuela*) industries.

### 5.4.2 Leftwing Governments and WSF

Assuming that left to their own will, without subordination to foreign manipulation, the desperate poor in Latin America will probably choose redistributive governments. Interestingly enough, many Latin American democracies already have started to follow this path by electing high social spending leftwing governments into Presidential office. The list of leftwing Presidents elected by democratic means now adds up to at least eleven countries. In all started in Venezuela with Hugo Chávez in 1998; Chávez won two more Presidential elections in 2000 and 2006, and one recall referendum in 2004. Argentina with Néstor Kirchner in 2003 and wife Christina Fernández in 2007 and 2011. Bolivia with Evo Morales

in 2005; Morales won a recall referendum in 2008 with 67%. Ecuador with Rafael Correa in 2006 and 2009. Uruguay with Tabaré Vázquez in 2004 and ex-guerrilla "Pepe" Mujica in 2009. Nicaragua with Daniel Ortega in 2006 and 2012. Paraguay with Fernando Lugo in 2008. El Salvador with Mauricio Funes in 2009. Peru with Ollanta Humala in 2011. And before the 2009 coup d'état, Honduras with Manuel Zelaya in 2005. (The list excludes Raul Castro, because Cuba is not a free democracy).

The eleventh country in the list is Brazil with the Lula da Silva phenomenon in 2002 and 2006, and ex-urban guerrilla Dilma Rousseff in 2010. It is important to recognise the following undeniable truth: the *Partido dos Trabalhadores* (Workers' Party, or PT) is closer to the Marxist populism in Venezuela than to rightwing governments that have close ties with the US such as Mexico, Costa Rica, Panamá, and Colombia (French, 2009). As a matter of fact, the deep relationship between Brazil and Venezuela has gone well beyond trade, which by the way has more than quadrupled to about US$6.5 billion per year since Lula took over in 2003.

In repeated occasions, Brazil has served as a vital guarantor of Chávez in the face of his enemies, just as it has supported the radical socialist government of Evo Morales, despite the abrupt nationalisation of Brazilian state-owned oil enterprise Petrobras interests' in Bolivia (French, 2009: 358). More importantly, Brazil not only backed Venezuela's controversial bid for a seat on the UN Security Council, but also, the two governments worked together to create the *Banco del Sur*, where a part of the national reserves are expected to go (Cameron, 2009: 344). Recently, Brazil went over the US in three relevant issues: (1) in attempting to broker an agreement with Iran on nuclear energy; (2) by criticising US for installing seven military bases in Colombia; (3) and by recognising the Palestinian state with its pre-1967 boundaries. "For U.S. hardliners, Lula strayed too far from acceptable diplomacy. During his last stretch in office, in the words of the Wall Street Journal, Lula pursued an increasingly anti-American foreign policy." (Ellner, 2011).

The icing in the cake came when President Dilma Rousseff did not attend the World Economic Forum (WEF) in Davos (Switzerland) to host the World Social Forum (WSF) in Porto Alegre (Brazil) from 24-29 January 2012, despite the fact that Brazil is one of the rising stars in the global economy. Ironically, while Davos praised capitalism as the best alternative, the slogan at the WSF was "the capitalist crisis." Latter that week, President Rousseff travelled to Cuba to meet with Fidel Castro and sign a series of mutual agreements with President Raul Castro. Fortunately, Brazil and the WSF exist, and fortunately both serve as a natural space of encounter based on horizontality and autonomy for the plural lefts in Latin

America (French, 2009: 363-364). The *Partido dos Trabalhadores* and the WSF are not defined by opposition to capitalism *per se*, but to neoliberalism. That is, it is not defined by opposition to all capital, but to domination by capital.

### 5.4.3   The 2011 Latinobarometro Report

The 2011 Latinobarómetro Report, released on 28 October 2011, is an annual public opinion survey by a non-profit NGO based in Santiago de Chile that involves some 19,000 interviews in 18 Latin American countries, which represents more than 400 million inhabitants. The 2011 survey received support from a number of international organisations and governments, including the Organisation of American States (OAS), *la Corporación Andina de Fomento* (CAF), the Swedish International Development Cooperation Agency (SIDA), the Canadian International Development Agency (CIDA), the Danish government, the United Nations Development Programme (UNDP), the Inter-American Development Bank (IDB), *la Agencia Española de Cooperación Internacional* (AECI), and the US Department of State.[25]

Overall, the 2011 Latinobarómetro Report sustain that countries with leftwing governments tend to perform better on inequalities and democracy institutions indicators. As a matter of fact, eight out of the first ten countries ranked in the following four key indicators are governed by leftwing governments (refer to Table 5.3): "justice in income distribution", "country governed for the common well of all", "trust in the government," and "satisfaction with democracy." (The coincidence is considered to be significant from any statistical perspective). The four key performance indicators are considered crucial to stability, which implies that leftwing governments in Latin America are in a good position to stay in power the necessary time needed to undertake radical constitutional reforms aimed at regional integration. At the very least, leftwing governments in the region should enjoy the popular support needed to reject future attempts of the neoliberal movement to institutionalise the FTAA.

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[25] The 2011 Report is available at http://www.latinobarometro.org/latino/LATContenidos.jsp.

**Table 5.3** Rank in Key Stability Indicators

| Country | Justice in income distribution | Country governed for the common well of all | Trust in the government | Satisfaction with democracy |
|---|---|---|---|---|
| Argentina | **10** | **5** | **6** | **2** |
| Bolivia | **8** | **6** | **10** | 15 |
| Brazil | 13 | **8** | **8** | **9** |
| Chile | 18 | 12 | 13 | 12 |
| Colombia | 16 | 10 | 11 | 16 |
| Costa Rica | 5 | 13 | 7 | 6 |
| Cuba | N/A | N/A | N/A | N/A |
| Dominican Republic | 17 | 18 | 17 | 11 |
| Ecuador | **1** | **4** | **2** | **4** |
| El Salvador | **9** | **9** | **5** | **10** |
| Guatemala | 11 | 11 | 18 | 18 |
| Honduras | 15 | 16 | 16 | 14 |
| Mexico | 12 | 15 | 15 | 17 |
| Nicaragua | **6** | **2** | 12 | **8** |
| Panamá | 2 | 7 | 3 | 3 |
| Paraguay | **7** | 14 | **9** | **7** |
| Perú | 14 | 17 | 14 | 13 |
| Uruguay | **4** | **1** | **1** | **1** |
| Venezuela | **3** | **3** | **4** | **5** |

The two inequality indicators, "justice in income distribution" and "country governed for the common well of all," respond to following questions: "how fair you think that income distribution is in (country)?;" and "generally speaking, will you say that (country) is governed for a few powerful groups in their own benefit, or is governed for the common well of all?" For the first indicator, figures range from just 6% in Chile who considers distribution is fair to the 43% in Ecuador who take this view (here only "very fair" and "fair"). For the second indicator, the perception that a government governs on behalf of the majority is considered central to stability.

The remaining indicators, "trust in the government" and "satisfaction with democracy," responds to the following questions: "would you say you have a lot, some, a little or no trust in the Government?;" and "in general, would you say that you are very satisfied, quite satisfied, not very satisfied or not at all satisfied with the working of the democracy in (country)?" These last two indicators relate how citizens perceive the state and the performance of government.

### 5.4.4 Heritage of Bolivarianism

The following impressive news report was released on 07 August 2011 as the main argument with which the BBC chose Simón Bolívar as the most outstanding American (north, central, and south): "With only 47 years of age, he fought 472 battles being defeated only 6 times, he took part in 79 big battles with the great risk of dying in 25 of them. He freed 6 nations, rode 123 kilometres (more than what was sailed by Columbus and Vasco da Gama together) was the Head of State of 5 nations, took the torch of Liberty for a lineal distance of 6,500 kilometres (this distance is approximately half turn to the Earth). He travelled 10 times more than Hannibal, 3 times more than Napoleon, and the double of Alexander the Great. His ideas of liberty were written in 92 proclamations and 2,632 letters. The most incredible is that most of them were simultaneously dictated in different languages to several secretaries. The most important is that the army he commanded never conquered only liberated!"

The most accurate account of Bolívar's legacy is Lynch's (2006) pragmatic masterpiece.[26] Different from previous biographies, Lynch (2006) emphasizes the importance of class and racial inequalities as a driving force to Bolívar's unstoppable quest for liberty and justice, with the argument that Venezuela was dominated by born Spaniards and recent generations of Venezuelan white elite, which only accounted for about .5% of the total population. Lynch (2006), however, makes two bias mistakes. In the first place, by calling Hugo Chávez a fake Bolivarian revolutionary, just after Chávez changed the name of the country to Bolivarian Republic of Venezuela (page 304). And in the second place, by undermining the strong influence of free-thinker Simón Rodríguez on Bolívar's life. Ludwig (1942) and Masur (1960), on the other hand, stress the influence of Rodríguez on a young Bolívar and argue that as an admirer of Holbach and Rouseau, Rodríguez was a strong advocate of placing sovereignty in the hands of the people. In 1819, at the Angostura Congress, Bolívar claimed: "Blissful is the citizen that has convened national sovereignty to exercise his absolute will."

Lynch (2006) argues that on top of the anti-imperialist and anti-liberalist ideology, Bolívar's dream was to unite the newly liberated territories. Way ahead of his time, Bolívar had the grandiose idea of uniting Latin America under a common government linking all the states in a confederation as a necessary counterweight to the growing power of the US

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[26] The works of Vicente Lecuna (1870–1954) deserve special recognition, but are less reader-friendly.

(Buxton, 2005: 440). One year before his death in 1830, Bolívar prophesized that the US seemed destined by Providence to plague Latin America with miseries in the name of freedom. Regrettably, Bolívar lived to see his dream vanished when the short-lived nation called Great Colombia was divided into Venezuela, Colombia, Ecuador, Panama, Guyana, and some territories of Peru and Brazil. Two centuries after Great Colombia's dismantle, Bolívar's dream has a good chance to become a reality; but only if the "good" and "bad" lefts in Latin America integrate into an institutionalised regional trade arrangement, more significant than a one-sided FTA with the US.

## 5.5  ANALYTICAL FRAMEWORK

### 5.5.1  Political Trilemma

Slowly but surely, the region is reviving Bolivar's dream to unite an independent and socially responsible Latin America. A united Latin America with self-determination to dictate its own political and socioeconomic path or at least to be free from the onerous terms set by the IMF, WB, and WTO. The trade-off here is actually straightforward. In theory, a market-oriented economy cannot coexist with redistributive democracies in a sovereign developing nation. That is, according to the political trilemma by Rodrik (2002), nation state, democratic politics, and economic freedom are mutually incompatible. At most, only two out of three can coexist at the same time. (Refer to Figure 5.2).

**Figure 5.2**   Political Trilemma "pick two, any two"
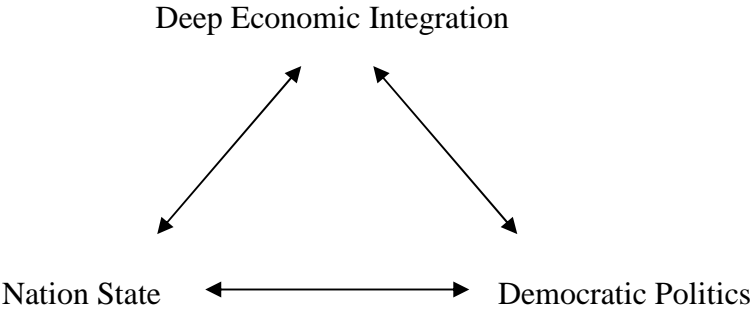
Nation state is the self-determination to govern without any supranational intervention. Democratic politics is when public policy decisions are made by those that are directly affected by them. And deep economic integration is basically to adopt the orthodox Washington Consensus neoliberal prescription of stabilisation, privatisation, and liberalisation. That is, to stabilise the monetary system by devaluing local currencies and eliminating capital flows controls and to tighten the budget by cutting social spending and replacing inefficient state enterprises with privately owned corporations, to the open market by liberating prices and slashing imports tariffs, and to liberalise the economy by relaxing labor legislations and minimising regulations restrictions.

Most countries fall somewhere between any two corners of Rodrik's political trilemma. For example, the EU chose to integrate and erect an extensive welfare system of social insurance, which fits perfectly somewhere between "deep economic integration" (top corner) and "democratic politics" (bottom-right corner). However, by foregoing "nation state" or self-determination, the EU member countries lost autonomy, namely on monetary and immigration issues. The US, on the other side of the Atlantic, chose a completely different strategy. The US has in fact reached momentary unipolar superpower status with an extra dose of the neoliberal recipe for economic development, especially when it comes down to free trade agreements, and strong self-determination to do whatever it takes in the international arena. However, by foregoing socially responsible policies, the US lags behind on inequalities; which can be measured by a terrible Gini coefficient historical track record in comparison to the EU, especially against eastern European countries.

Perhaps, the best option for Latin America is not to mimic the EU welfare liberal democracy, or the US nationalistic free trade. Perhaps, a third path focused on regional integration among leftwing governments is probably the best choice for Latin America. Maybe the orthodox Washington Consensus prescription of liberalisation, privatisation, and stabilisation, is simply not the best solution to Latin America's daunting array of problems. Maybe Latin America should learn from its recent traumatic experience with orthodox Washington Consensus policies, and reconsider the possibility of a third path; instead of embarking in another suicide neoliberal trip. The economic collapse of Mexico in 1994, Brazil in 1999, and Argentina in 2002, contributes to the ongoing debate whether market-oriented policies, especially FTAs, could ever produce real improvements in living conditions for a developing country's poorer citizens (Di Tella and Vogel, 2004a; 2004b).

To put the political trilemma into some practical use, I slightly modified its structure and the title words, without changing the original meaning. "Deep economic integration" was changed to "neoliberalism" and was placed on the far-right corner. "Democratic politics" was changed to "populism" and was place on the far-left corner. And "nation state" was changed to "nationalism" and was placed above all on the top corner. (Refer to Figure 5.3). This slight modification of Rodrik´s political trilemma reveals two relevant issues. First, the three most relevant regional trade arrangements in Latin America fit perfectly in one of the three corners. And second, populism becomes the key factor that divides MERCOSUR and ALBA. In other words, the "American Political Trilemma" implies that if extreme populism moderates its economic agenda towards the encouragement of private investment and stabilising the exchange rate system, the gap between MERCOSUR (the "good" left) and ALBA (the "bad" left) would automatically narrow down. In practical terms, if Venezuela is accepted into MERCOSUR and/or the SUCRE becomes a hard currency among ALBA members, the integration of Latin America's plural lefts will immediately follow.

**Figure 5.3**   American Political Trilemma
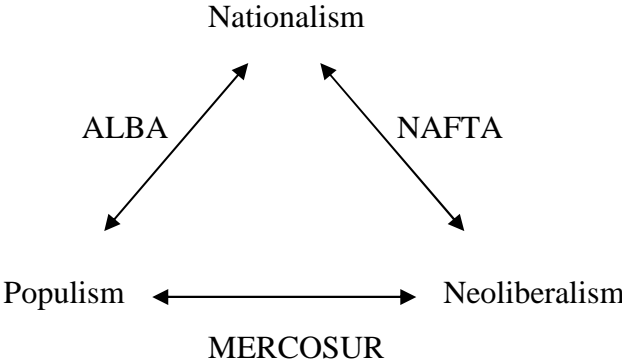


### 5.5.2   Evaluation Matrix

Ellner's (2010) matrix serves the purpose of evaluating the performance of government and to understand the existence of a "back door" to integration phenomenon of Latin America, which is not explored in this analysis because of its low probability of materialising into practice. That is, just as Venezuela holds the key to integrate ALBA into MERCOSUR, Argentina holds the key to integrate MERCOSUR into ALBA. This is due mainly because

Argentina lies somewhere between the two criterias of the matrix: "liberal democracy" and "radical democracy." (Refer to Table 5.4).

The legacy of Evita and the *piqueteros* phenomenon in Argentina are a constant remainder that the mobilisation of the popular sectors of society is a strong part of the Argentinean gene. This implies that judged by the "radical democracy" criteria, and similar to ALBA countries, the Argentinean government scores significantly better compared to being judged by the "liberal democracy" criteria. The Latinobarómetro Report (2011: 13) actually divides Latin American leftwing governments in three ideological types: (1) "center-left", (2) "21st-century socialist left", (3) and Argentina simply as "the left" somewhere in between.

**Table 5.4**  Evaluation Matrix

| | CRITERIAS | |
|---|---|---|
| | **Liberal Democracy** | **Radical Democracy** |
| **Pragmatic Decision-Making** | *NAFTA* | |
| **Social Prioritization** | *MERCOSUR (excluding Argentina)* | *ALBA (maybe Argentina)* |

STANDARDS

"Radical democracy" emphasizes quantity over quality or the majority rule by increasing the participation of the popular sectors of society. "Liberal democracy" emphasizes an institutionalised system of checks and balances that boosts national production and is hard on corruption at the same time, which is the main secret to Uruguay's outstanding overall performance. "Social prioritisation" or social national planning encourages a workers/management scheme in SOEs, such as the *empresas mixtas* in Venezuela. In contrast, "pragmatic decision-making" targets production efficiency mainly through the opening of the economy to global competition by means of FTAs such as NAFTA.

For example, judged by "liberal democracy" standards, the *chavismo* government has failed to substantially increase production and has moved very slowly towards institutionalisation (Ellner, 2010: 77). However, judging by standards associated with "radical

democracy" and "social prioritisation," which puts emphasis on the participation of the popular sectors of the population that were formally excluded and on guiding strategic national production towards social objectives in detriment to the efficiency incentives of profit-seeking, the *chavismo* government fares much better (Ellner, 2010: 80).

## 5.6  CONCLUSIONS

The twentieth century marked the beginning of Latin America's second independence. Instead of Europe, the US was the loosing side this time . Ellner (2011) supports this fact with three arguments. First, the CELAC will eventually serve as a parallel organisation of political dialogue to the US-dominated OAS. Second, Latin American nations have broadened commercial ties with countries like China, Russia, and Iran. And third, Latin America has resolved major internal conflicts without US inputs, including Bolivia's nationalisation of Brazilian oil and gas interests, coup attempts in Venezuela and Ecuador, Colombia's incursion in Ecuadorian territory, and an overthrown government in Honduras, which not-by-chance was a former full member of ALBA. The next frontier to conquer for the plural lefts in Latin America, now that the colossal step of partial independence from the US has finally been taken, is to institutionalise a regional trade arrangement more significant than a one-sided FTA. Instead of free trade, which only responds to the interests of international capital (Cole, 2010: 325), the integration of Latin America's plural lefts should emphasize the fight against poverty, inequalities, and social exclusion. (Or in Bolívar's terms: imperialism, liberalism, and slavery).

Nearly two centuries ago, Simón Bolívar united half of South America into The Great Colombia; but a handful of greedy caudillos quickly dissolved Bolívar's dream into four countries and parts of two more. Today Latin America is facing its second window of opportunity to unite, and just as it did before, it all started with the rise of Bolivarianism in Venezuela. Amazingly, just two years into his meteoric rise to power, Chávez was the only head of State at the Third Americas Summit in Quebec to vote against Clinton's proposal for the FTAA in 2001. This groundbreaking event deserves more credit, given that FTAs with the US is the fundamental issue that divides rightwing and leftwing governments in Latin America, the line that separates governments which have signed deals of this kind such as Mexico, Costa Rica, Colombia and Panama, from leftwing governments that are more

interested in regional integration such as Argentina, Brazil, Uruguay, Paraguay, Venezuela, Bolivia, Ecuador or Nicaragua (Sader, 2008).

Different from previous popular movements rise to power in the region, including Salvador Allende in Chile, Lázaro Cárdenas in Mexico, Getulio Vargas in Brazil, or Juan Perón in Argentina, the *chavismo* popular support is financed with exceedingly high oil revenues. In fact, the combination of favorable oil prices, the recapture of oil sovereignty by charging higher royalties, and the nationalisation of strategic oil-related companies, fuelled a public spending bonanza that increased fiscal expenses at an average annual rate of 73% between 2004 and 2008 (Figueroa, 2008: 8). Naturally, the expansionary spending program sparked the inflation flame in Venezuela to the extreme of becoming the country with the highest inflation rates in Latin America, and the second highest in the world.

High inflation is usually the end-result of an oversized public sector and fiscal disarray. Any program that does not attack these two direct causes will surely fail (Fernández, 1991: 143). However, attacking the problem from this perspective is unrealistic in big spending populist Venezuela. The issue is that while economic populism may be expansionary-Keynesian, it is also opportunistic by nature; hence, it can also find a way to actually succeed in improving social welfare without causing runaway inflation. It all boils down to the following argument: as the undisputed leader of the hard-left in Latin America, the integration of ALBA into MERCOSUR is dependent on moderating the Venezuelan economy by controlling runaway inflation through the encouragement of private investments and the stabilisation of the highly uncertain exchange rate system. That is, if high inflation is not controlled in Venezuela, the economy will eventually collapse as predicted by the classical four phase theory of populism. The collapse of the Venezuelan economy will in turn generate a series of harmful spillover effects on the integration phenomenon of Latin America's plural lefts.

One practical measure to cure the inflation disease in Venezuela and contribute to the integration of leftwing governments in Latin America is the implementation of the SUCRE as a hard currency among ALBA members. In addition to helping stabilise the highly uncertain Venezuelan exchange rate system with the SUCRE, an immediate investment booster would be the acceptance of Venezuela into MERCOSUR's massive trading block. These propositions support Levine and Renelt's (1991: 955) findings, which strongly sustain that the ratio of trade to output is robustly and positively correlated with the share of investment, and that share of investment is the most significant empirical linkage to economic growth, which implies an important two-link chain between economic union and growth through investment.

Share of investment in GDP is in fact the most significant explanatory factor of economic growth (Levine and Renelt, 1992: 950). More significant than government consumption, poverty traps, education, and stable political systems. As a final remark, nowadays that the odds for integrating Latin America's plural lefts are better than ever, it should not come as a surprise that with this new reality on its own backyard the north is shivering at the possibility of a united Latin America, owner and administrator of gigantic reserves of oil, water, fertile land, and oxygen. (Refer to Table 5.5).

**Table 5.5**   Integration of MERCOSUR and ALBA

|  | Population (2010) | Territory (sq km) | GDP (PPP) (2009) | Water Resources (cu km) | Oil Reserves (bbl) |
|---|---|---|---|---|---|
| **MERCOSUR** | | | | | |
| Brazil | 201,103,330 | 8,514,877 | $2,025 B | 8,233 | 12.6 B |
| Argentina | 41,343,201 | 2,780,400 | $558 B | 814 | 2.3 B |
| Uruguay | 3,510,386 | 176,215 | $44 B | 139 | - |
| Paraguay | 6,375,830 | 406,752 | $28 B | 336 | - |
| | | | | | |
| **ALBA** | | | | | |
| Venezuela | 27,223,228 | 912,050 | $350 B | 1,233 | 153 B |
| Ecuador | 14,790,608 | 283,561 | $108 B | 432 | 4 B |
| Bolivia | 9,947,418 | 1,098,581 | $45 B | 622 | 465 M |
| Nicaragua | 5,995,928 | 130,370 | $17 B | 197 | - |
| Cuba | 11,477,459 | 110,860 | $111 B | 38 | 197 M |
| Dominica | 72,813 | 751 | $1 B | - | - |
| S. Vinc. & Gren. | 104,217 | 389 | $2 B | - | - |
| Antigua & Barbu. | 86,754 | 443 | $2 B | - | - |
| | | | | | |
| **MERCOSUR + ALBA** | | | | | |
| Total | 322,031,172 | 14,415,249 | $4,033 B | 12,044 | 172 B |
| | | | | | |
| USA | 310,232,863 | 9,826,675 | $14,430 B | 3,069 | 21.3 B |
| EU | 492,387,344 | 4,324,782 | $14,510 B | N/A | 5.5 B |
| China | 1,330,141,295 | 9,596,961 | $8,789 B | 2,829 | 15.7 B |

Source: CIA World Factbook (2010).

# VI  GENERAL CONCLUSIONS

The four *papers* presented in the central chapters of this Doctoral Thesis answer the following general questions: (1) what is the relationship between corruption and population per first-tier subnational government?; (2) to what extent and why has flawed decentralisation contribute to the generalisation of corruption in Venezuela?; (3) and what are the institutional implications to Latin America's integration phenomenon of the PSUV's structural consolidation, the acceptance of Venezuela into MERCOSUR, and the creation of the SUCRE as a hard currency among ALBA members.

The first general question implies that countries which have more subnational governments relative to their population are perceived to be more corrupt. As an answer to this relevant issue a viable institutional reform to control corruption would be to decrease the number of subnational governments by consolidating unpopulated units.[27] The arguments vary from the probability that financial resources in relatively small subnational governments are usually not enough to finance public expenditures (Bardhan and Mookherjee, 2006); to the likelihood that corrupt subnational governments in developing countries are frequently governed and managed by incapable authorities and inefficient public servants (Prud'homme, 1995), who in turn are usually more susceptible to be captured by the corrupt local private elite (Tanzi, 1995).

In theory, centralisation enables a more homogeneous delivery of public services, which in turn reduces inequalities among subnational regions in a country. The ultimate solution, however, is not to re-centralise because a certain degree of decentralisation is always essential to improve the quality of government. The solution is not to decentralise either, or to deconcentrate or even to privatise because a simultaneous interaction of the four is necessary for the efficient functioning of the government. Deconcentration increases the benefits derived from economies of scale by strengthening the hierarchical relationship between national offices and field staff, while privatisation also introduces the profit motive as a factor of efficiency. Selecting the optimal mix between the four is, however, extremely difficult.

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[27] The findings are statistically significant and robust to a wide range of controls.

If selecting an optimal mix between decentralisation, centralisation, deconcentration, and privatisation is extremely difficult, then selecting the optimal mix between the different types of decentralisation may well be an impossible goal. Having said this, a good rule of thumb is to reinforce and strengthen subnational institutions, namely, the administrative (fiscal decentralisation), legislative (decision decentralisation), political (control decentralisation), and democratic (electoral decentralisation) institutions.

Decentralising public policies could strengthen subnational institutions by following a five-step strategy: (1) encourage fiscal decentralisation by increasing autonomy, especially tax collecting autonomy; (2) encourage decision decentralisation by clearly identifying the functions assigned to the different tiers of government; (3) encourage control decentralisation by empowering regional and local institutions to become potential veto players through the national legislature; (4) encourage electoral decentralisation by institutionalising democratic elections within every tier of government; (5) and limit structural and division decentralisation by decreasing the quantity of subnational governments with the consolidation of poor and unpopulated units.

Although decentralisation behaves different in each country, the five-step decentralisation strategy aimed at improving subnational institutions applies to a broad range of countries, including federal and unitary states. The logic seems to be irrefutable: less but more powerful and autonomous regional governments strengthen subnational institutions (administratively, legislatively, democratically, and politically), which in turn increases the incentives that combat corruption, such as improving the system of checks and balances.

To support this analytical claim, the quantitative evidence found in the second chapter (first *paper*) was then further explored in the third chapter, but instead of statistically analysing a cross-country comparison of regional governments, municipalities in Venezuela were used as the case study unit of analysis. As suspected, municipal atomisation (defined as newly created local units of government in relatively poor and scarcely populated small territories) came up as a relevant factor associated to increasing corruption. But municipal atomisation was not the only relevant decentralisation-related issue that led to more corruption. The increasing number of subnational bureaucrats in Venezuela was also a significant factor that dominated most focus groups discussions. The problem is relatively simple, on average Venezuela is not even close to the efficiency limit set by Chile of 500 citizens per local government employee. In addition to municipal atomisation and increasing local bureaucracy, the case study on flawed decentralisation and corruption in Venezuela identified the lack of local revenue autonomy as a possible source of corruption, and suggests

that an efficiency enhancing government measure would be to empower the newly consolidated local governments to change sales or property tax rates.

Venezuela is an interesting phenomenon. And not just because of the dramatic changes taking place there. Venezuela is in fact a feasible case since the government in power has repeatedly proposed the reduction of subnational units (namely local governments) as a measure to dismantle the rigid and obsolete subnational bureaucratic system. It is also a fact that the Venezuelan political economy has the cash and the popular support to counterweight the significant social costs of a radical reform that would decrease the number of subnational public employees. According to the recent Latinobarometro Report, Venezuela leads the region in "the difference of GDP growth between 2010 and 2011" of 5.9 percent, from -1.4 percent to 4.5 percent (p. 24).[28] Venezuela is also first in "support for democracy" (p. 38); third in "fairness in distribution of income" (p. 34) and "democracy guarantees the fair distribution of wealth" (p. 60); and fourth in "confidence in the government" (p. 51).

The secondary *papers* of this Doctoral Thesis lack the empirical rigour found mostly in the first, but are full of rich economic and political details. The third *paper* (chapter Nº 4) explores the structural consolidation of the *Partido Socialista Unido de Venezuela* (United Socialist Political Party of Venezuela, or PSUV) as a significant step towards a constructive democratic system. The consolidation of the PSUV, however, is only the first step. In order to become an institutionalised leftwing political party such as the Workers' Party in Brazil or the Justicialist Party in Argentina, the PSUV has to evolve into an independent phenomenon more significant than its founding leader bonding effect. Consequently, to reach this objective, internal voices within the PSUV have to be harnessed rather than suppressed, and headquarters in Caracas has to enforce a clear division of power. The fourth *paper* identifies the following two domestic causes of the recent stagflationary episode (years 2009 and 2010) in Venezuela: (1) exchange rate uncertainty, and (2) low private investment.

It is important to note that one specific limitation present in any study concerning the corruption and decentralisation is that the measurements tend to ignore key issues, such as cost of living, real salaries, index of wellbeing, and the happiness of the consulted individuals, while incorrectly concentrating on the economics of specific corrupt activities, such as bribery. And since corruption is a criminal activity, the methodologies have to be sustained on the subjective perceptions of questionnaires and surveys which distort any possibility of achieving precise measurements.

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[28] On average, Latin America decreased 1.2 percent less in 2011 compared to what it had grown in 2010.

The intrinsic problem with relying on the perception of bribery is that bribery has different meanings to different people. Even within countries bribery varies greatly depending on the nationality of the corrupt individual. For example, it is common for foreign businessmen to pay sums of money far in excess for the exact building permit compared to the money paid by local entrepreneurs. On top of these relevant limitations to measure corruption with bribery, quantifying the real impact of corruption on society based mainly on the cases of bribery is also very misleading. For example, what is more corrupt? To pay a restaurant waiter an extra tip for a beachfront window table in Rio de Janeiro, to resale tickets for a baseball game in Santo Domingo, to collect traffic bribes by a low paid police officer in La Paz, or the multi-billionaire military contracts of the USA Department of Defence. Based solely on the amount of money, then there should be no doubt what is more corrupt.

The direction of causality also presents a significant limitation that is very hard to solve because decentralisation alone can be a cause for corruption. It is common for corrupt national governments in developing countries to promote decentralisation as a political tool to cloud poor public performance, divide and weaken subnational political opposition or, simply, create new governments as means of additional income.

One final limitation that should always be taken into consideration is that reversing the effects of flawed decentralisation by encouraging the transfer of decision-making powers, including real control over revenues, to subnational, democratically elected tiers of government, could ignite separatist tensions, especially in developing areas with precarious institutions. Bolivia is especially relevant here because the decentralisation reforms that took place a few decades ago with the drawing of boundaries and the creation of subnational institutions are now becoming the building blocks for the legitimisation of separatist movements. Moreover, the 1993 Popular Participation and Administrative Decentralisation reform sponsored by President Sánchez de Lozada was the starting point of the now infamous half moon. One half is rich as a result of gas, and the other half is Indian and is predominantly poor.

Finally, this Doctoral Thesis also introduces opportunities for further research. For example, the statistical findings of the first *paper* offer a fantastic opportunity to further test and explore the negative relationship between corruption and education. Because it does not support the classical theories of corruption, as is the case with the insignificant effect of three traditionally significant controls of corruption: income inequalities, liberty of press, and openness to trade. Furthermore, the four decentralisation-related factors of corruption

identified in the second *paper*, could become the starting point to focus on one of the factors, such as the creation of community councils.

In reference to the third and fourth *paper*, where it lacks empirical rigour is vastly compensated by great opportunities for future research. For example, the two stagflationarry causes identified in the fourth *paper* (exchange rate uncertainty and low private investment) could serve as the theoretical background to a statistical *paper*. Even more significant, the fourth *paper* introduces the integration phenomenon of Latin America. Specifically, it suggests that the development of Venezuela is highly dependent on its eventual acceptance as a full member of MERCOSUR's massive trading block (Brasil, Argentina, Uruguay, and Paraguay) and on the institutionalisation of the SUCRE as a hard currency among ALBA members (Venezuela, Bolivia, Ecuador, Nicaragua, Cuba, Dominica, Saint Vincent & the Grenadines, and Antigua & Barbuda). MERCOSUR and the SUCRE are very significant to Venezuela. This is due mainly because the acceptance of Venezuela into MERCOSUR's single market would increase trade and direct investment in the long run. And also because the institutionalisation of the SUCRE as a hard currency would solidify the monetary union among ALBA members and would immediately help stabilise the highly uncertain Venezuelan exchange rate system, which often generates inflationary pressures.

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  Babson College
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- 'Flawed Decentralisation and Corruption in Venezuela', Public Performance and Management Review (Revise and Resubmit).
- 'Restructuring Venezuela's Political Institutions', *Monthly Review* (under review).
- 'Stagflation in Neopopulist Venezuela and the Integration of Latin America's Lefts', *Latin American Perspectives* (Revise and Resubmit).

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- 'Why is Flawed Decentralisation Generating Corruption in Venezuela?', *27th European Group for Organisational Studies* (Gothenburg, July 07-09, 2011).
- 'Public Sector Reforms in Venezuela', *6th International Conference on Accounting, Auditing and Management in Public Sector Reforms* (Copenhagen, Sep 01-03, 2010).
- 'Public Performance and Decentralisation in Emerging Countries', *10th European Academy of Management* (Rome, May 19-22, 2010).
- 'Chavismo Popular Movement Decentralisation Reforms', *1st Governing Good and Governing Well* (Amsterdam, May 28-30, 2009).
- 'Corruption and Decentralisation of Sub-National Governments' *29th European Group of Public Administration* (Madrid, Sep 19-22, 2007).
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- '*Margarita: La Isla de Los Cruceros*' (January 28, 2000) p. 4
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