Microeconomic binding constraints on private investment and growth in Venezuela

Richard Obuchi, Bárbara Lira, Daniel Raguá

Editor: Alfredo Guerra

October 2016

Center for International Development
at Harvard University

Microeconomic binding constraints on private investment and growth in Venezuela

Richard Obuchi[1], Bárbara Lira[2], Daniel Raguá[3]
Editor: Alfredo Guerra[4]

Abstract

Venezuela's business environment is systematically evaluated as one of the worst in the world. Producing and investing in the country imposes costs and risks arising from macroeconomic instability. Beyond the problems of inflation, fiscal deficit and trade balance; firms and entrepreneurs also face enormous difficulties and discouragement going from the uncertainty about property rights to lack of electricity. To identify binding microeconomic constraints for investment in Venezuela, we reviewed international rankings and experiences about key elements of the business environment and conducted interviews with members of guilds and managers at large companies in the country. We find that the most biding constraints to investment are within the functioning of institutions, including weak property rights, and arbitrary, unbalanced and unpredictable enforcement of the law. Also binding is the flawed functioning of markets, including access to inputs and price controls.

[1] Instituto de Estudios Superiores de Administración (IESA), ODH Grupo Consultor.
[2] ODH Grupo Consultor.
[3] Universidad Católica Andrés Bello (UCAB), ODH Grupo Consultor.
[4] Harvard Kennedy School.

1. Contents

Graphs and figures

Figures

Boxes

Graphs

Tables

Introduction

By the end of 2016, Venezuela will be in its third consecutive year of economic recession. Although the estimates might vary, even in the most conservative scenarios the cumulative loss of economic activity might be around 30%. The country has a three-digit inflation, exports a third than what it used to in 2012, displays a weak position in external assets, and a large dependence on imports that it can no longer afford. The nation is facing severe shortages of basic goods, critical conditions in the provision of energy and water, and a sharp rise in poverty.

Although the deterioration of the economy and the living conditions have accelerated significantly after 2013 with the drop in oil prices, it does not follow that the current crisis in Venezuela is circumstantial. The dreadful economic performance of the country is the consequence of an economic model based on all-mighty State, which gradually took over different areas of the economy, eliminating incentives to private initiative, efficiency, productivity and investment. As a consequence, foreign companies are deconsolidating or selling their operations[5]; industries are working at an average below 50% of their installed capacity[6]; the number of industrial establishments fell from 12,700 in 1998 to 4,000 in 2016[7]; and an estimate of 300 commercial establishments are closing every day[8].

In order to overcome this situation and increase the quality of life of Venezuelans, the country needs economic growth. When economies grow, they can sustainably reduce poverty, create jobs or generate enough wealth to provide for better health and education. Growth is a goal that in all likelihood requires increasing levels of investment. A report for the Commission on Growth and Development of the World Bank, found that 13 economies[9] managed to grow over 7% per year for more than 25 consecutive years in the post war period. One of the key and common elements found in those economies was high rates of savings and investment (World Bank, 2008).

Investment in Venezuela, when compared to other countries in Latin America, shows clear signs of an economy falling behind. According to data from the Economic Commission for Latin America and the Caribbean (ECLAC), Venezuela's income from foreign investment in 2000 was US$ 4.7 billion. The amount was not far from the one received by Chile (US$ 4.9 billion) and it was nearly double the amount received by Colombia in the same year (US$ 2.4 billion). In 2015 Venezuela's foreign investment amounted to US$ 1.5 billion: 7% of Chile (US$ 20.5 billion), and 12% of Colombia's foreign investment amount in the same year (US$ 12.1 billion). In 2015, Venezuela was the only country in Latin America in which foreign investment decreased compared to the average amount that the country received in the nineties.

[5] For example, Ford deconsolidated its operations in Venezuela in January, 2015 (Ford Motor Company, 2015); General Mills sold its operations in Venezuela in March, 2016 (General Mills, Inc., 2016); Kimberly Clark deconsolidated their operations in Venezuela in February, 2016 (Kimberly Clark Corporation, 2015) and stopped operating in July, 2016; afterward was "occupied" by the government.

[6] According to the quarterly Industrial Survey from the Venezuelan Confederation of Industries (Conindustria), first quarter 2016.

[7] According to the Venezuelan Confederation of Industries (Conindustria, April, 12th, 2016).

[8] Estimation from the National Council of Commerce and Services (Consecomercio, July, 6th, 2016)

[9] The 13 economies of high sustained growth were: Botswana; Brazil; China; Hong Kong, China; Indonesia; Japan; the Republic of Korea; Malaysia; Malta; Oman; Singapore; Taiwan, China; and Thailand (World Bank, 2008).

Then, to answer the question on how investment could be increased in Venezuela, we must begin by zeroing on why did it fell behind in the first place, and what are the issues restraining it in the present.

It might sound rather evident, but sustaining and attracting investments requires, among other things, a favorable business environment. And Venezuela's business environment has been systematically ranked among the worst in the world. According to the Doing Business Report[10], by 2016 Venezuela is the 4th worst country in the world to do business, after Eritrea, Libya and South Sudan (World Bank, 2015). Investors face greater costs and risks in Venezuela than they do in almost every other country.

Sources of cost and risk come on one side from macroeconomic instability: high inflation, an unstable growth path for the last three decades and uncertainty about fiscal, monetary and exchange rate policies. In the Global Competitiveness Report[11], Venezuela ranks 135th among 140 countries as one of the worst macroeconomic environments in the world, and the worst one in Latin America. But even if the issues relating to inflation, fiscal deficit and trade balance were suddenly addressed, firms and entrepreneurs would still find themselves dealing with large difficulties and sources of discouragement. These obstacles range from the uncertainty about property rights to lack of electricity. Across the board, Venezuela showcases a hostile business environment, as becomes evident when considering the characteristics of its regulations, institutions, infrastructure and public services.

In this paper we address the question of what are the most binding microeconomic constraints for investments and private sector development, in order to identify priority areas for policy reform oriented to achieve substantial improvements in economic results.

The report is organized in the following way. In the first section, *Venezuela's business environment,* we discuss the public policy orientation since 1999 and its relation with the deterioration of the private sector environment in Venezuela. Then, we identify three key sets of constraints for private sector development: institutions, the functioning of markets, and infrastructure and public services. Constraints regarding *institutions* include rule of law, the way bureaucracy works and the way regulations are designed and applied. Another key set of constraints is related to the way *markets* currently operate. Like other economies in the past that implemented extended controls over prices and the allocation of key inputs and products, such as currency or energy (Svejnar, 1991), in Venezuela relative prices and incentives are highly distorted. A third group of constraints have to do with the lack of proper *infrastructure*

[10] The Doing Business Report "measures business regulations and their enforcement across 189 countries. It evaluates areas affecting domestic small and medium-sized firms". The report builds cross-country indicators on how easy (or difficult) is for a firm to comply with basic procedures like starting a business, getting a construction permit or paying taxes. The methodology "is based on standardized case scenarios in the largest business city of each economy. […] Doing Business relies on four main sources of information: the relevant laws and regulations, Doing Business respondents, the governments of the economies covered and the World Bank Group regional staff." The data for all sets of indicators in Doing Business 2016 are for June 1, 2015 (except for the Paying Taxes indicator, for which the data refer to January-December 2014) (World Bank, 2015).

[11] The methodology for the Global Competitiveness Report defines competitiveness as "the set of institutions, policies, and factors that determine the level of productivity of an economy, which in turn sets the level of prosperity that the country can earn." The index combines 114 indicators, grouped into 12 pillars: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication, and innovation. The index includes statistical data from internationally recognized agencies (such as the International Monetary Fund; the United Nations Educational, Scientific and Cultural Organization; and the World Health Organization); and it also includes data from the World Economic Forum's annual Executive Opinion Survey to capture concepts that require a more qualitative assessment (WEF, 2015).

and public services. Problems in this area go from unreliable electricity provision to Venezuela's dramatic crime problem.

In the following three sections, we argue specific issues related to the most binding constraints for investment in the country, for each of the three categories previously identified: *institutions, markets, and infrastructure and public services*. To identify binding constraints we reviewed comparative international studies about business environment, and conducted interviews with members of guilds and managers at large companies in Venezuela. For some of the issues we also evaluated the shadow price of the constraint, the private costs of bypassing the restriction, and the impact on the removal of the constraint in the goal of economic growth.

In the final section*, public policy recommendations for private sector development,* we translate key findings into policy recommendations that could produce significant positive effects on private sector development and investments in Venezuela. For this purpose, we suggest fundamental elements of the overall orientation of the policy reform process and also highlight key first steps and the most important areas for reform.

2. Venezuela's business environment

In a country where people queue for food and basic goods, where it is difficult to find a car battery, sugar or shampoo, why aren't those needs translating into an incentive for enough people to become producers? Why aren't local producers increasing the volume of their operations if they have idle capacity? In the 15 years between 1999 and 2014, why did growth in local supply came mostly from imports (that increased 142%) instead of local production (that increased 51%)[12]?

It might seem trivial to note it, but a decision to invest in a certain industry of a certain country does not depend exclusively on the apparent existence of an opportunity –be it unsatisfied demand of any good or service, or the availability of a resource (such as large oil reserves)-. There are many conditions needed for private initiative to grow in a country, including technical, market related and regulatory issues.

In this section we discuss the role of the public policy orientation in the deterioration of the business environment –which is characterized by uncertainty and high transactional cost-, and classify the most important and problematic policies in three areas: institutions, markets, and infrastructure and public services.

2.1. Public policy orientation and the deterioration of the private sector environment in Venezuela

How Venezuela's business environment became as difficult as it is? Economic policy aimed towards control and short term –political- gains, and in consequence sidetracked away from private initiative, efficiency, productivity and investment.

Since the beginning of Hugo Chavez government in 1999, an explicit goal of the national government was to create a new economic model. At the beginning of his administration, this goal translated into developing a "social economy": one where property focused on

[12] Aggregated supply and demand data from BCV, measured in real terms (constant VEF from 1997). The increase in imports and local production allowed an increase in private final consumption of 103%.

cooperatives, community enterprises or "peasant enterprises"[13]. This new "social economy" would be a complement to traditional market structures. However, a few years later the explicit intention became to build a new kind of socialist state -21st century socialism- where state direct participation and "social economy" had predominance in economic activities, while "capitalistic private firms" were less relevant[14]. Furthermore, early on started to emerge signs of a fundamental economic policy goal for Chavez: direct control over economic activities.

Already in 2001, a new land law[15] declared all agricultural land as public utility, making any expropriation process easier[16]; and a new hydrocarbons law[17] required a majority partnership for the state in any joint venture in the sector. The legislature approved an "enabling law" that allowed the president to enact laws by presidential decree, resulting in 49 laws approved by this mechanism in late 2001, all without public discussion, participation or debate with affected parties. Businesspersons and other actors in the country considered these norms harmful –particularly to property rights- and protested the measures. This led to a period of political instability between 2002 and 2003[18].

During 2003 the Chavez's government begun to implement the economic measures that would become basic components of his economic policy: exchange rate control, extended controls in prices and tariffs for goods and services, and the implementation of social programs called "*misiones*"[19]. A massive round of expropriations and nationalizations ensued, all nominally justified by the argument of a fight for productivity, labor stability or food sovereignty. The government also created new state owned firms to ensemble cars or cellphones with partners from governments with close political ties to the Venezuelan government, such as Iran or China. State-owned enterprises started to compete with their private counterparts on unfair grounds, as they avoided most of the surveillance apparatus and regulations the private businesses were suffering. Moreover, the state reserved for itself strategic sectors such as electricity or cement, after high profile nationalization processes.

Nowadays, the Venezuelan public sector is a mammoth structure, which besides government dependencies also include companies in sectors as diverse as agriculture, chemicals, supermarkets, telecommunications, mining, banking or hotels. In general, results from state firms show: production levels below the goals set by the authorities; inefficient management; and financial losses that become a chronic need for subsidies from the central government (Abadi, Lira, & Obuchi, 2010).

Direct participation of the government as a producer –meaning state ownership of the means of production- is only one of the ways the government uses to keep control over economic

[13] These goals are in the "Development Plan for the Nation, 2001-2007", that Hugo Chavez presented as a guideline for his term in government.

[14] Making "capitalistic private firms" less relevant was an explicit goal of the "First Socialist Plan for the Nation, 2007-2013".

[15] "Law of land and agricultural development". Official Gazette No. 37.323, from November 13th, 2001.

[16] The first requirement to execute any expropriation, is to declare the assets of "public utility and social interest". In the land law of 2001, the elimination of "*latifundio*" (private ownership of large areas of agricultural land) was declared of public utility, so the regulator (the National Institute for Land, INTI) could proceed with the expropriations required for the "sustainable organization of agricultural land" (article no. 72, law of land and agricultural development, 2001).

[17] "Hydrocarbons Law". Official Gazette No. 37.323, from November 13th, 2001.

[18] Fedecamaras (the largest business guild), together with the CTV (the largest union association) and political opposition, led protests against the government after the 49 laws were enacted. Protests lead up to a situation that briefly took Chavez out of power, and then to a general strike.

[19] Paramount early examples of *misiones* were "*Barrio Adentro*" (for the provision of primary health care) and "*Mercal*" (to directly supply food and other basic goods).

activities. The other way is supervision of private activity and control over key variables of the production or commercialization processes.

Currently, decisions that in most economies of the world would be made by a company's management, in Venezuela depend to a large extent on bureaucracy. A decision to import new equipment depends on an approval from the government to buy foreign currency; the possibility to export might depend on an permit certifying local demand for the product is satisfied; the sale price of a product is fixed by the government (prices of basic goods are set by regulation, while all goods in the economy are allowed to earn a top 30% margin by law[20]); distribution of a product to one city in Venezuela or the other, has to be approved by the government that issues a "mobilization guide".

Both regulation and the institutions in charge of enforcing them have evolved over time: norms have created increasing costs for operating in the market –such as new permits or new tariffs- and also increased uncertainty, since rules have not been stable nor predictable and their enforcement is discretional. The decision of whether a firm complies or not with certain law, and the decision of whether the proper sanction for not compliance is a penalty or temporary occupation of a plant, are all arbitrary. When the regulator has these choices at hand, opportunities for corruption emerge.

Box 1. What are "Fair Prices"?

Price controls work as an example of how regulations are designed and applied in Venezuela. These controls evolved from fixing the price of a group of basic goods, to determining a 30% margin for earnings to *all* good and services in the economy.

Since price controls were implemented in 2003, price adjustments were not regular or predictable, they did not depend on a known formula that considered either costs or reference variables, and they were usually not the result of a debate between regulators, producers and consumers. In a context of persistent inflation, if a manufacturer combined the production of a regulated good with other not regulated ones, he could manage to keep a profitable activity. The manufacturer could, for example, produce yogurt instead of fresh milk, or parboiled rice instead of regular rice. By 2008, the government determined that kind of diversification was "inappropriate use of the means of production", and this justified actions like the nationalization of "*Lácteos Los Andes*" (2008) and the Cargill plant of "*Arroz Cristal*" (2009).

By March, 2009, the government defined a complementary regulation to price control of basic goods: "mandatory minimal proportions" for the production of regulated presentations. 70% of pasta production had to be regulated pasta, 80% of regulated rice, or 95% of regulated coffee.

In 2011, the government approved the "Law of fair costs and prices"[i], which created a new institution -the National Superintendence for Costs and Prices, Sundecop- to evaluate the cost structure of *all* goods and services in the economy, starting by 19 products that included mineral water, shampoo, diapers or toilet paper. Sundecop fixed the prices of the 19 products, those prices were not adjusted regularly or predictably, and by 2013 goods that had not experienced shortages before, were notably scarce on the shelves. For example, according to BCV, the scarcity index[ii] for toilet paper went from 5% in July 2012, up to 75% in July 2013.

By 2014, now with Nicolas Maduro in office, and in the middle of an accelerated inflation that the government attributed to "speculation" from "capitalism", a new law of "fair prices"

[20] The "Law of fair prices" (LPJ) was approved by enabling law, in Official Gazette No. 40.340, January 23rd, 2014. It was then reformed in Extraordinary Official Gazette No. 6.202, from November 8th, 2015.

elaborated on the existing regulatory framework. It established a 30% cap for earnings of all firms. The goal was to "protect the income of all citizens, and especially the wages of workers" (article no. 1, Law of Fair Prices).

This new law of fair prices was made official by presidential decree, without previous meaningful dialog with the private sector or even public parliamentary debate. There is little explanation about what makes 30% the "fair" rate of earnings, and according to local businesspersons we interviewed, 30% can be a lot to some, but too little to others, particularly taking into consideration that the government decides what are the relevant costs –some costs, as advertisement, have been a priori excluded-.

The new law created new institutions and an additional bureaucratic process. The new Superintendence for the Defense of Socio-Economic Rights (Sundde), is the institution that substitutes two previous institutions: Indepabis (that protected consumers) and Sundecop (that evaluated fair costs and prices). The law also created the "unique registry for people developing economic activities" (RUPDAE), where all providers of good and services in the country have to register themselves as a pre-requirement to obtain other permits.

Also, to enforce the law, a large team of "*fiscales*" receive and process complaints from the people, and are entitled to sanction firms. Since verifying cost structures for every company and every product in the country is an impossible task, the application of the law is uneven and discretional. This opens a window for corruption, like some registered cases of extortion have shown[iii].

It is worth remarking that the existence of Sundde has not successfully protected the income of the citizens –as it explicitly intended-, which by 2016 is diminished by a triple digit inflation.

---

[i] "Law of costs and fair prices". Official Gazette No. 39.715, from July 18th, 2011.

[ii] The scarcity index from BCV, measures the number of cases a product and its substitutes were not available in an establishment visited. For example, if the scarcity index of a product is 20%, it means that out of every 100 visited establishments, in 20 cases the product and its substitutes were not found.

[iii] For example, an inspector of Sundde was formally accused for demanding a payment to a businessperson in the state of Falcon, in exchange for not processing the claims some people had made against the commerce for selling at high prices (El Nacional, August 21st, 2015). For another example, the regional coordinator of Sundde in Apure was arrested for demanding payment to businesspersons in exchange for allowing them to sell with prices above regulation (LaIguana.tv, March 13th, 2016).

It is worth mentioning that the government's hostility towards private sector activities has been openly part of the political discourse. Private sector is basically an "enemy" of the people and the government. Private firms belong to the "oligarchy" harming the country by "hoarding" and "speculation". In this framing, keeping open and effective channels of communications with the private sector was not a priority for the government, even when eventually some meetings take place. Most regulations –like the land law back in 2001, and most ever since- are not previously consulted with local organizations (businesses, consumers, or others), and are not evaluated jointly later.

Beyond discourse, why would the government keep imposing these costs and uncertainty on private sector activities? Why keep price control even though the regulation has failed to slow down inflation? (See Box 1). Why keep expropriating companies -or threatening to expropriate companies- after a decade watching state firms perform under their goals of production and generating losses? The answer lies in the intertemporal tradeoff between short-term political gains and long-term efficiency costs, in particular with a government that seems to have a very large discount rate.

For example, as we mentioned above, the government became the owner of "*Lácteos Los Andes*" in 2008. Months before the announcement, the country suffered a significant episode of milk shortage[21]. The government responded by nationalizing the largest private company producing milk for the final consumer, arguing that the problem was the private management. The solution, following the official logic, was for the state to buy the company and operate it according to "people´s needs". The first few months in state hands the company officially reported an increase in fresh milk production. A little later, it became largely inefficient, unable to survive without government subsidies and transfers, with decreasing investment and loss of capacity.

Box 2. Expropriations, deterioration of trust, and weakening of production chains

Expropriations are one of the most notorious policies used by the Venezuelan government. Since the approval of the "land law"[i] back in 2001, expropriations have reached over 3.7 million hectares of land, and assets in food manufacturing, agrochemicals, construction inputs, real estate development, and retail, among others.

Expropriations allowed the government to gain control of key economic activities by making the state the owner of the assets, but also allowed the government to gain control over private activities through the *threat* of expropriation. Expropriations were used during the Chavez's administration as a tool of coercion and even as a formal sanction for economic infractions. Expropriations gave new meaning to what was considered of public interest, since their justification was far from trying to solve a market failure.

Beyond the official rationale for expropriations –that included "endogenous development", "labor stability" or "food sovereignty" – it is clear that efficiency and productivity were not the primary goals. State-owned companies now display largely inflated payrolls, underinvestment and loss of capacity, and are unable to survive without large transfer from the public sector that have come to engross the fiscal deficit.

In the interviews we conducted, no case of expropriations was evaluated as successful. The most burdensome problems of this policy are related to the fact that some of the affected companies are the suppliers of key inputs for other economic activities. In the hands of the state, companies in industries such as steel, cement, petrochemicals, or agricultural inputs are failing to meet demand, and they end up disrupting or restricting the economic activities in other areas such as construction or manufacturing. The most mentioned case was a steel company, Sidor. There were also mentions to Agropatria (agrochemicals), Sidetur (steel), "*Lácteos Los Andes*" (dairy products), and the cement plants that used to be Holcim, Cemex and Cementos La Vega, that are at best working at minimum.

[i] See note 15.

[21] According to data from BCV, scarcity index for fresh milk was above 60% during the first trimester of 2008. Average scarcity for goods in the consumption basket for Caracas Metropolitan Area was 21% in the same period.

The orientation and goals of the public policy process in Venezuela since 1999 provided the basis for regulation design and for the functioning of key policy institutions. All the implemented measures considerably changed not only explicit rules, but also the social and political interactions in the country, in a way that allowed the national government to obtain substantial political control over a wide range of aspects of the daily life of the Venezuelan people.

For the Venezuelan government, gaining such a large political control was eased by two factors: First, the Chavez administration enjoyed an unprecedented amount of fiscal resources coming from the greatest oil boom in Venezuelan history. Second, Chavez faced little restrains from the institutions that should have had to function as his checks and balances. He ruled with a National Assembly completely favorable to his decisions since 2005, and a Supreme Court that routinely decided in the administration's favor. Between 2005 and 2014, from 45.474 decisions made by the Court, not one favored the claimant when the respondent was a high official of the State (Canova, Herrera, Rodríguez, & Graterol, 2014). Chavez also expanded the power of the Executive, giving it wide capabilities for supervision and sanction, where the criteria for selecting officials gives better rewards for political alignment than for efficiency or knowledge. After Chavez, Nicolas Maduro still enjoys the benefits of keeping tight control of the Executive over the rest of institutions.

2.2. Identifying binding constraints to investment

Decisions to invest are not easy to make, and in particular not in a country with deep political, social and economic problems, macroeconomic and microeconomic. When a firm decides not to invest in Venezuela, are complications to get permits more relevant than the failures in electricity? Is the difficult access to inputs more constraining for investment than the weakness of property rights?

Given the range of problems and the variety of microeconomic issues that make Venezuela's business environment hostile, we attempt to identify which are the most binding constraints for investment in the country. To identify binding constraints we reviewed comparative international studies about business environment, and conducted interviews with members of guilds and managers at large companies in Venezuela.

Reviewing international rankings allowed us to compare Venezuela's performance to other countries, in the sense of having an international benchmark. This is one commonly used method to find binding constraints to growth. For a case such as Venezuela's, in which international rankings show a poor performance in all indicators, we should be careful with the idea that everything is wrong, so everything is binding.

Even when everything is wrong –as measured by the available indicators-, some areas perform consistently worse than others in time and between different methodologies –i.e. reports-. We take those worst performing indicators as a signal of how binding an issue could be. But also, we note that some areas are more important than others according to theory. For example, in the Global Competitiveness Report, technological readiness is a relevant issue for competitiveness, but institutions are a *basic* pillar for it. Furthermore, evidence proves the way institutions work are a fundamental element that can either foster or hamper prosperity (Aceglemou & Robinson, 2012). Then, if in an international ranking Venezuela performed equally poorly in the issues of institutions and technological readiness, we would assess institutions as more binding.

As much information as can be taken from international rankings, the reach of such information is limited. Issues affecting growth in each country are different, numerous, and also, not necessarily measured by an indicator in a ranking. This is the reason why we complemented the benchmark analysis with qualitative research. We interviewed guild representatives and managers from private firms to find which issues are hindering investment in the context of current business decisions. We note that results from interviews are also limited, particularly since the sample is small and biased (see Annex 1), but the views and experience from the key players we interviewed provide valuable insight to calibrate the relative importance among issues that negatively affect investment.

Our results from international benchmarking and qualitative research point to large sectors by nature of the methodology employed, which shed some light on the general issues that have noticeably hurt private sector development. Some of those issues find translation into specific regulations -or groups of regulations- that were enacted since 1999. Research done by Claudia Curiel (2015) provides a useful review of a compendium of policy initiatives, laws and other norms that have been detrimental for the business environment in Venezuela (see Box 3). We present her results both as a confirmation of the binding nature of the general issues we find, but mostly, as a depiction of the potential channels through which these constraints can impact economic activity from a regulatory standpoint.

Box 3. The regulatory siege: which are the most negative regulations for the business environment? [i]

Regulations are a reflection of the policy orientation. They also define much of the practical framework where economic activities have to develop. In this sense, it is quite important to identify the specific regulation that results most harming to the development of economic activities and private sector development. Research by Claudia Curiel (2015) presents a comprehensive analysis of the over 350 laws or norms concerning private production, which have been written and applied since 1999 in Venezuela. The author builds a list of all the regulatory measures, and then evaluates each issue depending on how harmful it results to private initiative. Regulations were classified in three groups:

1. **Constraints for trust.** Considers costs and risks that result from the behavior of institutions. Includes regulations imposing institutional risks, adding transaction costs, making companies subject to discretionary measures, increasing operational costs and hurting confidence.
2. **Constraints for operations and competition.** Measures that create unfair advantages for some actors in the marketplace, decrease decision making space, move resources away from regular operations, decrease or restrict access to infrastructure or public services, create market barriers, increase labor costs and deny access to export markets.
3. **Hostile supervision.** Includes measures that incorporate new actors (such as community representatives or militia) to the control private activities; measures that allow supervision to be executed without proper capabilities in the public officials in charge; and measures that change the institutional framework.

From the full list of public policies evaluated, four get the top negative evaluation: expropriations, the Law on Fair Prices, the accumulation and non-recognition of debt in foreign currency with international suppliers from the domestic private sector, and labor solvency and labor release certificate. See Annex 2 for the full rankings and evaluation.

Table B3.1. Top negative regulations by area

Constraints for trust	Constraints for operations and	Hostile supervision

	competition	
• Expropriations. • Law of Fair Prices. • Accumulation and non-recognition of debt in foreign currency. • Criminalization and severe penalization of noncompliance of economic misdemeanors. • Expansion of the number of supervision and control entities.	• Labor solvency (a permit that is a prerequisites for other solvencies). • Foreign exchange control. • Labor immobility decrees. • State as a major importer.	• *"Estado Comunal"* • Socialist Workers' Councils. • Social control (allowing consumers and communities to oversee a firm's operation). • Conditioning of investment to communities, creating patrols to supervise activities of the companies. • Incorporation of militia in councils and committees.

The sum of all regulations in all categories results in a business environment where private property is reduced, market mechanisms suffer great distortions, supply chains are disrupted, companies close -and markets become more concentrated- and the government has significant control over a highly restricted private economic activity. Companies have a reduced space to make decision where variables such as prices or the quantity of product in inventories are determined not by the firm, but by the government.

[I] This section, as well as the more detailed content in Annex 2, is based on research and evaluation of the regulatory framework done by Claudia Curiel. We are very grateful for the data, and above all, the insights and comments she provided. Original content was published in 2015, and it was updated for this work in July, 2016.

Nevertheless, international benchmarking and qualitative research are not the only way to define an issue as a binding constraint to investment and growth. Haussman, Klinger and Wagner (2008) suggest a framework denominated growth diagnostic to asses binding constraints based on four properties: 1) The shadow price of the constraint should be high, 2) Agents in the economy should be attempting to overcome or bypass the constraint, 3) Movements in the constraint should produce significant movements in the objective function (in this case, growth), and 4) Agents less intensive in that constraint should be more likely to survive and thrive, and vice versa (Hausmann, Klinger, & Wagner, 2008). Since these properties are not easily measured for all the constraints, in consequence we rely on the nuances provided by local players and the observation of public events, as examples which indicate the presence of these properties among the binding constraints.

2.3. A road map of microeconomic constraints on investment in Venezuela

It is easy to find symptoms of an economic depression in Venezuela in 2016. Problems affecting economic activity are chronic, and in consequence all sectors, and all regions are affected. Examples are abundant in the testimonies from local businesspersons[22]: a farmer who owns 12 tractors, works only with the two he found batteries for. Some hotels can only offer 20%-30% of their installed room capacity because of restrictions on water or electricity supply. Businesspersons from large agro-industry, chemicals, and massive consumption firms we interviewed, mentioned how production is being reduced while industrial capacity is left inactive for days, weeks or months due to lack of inputs or refractions. In agriculture, construction and auto-parts, many companies -especially the smaller ones- have closed because they had no profitability due to fixed prices, insufficient access to credit or collapse of domestic demand for their products. Households are affected by shortages of basic goods and a poor quality of life (described by local actors by issues such as the lack of health, education, employment, nutrition or the loss of the ability to choose amongst products or brands), a situation with deep negative effects on productivity and availability of human resources, that significantly affect overall perceptions about the future of Venezuela's economy.

But difficulties for households and firms operating in Venezuela, go well beyond the deterioration in economic variables. Everybody has to deal with issues such as political instability and deep social problems, like crime. Some farm owners can't visit their fields and farms for fear of kidnapping, or some companies deal with frequent theft of their products and equipment, sometimes with the complicity of their own employees.

Issues that represent the greatest difficulties to production and discouragement to investment are well reflected in the concerns expressed by private sector players in Venezuela. The issues most commonly mentioned as obstacles to investment are: a) lack of legal security (referring mostly to weak property rights, restricted possibility of profit and arbitrary application of the law), b) the difficulties to access inputs (an issue related to the flaws in the functioning of markets) c) lack of balance in labor regulation; and d) insufficient availability of labor. Accordingly, among the most repeated words in the interviews conducted were "control", "government", "inputs", "workers" and "currency" (see Figure 1). Other noticeable mentions are "electricity" and "security" (both within the area of infrastructure and public services).

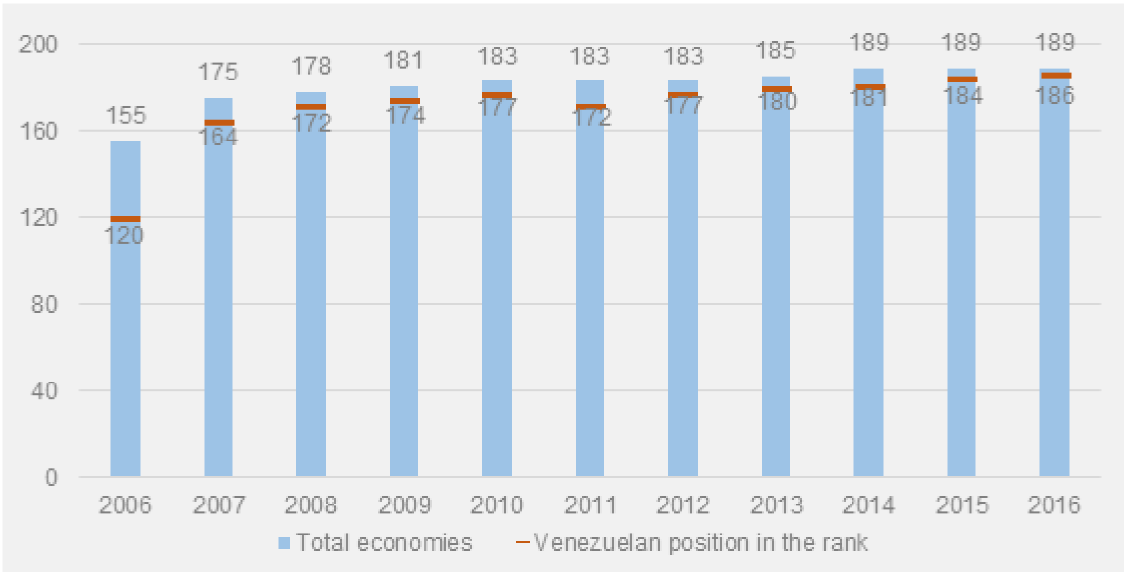
Figure 1 - Top 150 words from the interviews

Source: Wordle.net

[22] We conducted 11 individual interviews with managers of large companies and guild representatives from different economic activities: agriculture, cattle farming, agro-industry, chemicals, manufacturing, industrial inputs, steel industry, construction, auto-parts, massive consumption and real state. The interview addressed their general views on the country situation, and their evaluation about microeconomic constraints for investment. See Annex 1.

In international comparative studies about the quality of business environment, there is ample consensus about the dire perception of the Venezuelan situation. In the Doing Business Report, Venezuela's position in the ranking has been worsening for years (see Graph 1). The country went from the position 120 from 155 nations in 2006, to 186 from 189 nations in 2016 (World Bank, 2015). This means that in 2006, 23% of countries in the sample had a worse business environment than Venezuela while in 2016 Venezuela was in the bottom 2%.

Graph 1 - Venezuela's position in the Ease of Doing Business Ranking



Source: Doing Business, World Bank.

While most countries improved their business environments by simplifying procedures and reducing the time needed to comply with regulatory requirements, Venezuela shows no improvement for most indicators evaluated, like the time needed to start a business, the number of steps required to obtain electricity, or the number of tax payments a firm has to do in a year. Starting a business in Venezuela in 2004 took 16 procedures, 143 days and the cost was 43.9% of income per capita. In this particular issue, Venezuela was ranked above Colombia, Paraguay or Saudi Arabia. By 2016, starting a business takes 17 procedures, 144 days and costs 88.7% of income per capita. The country now only ranks better than Equatorial Guinea, Haiti and Central African Republic. Measured in days, Venezuela has the longest procedure to start a business in the world, followed by Equatorial Guinea, with 135 days.

The broad scope of regulation of economic activities, the regulatory preference for direct control of key variables in key sectors, the large discretionary powers of the public officials in charge of supervision, and the lack of effective or balanced conflict resolution mechanisms, create uncertainty, and consequently, a very discouraging business environment. Even more, these characteristics create additional problems such as inefficiency, rent seeking behaviors and corruption.

In order to provide analytical order and highlight basic differences among the complex array of constraints to investments currently in place in Venezuela -problems and difficulties go well beyond slow and cumbersome procedures to start a business or operate them- we classify restrictions in three large groups: institutions, the functioning of markets, and infrastructure (see Figure 2). In this sense, it is important to remember that we do not try to present a comprehensive list of obstacles to investment in Venezuela but rather we focus on the most important binding constraints. Also, we assume that macroeconomic stability is a basic feature of an attractive business environment, one that requires very specific measures that go beyond the scope of this study, so we do not attempt to enumerate the macroeconomic issues or problems that could represent restrictions to investment. What we aim for is to identify the main microeconomic issues hindering investment, and outlining some relevant elements related to the constraint we found.

Figure 2 - Classification of key microeconomic issues for private sector development

Institutions	Markets	Infrastructure and public services
Provision of fundamental guarantees: *Property rights *Possibility of profit *Conflict resolution *Effectiveness of bureaucracy:* *Balance controls with simplicity. *Availability of key information.	*Efficiency of markets in the allocation of goods and services:* *Inputs *Price formation *Labor force *Financing *Promotion of formalization of the market agents, and promotion of competition:* *Local and foreign investment *Moving from informal economy towards formality * Tax policy	*Provision of public goods and services needed for competitiveness:* *Energy *Personal security *Transportation *Communications *Basic health and education

In the next sections, within these broad categories, we assess which elements represent the largest obstacles to investment in Venezuela.

3. Institutions

Our first category of key issues for private sector development is institutions. Economic performance is determined by the way institutions shape incentives for people and firms in a country. Aceglemou & Robinson (2012) posit that economic institutions foster prosperity when they are inclusive: i.e. they secure "private property, an unbiased system of law, and a provision of public services that provides a level playing field in which people can exchange and contract; […] permit the entry of new businesses and allow people to choose their careers". On the contrary, countries with lack of law and order fail to achieve or sustain improvements in the quality of live for their people. This last is the case for Venezuela.

According to the Global Competitiveness Report, institutions are the first basic pillar of competitiveness, since they provide the needed confidence for citizens to engage any economic activity. The measurement of the quality of institutions includes both the formal rules for economic activities and interactions, and the informal ways of behaving in an economy (WEF, 2015).

In the pillar of institutions from the Global Competitiveness Report, Venezuela ranked 91 from 104 countries by 2005. But in 2016, Venezuela was in the last position among 140 countries; it has the worst evaluation for public institutions in the world, deteriorating its relative position in the last ten years.

Looking at the components measured within the pillar of institutions for 2016, Venezuela is in the last position in the world in property rights, ethics and corruption from public institutions, undue influence, public sector performance and security. More disaggregated data shows Venezuela ranks last in the world regarding issues such as: diversion of public funds, public trust in politicians, irregular payments for awarding public contracts and licenses, judicial independence, favoritism in decisions of government officials, wastefulness of government spending, burden of government regulation, efficiency of legal framework in settling disputes and in challenging regulations, and transparency of government policymaking. Private institutions perform only marginally better, ranking 137th amongst 140 countries (evaluating ethical behavior of firms and accountability).

The issue of property alone is key to note. There are large economic differences between countries with strong property rights and those without it. The International Property Rights Index -IPRI- (Property Rights Alliance, 2016) provides comparative data related to property rights, showing its relation with the values and principles of individual liberty and the creation of free markets and driving economic growth. The IPRI measures 10 components distributed among three core categories: 1) Legal and Political Environment: includes Judicial Independence, Rule of Law, Political Stability and Control of Corruption; 2) Physical Property Rights: including Protection of Physical Property Rights, Registering Property and Ease of Access to Loans, and, 3) Intellectual Property Rights: including Protection of Intellectual Property Rights, Patent Protection and Copyright Piracy. The IPRI's 2016 scores and rankings are based on data obtained from official sources made publicly available by established international organizations and the overall grading scale ranges from 0 to 10, where 10 is the highest value for a property rights system and 0 is the lowest value.

In its 2016 edition, Venezuela ranks last in a pool of 128 countries obtaining and overall score of 2.7. The Legal and Political Environment sub-index got a score of 1.8 –position 128-, the Physical Property Rights sub-index a score of 3.8 –position 125- and the Intellectual Property Rights sub-index a score of 2.6 –position 124. Venezuela ended last in particular components of the sub-indexes: judicial independence, rule of law, protection of physical property, and protection of intellectual property rights.

Venezuela also performs poorly in measurements of the rule of law. According to the World Justice Project, to have rule of law means four things:

1. "The government and its officials and agents as well as individuals and private entities are accountable under the law.
2. The laws are clear, publicized, stable, and just; are applied evenly; and protect fundamental rights, including the security of persons and property and certain core human rights.
3. The process by which the laws are enacted, administered, and enforced is accessible, fair, and efficient.
4. Justice is delivered timely by competent, ethical, and independent representatives and neutrals who are of sufficient number, have adequate resources, and reflect the makeup of the communities they serve" (World Justice Project, 2015).

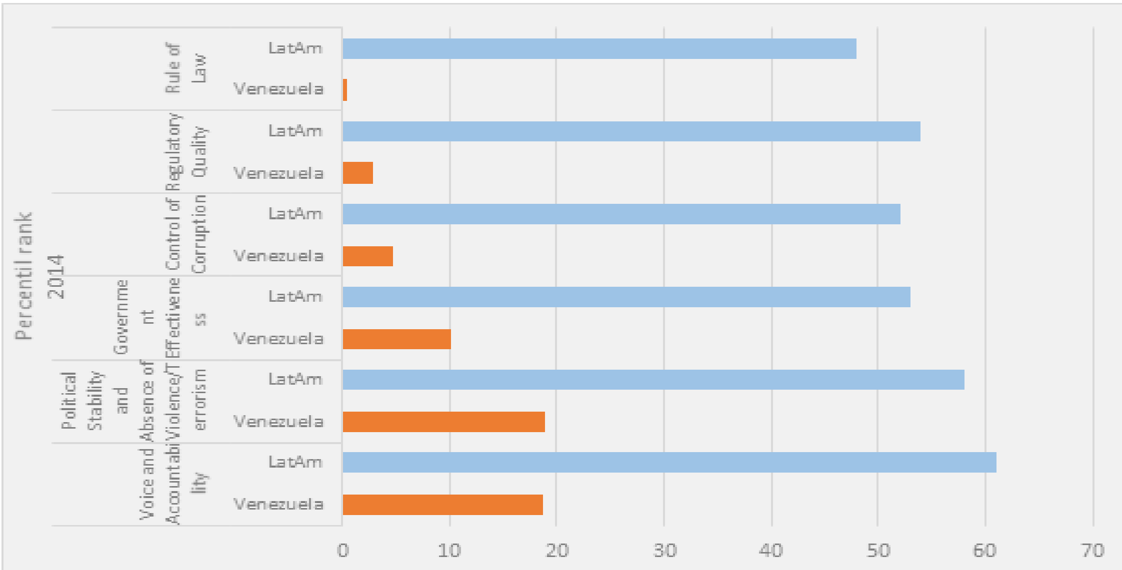
The World Justice Project builds an index[23] to evaluate rule of law by considering 8 aspects: constraints on government powers, absence of corruption, open government (this considers the right to information), fundamental rights (such as due process, freedom of religion and of expression), order and security, regulatory enforcement (including no improper influence, no unreasonable delay), civil justice and criminal justice. Venezuela performs poorly in all aspects and, overall, ranking last in the rule of law index among 102 countries.

Other measurement about the quality of institutions is in the Worldwide Governance Indicators[24] by the World Bank. This study includes indicators for six dimensions of governance: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption (World Bank, 2015). When compared to most countries, and particularly when compared to Latin America, Venezuela underperforms in all indicators (see Graph 2).

[23] The Rule of Law Index compiles data about how rule of law is experienced by the general public in 102 countries. The World Justice Project administers a set of 5 questionnaires to experts and the general public, in order to measure how rule of law is experienced in everyday situations. They ask, for example: "How frequently do people (or private companies) have to pay bribes, informal payments, or other inducements to register an ownership title over immovable property" (World Justice Project, 2015).

[24] The World Governance Indicators project "reports aggregate and individual governance indicators for 215 economies over the period 1996–2014 (…). These aggregate indicators combine the views of a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. They are based on over 30 individual data sources produced by a variety of survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms" (World Bank, 2015).

Graph 2 - World Governance Indicators for Venezuela and Latin America (percentile rank)



Source: Worldwide Governance Indicators, 2014.

From this particular set of indicators, we highlight the results in regulatory quality[25] and government effectiveness[26]. These indicators show the negative perceptions about the ability of the government to build and sustain policies favorable to development, and to provide public services efficiently. Venezuela performs poorly in these indicators, and worse than it did ten years before. Between 2004 and 2014, Venezuela went from the 12th percentile to the 10th in government effectiveness, and from the 14th percentile to the 3rd in regulatory quality (considering that 100 is the best ranked country and 0 is the worst ranked in the world).

Additional costs and uncertainty result from corruption, which is yet another indication of weak institutions. According to Transparency International, Venezuela and Haiti are the two countries in Latin America perceived as most corrupt (Transparency International, 2016). As mentioned in this section, in the Global Competitiveness Report, Venezuela ranks last among 140 countries in ethics and corruption indicator of public institutions. In the World Governance Indicators (see Graph 2), Venezuela has the weakest control of corruption[27] in Latin America, and ranks 8th worst in the world in corruption control, only above Zimbabwe, Sudan, Angola, Guinea-Bissau, Syria, Yemen and Libya. In this governance indicator (the country with the best control of corruption gets 100 and the worst gets 0), Venezuela went from a percentile rank of 34.63 in 2000 (the best position registered for the country) to 4.81 in 2014 (the worst position registered for the country).

---

[25] Regulatory quality "reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development" (World Bank, 2015).

[26] Government effectiveness "captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies" (World Bank, 2015).

[27] Control of corruption "reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests" (World Bank, 2015).

All indicators mentioned so far point to how institutions fail to provide certainty in fundamental issues such as property or regulatory enforcement. But beside these issues, the actual regulations and bureaucratic processes in Venezuela are also a relevant subject to consider when we are describing the business environment. Within this context, it is useful to review some of the indicators in the Doing Business report, which evaluates 10 different areas of regulation. As we mentioned above, in this ranking Venezuela is the 4th worst country in the world to do business.

The relatively worst ranked regulation in Venezuela is tax payment. The country ranks 188th from 189 countries in paying taxes, only above Bolivia. Companies in Venezuela need to make 70 payments a year, representing 792 hours, with a tax burden that amounts to 65% of their pre-tax profit[28]. If we compare these results to those showed in 2006, when it ranked 167 from 175 countries, the relative position of the country has worsened.

The second area of regulation where Venezuela performs poorly is trading across borders. The country ranks 186th from 189 countries, above the Democratic Republic of Congo, Yemen and Eritrea. Border compliance for exporting a container from Venezuela takes 816 hours and US$ 1,475, while documentary compliance takes 528 hours and US$ 375. Both the duration and costs to export are well above the Latin American average[29]. Similarly, importing a container to Venezuela takes more time and costs than the average from Latin America. Even more, the 1,330 hours it takes to achieve border compliance for importing a container is by far the slowest in the world (since it's followed by the 588 hours it takes for an import in the Democratic Republic of Congo)[30].

Venezuela's results for the rest of the components of ease of doing business are also disappointing. To start a business, Venezuela ranks 186th. In protecting minority investments, it ranks 178th. For getting electricity, the country ranks 171st; for enforcing contracts, 141st; for registering property, 129th; for obtaining a construction permit, 125th; and to get a credit, Venezuela gets its best result in the study, ranking 109th. All the difficulties for getting permits and paying taxes measured by the Doing Business impose direct costs in time and money on entrepreneurs.

3.1. Binding constraints

3.1.1. Rule of law: no trust in the legal framework

---

[28] According to the Doing Business report "the total tax rate measures the amount of taxes and mandatory contributions payable by the business in the second year of operation, expressed as a share of commercial profits. [...] Commercial profit is essentially net profit before all taxes borne. It differs from the conventional profit before tax, reported in financial statements. In computing profit before tax, many of the taxes borne by a firm are deductible. In computing commercial profit, these taxes are not deductible. Commercial profit therefore presents a clear picture of the actual profit of a business before any of the taxes it bears in the course of the fiscal year" (World Bank, 2015).

[29] In Latin America, on average, border compliance to export a container takes 86.1 hours and US$ 492.8, while documentary compliance takes 68.0 hours and US$ 134.1 (World Bank, 2015).

[30] It should be noted that according to the Doing Business methodology "border compliance captures the time and cost associated with compliance with the economy's customs regulations and with regulations relating to other inspections that are mandatory in order for the shipment to cross the economy's border, as well as the time and cost for handling that takes place at its port or border". Trade data included in this review was collected up to June 1, 2015. For the case of Venezuela, this date is important to mention. A larger trade volume might cause congestion in ports, and in consequence, some delays that could worsen the country's ranking in the component of trading across borders. However, by June, 2015 imports from the first semester (as reported by BCV) were already 11% lower to the ones in the first semester 2014, and 13% lower than imports from the first semester 2013. From the Doing Business Report in 2014-2015, to the report in 2015-2016, there was no change in rank for the trade across border indicator or its components. This implies Venezuela's poor performance in the ranking in trading across borders is not a consequence of a circumstantial congestion problem caused by an increase in trade volume.

The regulatory framework in Venezuela has been changing significantly in order to provide legal basis to the economic model promoted by the government. The pursue of control of economic activity resulted in the state ownership of a relevant fraction of assets in key sectors, and also gave the government the capacity to supervise private activities by applying regulations with no predictability, in an unbalanced way, and little possibility of defense for private sector against the actions of the government[31].

The deterioration in the rule of law is the issue worst ranked in comparative international studies (as discussed in the previous section). Also, in the interviews it was mentioned as a top general problem of the country. The lack of rule of law was the most mentioned issue as a binding constrain for investment, and in fact, at least the expectation of an improvement in this area –given first by signs of change in the economic policy general orientation-, was considered a prerequisite for any hypothetical decision to increase in production, payroll or investment.

Hence, we find the largest constraint to investment in Venezuela is within the general category of institutions, and it is particularly their inability to provide fundamental guarantees about property rights, mechanisms for conflict resolution, and certainty about policy development and application. All these elements result from following a policy orientation hostile to private sector development. We summarize these elements in the weakness of rule of law.

When evaluating this constraint, we find that uncertainty regarding economic policy undermines trust. The elements generating the most uncertainty are:

Weakened property rights. Aiming for economic control has made the government choose state ownership of the means of production, over efficiency in the production in sectors as different as food or steel (see **Box 2**). Investors face a non-negligible risk of losing their assets to the state, and possibly without a fair process or a fair payment[32]. But beyond the risk of losing formal property of assets, the exercise of property rights is limited: businesspersons in Venezuela are not entirely free to decide how they use their assets. Basic commercial decisions such as the sale price, if and when you import new equipment, or whether you produce regular coffee or vanilla flavored coffee, are all decisions that depends on government's approval.

Expropriations. For private sector representatives, expropriations alone are an issue particularly damaging to trust[33], not only for the loss of property that some actors have suffered, but for the constant threat the measure represents. Since 2005 many of the laws that have been reformed have included the expropriation as a sanction for economic wrongdoings (that are in themselves an ever changing definition discretionary applied by the government). For example, the law of fair prices that came into effect in 2014[34], defines expropriation as a

---

[31] As we mentioned when we discussed public policy orientation, a clear evidence of the little possibility of defense is that between 2005 and 2014, from 45.474 decisions made by the Supreme Court of Justice, not one favored the claimant when the respondent was a high official of the state (Canova, Herrera, Rodríguez, & Graterol, 2014).

[32] For example, Venezuela faces multiple demands for infringements of investment protection bilateral agreements (such as the International Centre for Settlement of Investment Disputes, ICSID) regarding the expropriations of assets of foreign companies. Some noticeable cases are: Conoco Phillips (oil, 2007, ICSID Case Nro. ARB/07/30), Owen Illinois (glass, 2012, ICSID Case No. ARB/12/21), Holcim (cement, 2009, ICSID Case No. ARB/09/3).

[33] We asked what the issue most harmful to confidence was. Exchange control, was the first individual issue with most repetitions, with 6 mentions in the 11 interviews. Expropriations got 4 mentions. However, mentions to issues referring to policy orientation (including: legal security, wrong direction of policies, the regulatory framework, lack of long term vision, impunity, and corruption) add 9 mentions.

[34] See note 20.

possible sanction if the company in cases of speculation, hoarding, usury, cartelization, among others.

Arbitrary, unbalanced and unpredictable law enforcement. This has significantly increased uncertainty about the possibilities of doing business in the country. On one hand, law enforcement has been used by the national government as a tool of control and threat that has undermined the exercise of private property. On the other hand, the imbalance of the enforcement towards the private sector over the public sector has brought unfair competition.

Poor communications between public and private for policy design and evaluation. Communication between the government and the private sector is either not existent or not effective. Even when cordial discussions happen, they fail to translate into fruitful economic policy change. This situation implies not only problems with both formal and informal conflict resolution mechanisms but also lack of participation or consultation with the private sector in key policy making processes. An additional issue that was mentioned in interviews is that the government communication to the general public lacks transparency. Official information about economic results (even basic statistics, like GDP or inflation) is increasingly unavailable. This opacity adds to general uncertainty and in some cases create additional costs (for example, processes like salary adjustments or filing taxes, may be delayed or flawed if they depend on the availability of the official inflation figure).

3.1.2. Bureaucracy

Another key constraint is poor functioning of bureaucracy in itself, the lack of effectiveness and the complexity of the processes it imposes. Among the most worrisome elements in this area we found the following:

Complexity in the procedures. There are multiple institutions and permits that behave as obstacles for production and investment in the country. Permits to register a company, import and export, or move products inside the country, are difficult to obtain since they are subject to an uncertain and cumbersome process of approval. The process tends to be long, with a lot of uncertainty regarding time and the possibility of success. Results depend not on the compliance of requirements, but on the will of the official in charge or even high level authorities. Also, according to our interviews, some permits –or institutions- are perceived as redundant or unnecessary, and the framework creates room for corruption (*"matraqueo"*). Moreover, some regulations show a punitive orientation, so companies face frequent audits, and decisions -like receiving or not the approval for an import- are sometimes politically biased. It can take months to obtain sanitary permits, mobilization guides (to be able to sell and ship products to other states of the country), permits necessary to start a business, among others.

Bureaucracy creates a loss of efficiency. Operating firms in the country make large efforts to deal with bureaucracy and overcome the obstacle it imposes. This is one of the defining properties of a binding constraint according to Growth Diagnosis. Among the efforts they make, it is particularly relevant the allocation of additional resources –such as labor- just to deal with bureaucracy. This is an irretrievable loss of efficiency. Moreover, it is a strong disincentive to new investment and it could be a driver for closing operations given that it implies significant costs (employees, lawyers, time, and other transaction costs) with high uncertainty about the overall result in terms of restrictions to basic business activities.

Exports and import permits are the most complicated. Among all permits necessary to produce in Venezuela, interviewees highlighted those required to export and import. In one of the interviews, a representative of an input manufacturing industry mentioned a remarkable example: *"[Before an export] they [regulators] destroy merchandise to see if there are drugs. Afterwards there are no drugs, and you have no merchandise".*

Not all institutions are equally burdensome. Apart from obtaining permits, other interactions with institutions also require effort. According to our interviews, the most complicated institutions to deal with are the Superintendence of Fair Prices (Sundde), the Ministry of Food, and labor regulators. Nonetheless, it is important to note that each sector has to deal with sector specific institutions, such as INTI and the Ministry of Agriculture in the agricultural sector. Plenty of institutions add obstacles for production and investment, such as: Ministry of Health, or Courts, among others.

4. Markets

Our second group of relevant issues for private sector development is the way markets work, and how policy actions affect competitiveness. According to the Global Competitiveness Report, one efficiency enhancer for competitiveness is goods market efficiency, and Venezuela is perceived as having the least efficient goods market in the world.

According to the report, "when markets for goods and services function efficiently, each factor of production is allocated to its most productive use. That means businesses produce the goods and services most desired by customers and sell them for the lowest possible price" (WEF, 2015). Venezuela has the lowest degree of domestic competition (ranking 140 from 140 countries in this indicator), and a similarly low quality of demand (ranking 131st). This last element considers if markets are consumer oriented and how sophisticated buyers are, since according to the report, demanding customers can force companies to be more innovative and efficient.

The other component of goods market efficiency is foreign competition, and in this component Venezuela ranks 138th from 140. Healthy foreign competition rewards productivity and efficiency, but Venezuela has barriers affecting foreign investment[35]. For a case as particular as Venezuela, where so many domestic issues need attention, it is important to remind that the country is still part of a global market. Local producers still face the challenge to compete in international markets, and foreign investors have a myriad of location choices other than Venezuela.

Another pillar of competitiveness is labor market efficiency, one more issue where Venezuela ranks last. Labor market in Venezuela, as measured by the Global Competitiveness Report, is the one with the least flexibility in the world, with the least ability to attract talent to the country and with the second worst ability to retain talent in the country.

Financing is also a relevant issue for private sector development. According to the Global Competiveness Report, an "efficient financial sector allocates the resources saved by a nation's population, as well as those entering the economy from abroad, to the entrepreneurial or investment projects with the highest expected rates of return rather than to the politically connected" (WEF, 2015). In the pillar of financial market development, the report evaluates elements like the availability and affordability of financial services, and the soundness of banks. In this pillar Venezuela ranks 129th from 140, better than countries such as Greece (131st) or Argentina (132nd).

Beyond what international rankings measure, markets in the Venezuelan economy show distorted relative prices, incentives that have little to do with economic efficiency, and policy imperatives dominated by political goals, so that for example, increasing the payroll in a state company might be a higher priority than increasing the production levels or the quality of the product of that same company. These characteristics are similar to the ones other controlled economies have shown in the past –such as eastern Europe socialist and communist

[35] Venezuela ranks 139th from 140 countries in "business impact of rules on foreign direct investment". The component measures responses to the question: "In your country, how restrictive are rules and regulations on foreign direct investment (FDI)? [1 = extremely restrictive; 7 = not restrictive at all]". The answer for Venezuela is 2.1, only better in the world than the 2.0 from respondents in Zimbabwe. A noticeable example of these barriers is the Law for Foreign Investments (Extraordinary Official Gazette No. 6.152, from November 18th, 2014) that establishes that to get a register for a foreign investment, the minimum amount is US$ 1 million, and the investment has to stay in the country for at least 5 years, meaning during those 5 years repatriation of capital is not allowed.

economies in the 20th century-, where they attempted to impose extended controls over property, prices and the allocation of key inputs like energy, labor, or currency.

Like those countries in the past, Venezuela in 2016 has chronic shortages of goods. As local businesspersons explained during our interviews, the lack of inputs is one of the greatest obstacles for production and investment. Inputs –as well as spare parts, equipment or goods for sale- are not available in the desired amounts, partly because imports are limited by an exchange system where government chooses what gets bought and when. But also, because the closing of key local producers of inputs or services in the middle of production chains severely restricts production possibilities (see Box 4).

We should consider two additional issues mentioned by local businesspersons while describing the way markets function in Venezuela. First, unfair competition. The government gives favorable conditions to some firms for political reasons. State owned firms, companies from preferred commercial partners like China, Iran, or others, may find it easier to obtain permits or may have lower risks of penalties in case of non-compliance with certain regulation. And second, access to some goods and services increasingly relies on informal –and illegal- markets, where buyers and sellers face greater risks, there is little information, there are no protections for producers or consumers, and as a result of all these issues, prices are higher.

4.1. Binding constraints

4.1.1. Access to inputs

Markets are failing to provide the goods and services required not only for consumers –that have trouble to find deodorant or coffee- but also for companies. The current restriction in access to inputs is severe. Firms have trouble to find raw materials, equipment and parts. Inventories of inputs have been decreasing up to the point where production lines stop working, and entire companies -particularly medium and small- stop operating for weeks or months while raw materials are unavailable.

We asked local businesspersons to evaluate the availability of inputs on a scale from 1 to 10, where 1 means there is no availability of any of the inputs required for operations, and 10 means all inputs required are available. Respondents ranked the current situation of access to inputs –on average- in 2.5.

Companies have followed different strategies to try to sustain their operations under these conditions[36]: they have adapted their production processes to the availability of materials, so that for example, a cereal box in Venezuela is now brown instead of bright white, since the chemical needed for whitening the cardboard box is not available. Some companies have relied on collaboration within industries, lending and borrowing inputs from one firm to another, when available. It is important to note that even when companies manage to keep operating, they do so while making sacrifices in terms of physical and financial capital.

While operations are interrupted, and therefore sales are interrupted, expenses keep increasing (and remarkably, payroll). Also, frequent interruptions and operating outside the technically optimal criteria (for example, because there's not enough volume of raw materials), is not only inefficient, but is potentially damaging to assets.

[36] Trying to overcome the constraint is one of the properties that qualifies it as binding according to growth diagnosis.

Among the requirements for private sector development, in the category of markets, we find a binding constraint in the difficulties to access inputs and equipment. These difficulties come from two main sources: first, local provision of inputs has decreased in the last years and production chains are broken; and second, imports are under tight control by the government, and after 2013 (with the fall in oil prices) currency availability for allocations through official exchange systems diminished.

Box 4. Broken supply chains: Could some activities be on the verge of extinction?

According to local businesspersons, Venezuela is going through a severe process of deindustrialization. The production of many goods and the creation of many jobs are lost, while production chains get broken: someone producing certain basic input may find she no longer has a buyer for that input, so she stops producing it. Then another firm further downstream still in need of the intermediate good, finds it now needs to import that intermediate good, since it can't be found locally anymore. When a basic industry fails to supply the needed quality of an input, or at the required time, firms further along in the industrial chain cannot function properly either.

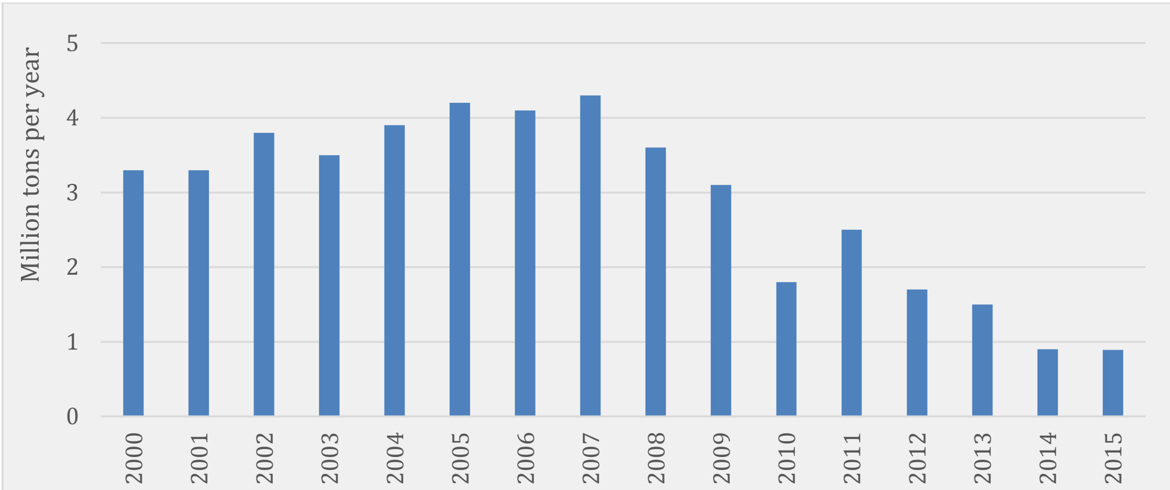
The auto parts sector is an example of this. Venezuela's auto part industry used to be able to export, but currently it is "on the verge of extinction" (according to a businessperson in a related sector). The sector has two main branches: one selling refractions to car owners, and one selling parts to automakers. Automakers currently have no currency to import raw materials, so they recently were allowed a new sales model, under which they can sell vehicles in US dollars.

In 2008, the market sold on average 22.600 cars a month, 11.300 of those being locally produced (according to statistics from CAVENEZ). With the new sales arrangement, demand falls to an estimated of 900-1000 units a month. Those firms producing the car floor, the wheels, the radio and every other part sold exclusively to automakers, find themselves currently without a buyer. This sector has about 30.000 employees, adding direct employment from automakers (companies with 3.000 employees each) and grand, medium and small suppliers of parts for automakers. The entire sector is at risk.

With regards to access to inputs, we consider particularly concerning:

Falling output from state-owned companies in key industries. Since 2007, Venezuelan government increased purchases of key productive assets. That year, the government bought the electric companies (such as "*Electricidad de Caracas, EDC*"); and CANTV, the largest provider of telephony and internet. In 2008, the government announced the expropriation of Sidor, the largest steel producer. That year it also declared the cement industry as strategic, and expropriated the assets of Cemex, Holcim, and Lafarge. In 2010, the government went on to expropriate Agroisleña, the largest provider of agrochemicals in the country, and Owen-Illinois, the largest provider of glass containers. All these assets represent essential link within productive chains of the economy. The case of steel is a particularly good example –and also the case most mentioned by the businesspersons interviewed: steel is a key input to construction, auto parts manufacturing, food manufacturing (for packages), and even primary cattle farming (since farms use bearded wire). Under state administration, production of liquid steel fell from 4.3 million tons per year, to 1.1 million tons per year (see Graph 3), and the fall in steel production has had a direct negative effect on all related sectors. Similarly, the loss in efficiency and the fall in output of the companies that were nationalized (and also of the companies that were already in state hands, but underperform, like Pequiven in petro chemicals), have negatively impacted related sectors in the economy.

Graph 3 - Sidor liquid steel production



Source: *Correo del Caroni.*

Fewer private suppliers and broken production chains. Many providers have left the market due to very diverse reasons: price controls, loss of profitability, expropriation, delays in access to currency, unfair competition against imports[37] or limited access to credit. As we mentioned before, a missing link in the production chain means not only one less supplier of national inputs, but also one less client for the next link in the production chain. One less link in the production chain probably also increases import requirements, which becomes a significant constraint when foreign currency availability is low.

Delays in currency disbursements for imports and commercial debt with international providers. Especially since 2013, private sector guilds have been warning about delays on currency allocations[38] and disbursements required to execute imports through the official exchange rate control regime. With less availability of currency in the official mechanisms - resulting from less export income, not enough available savings (either in international reserves or other funds), and not enough assets to liquidate-, the government has restricted currency allocations to the private sector[39]. Therefore, imports from the private sector are also restricted, and it is key to note that those imports are mostly inputs and capital goods[40] required for production. Additionally, a large commercial debt with international providers has been accumulating for imports that were approved by the government but did not get

[37] The government has kept the exchange rate fixed for a long period of time, making imports increasingly more attractive compare to local production, as local inflation increased more rapidly than the inflation in the rest of the world, and the gap between the black market, and the official rate was larger. Producing locally also had more difficulties and risks (from policy orientation) than importing. Additionally, the government gave advantages and executed directly imports of final goods, particularly from countries considered political allies (like China or Brazil).

[38] In Venezuela, the government controls both the exchange rate and the mechanism to access currency. By 2016, the only legal way to access currency was through official allocations from one of two systems: CENCOEX (at exchange rate of Bs/US$ 10) or SIMADI-DICOM (at exchange rate of over Bs/US$ 600) (see Box 5).

[39] On a related issue, government has given preference to imports it can directly execute. According to data from BCV, in 1999, imports from the public sector were 11% from total imports. By 2010, public participation in imports grew to 39%, and by 2015, public sector represented 50% of total imports.

[40] According to data from BCV, since 2010 imports for “intermediate consumption” and “gross fixed capital formation” account for over 70% of total private non-oil imports.

currency disbursements from the official systems (see Box 5). Only for the manufacturing sector, according to Conindustria, commercial debt reaches US$ 12 billion, which has hurt the ability of local firms to import through credit. This kind of debt is particularly more difficult to handle for small companies, since they lack capital to sustain operations in case of long delays in disbursements or alterations in the exchange rate of the realization of those payments.

Box 5. Access to currency from the view of growth diagnostics

How the exchange control mechanism works. In Venezuela, the government controls both the exchange rate and the mechanism through which citizens can gain access to foreign currency. As of 2016, the only legal mean to access currency is through official allocations from one of two systems: CENCOEX-DIPRO (at an exchange rate of Bs/US$ 10) or SIMADI-DICOM[i] (at an exchange rate over Bs/US$ 600).

According to BCV, in 2016 over 90% of official currency allocations came from CENCOEX-DIPRO. To access currency in this system, a company sends a request to Cencoex (the government agency in charge of managing foreign currency allocation among private economic actors) justifying the amount of foreign currency needed and its purpose. If Cencoex approves the request, it replies with an ADD (authorization to acquire currency) that certifies the government's intention to supply the requested amount of currency for the purpose indicated by the company. After an AAD is issued, for the firm to be able to purchase the currency amount at the agreed rate, Cencoex must issue an additional document: the ALD (authorization to pay the currency).

The other official system, SIMADI-DICOM, was initially thought of as an auction system where any individual or firm could post an offer to buy or sell currency through the local banking system. However, since the exchange rate is chosen by the BCV at a lower-than market rate, supply is constantly outstripped by demand, mirroring the problem of the stronger Cencoex rate. A company attempting to buy currency in this system posts an order at a local bank, and waits to see if any currency is assigned to it.

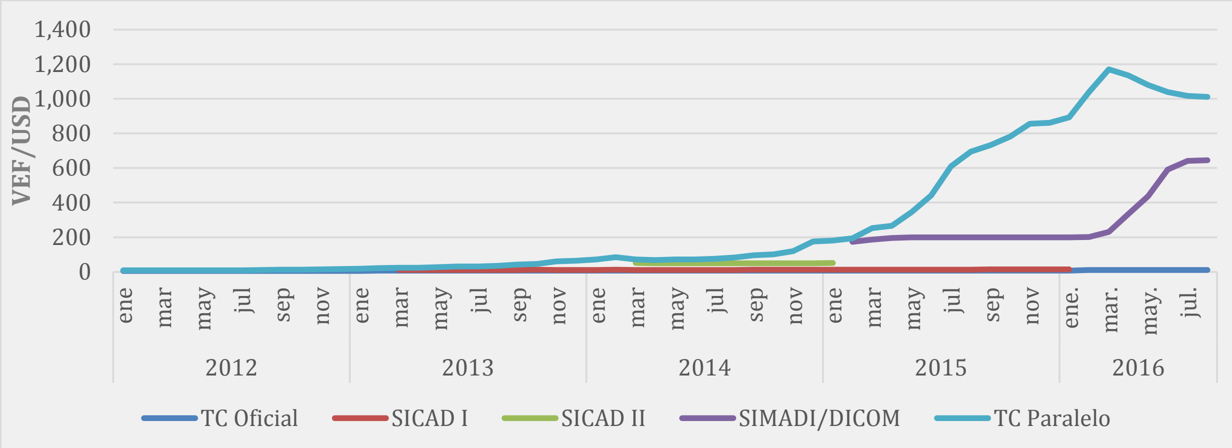
In both systems, whether a company receives currency or not depends on a government decision, making the allocation uncertain, and usually untimely. The untimely nature of foreign currency disbursements have intensified particularly after 2013, as shown by companies' numerous complaints regarding delays in the issuing of ALDs for transactions that had been approved by the government (transactions with issued ADDs)[ii].

One specially damaging consequence of these delays is the loss of commercial credit lines. Under normal circumstances, Venezuelan firms could go to a foreign provider with a document proving the availability of funds to pay (the AAD), so it could purchase the required good or service with credit. But since delays intensified, debts to foreign providers also grew. Local firms either paid with their own resources abroad negatively impacting their capital, or failed to pay, harming the commercial relation. Nowadays, Venezuelan firms, even PDVSA, are requested by providers to pay in full upfront, which makes cash management more troublesome for businesses.

A high shadow price. Since access to currency through the official systems is restricted, there is also a parallel market for unregulated access to foreign currency; one that has been deemed illegal by the government since 2010. For the first half of 2016, the black market exchange rate averaged 3 times the exchange rate from SIMADI-DICOM and 100 times the exchange rate in CENCOEX-DIPRO, where most official allocations come from.

Since actually getting currency in the official systems is both so difficult and so important, people and firms are willing to pay 100 times more VEF to get the same dollar: then, the steadily increasing FX rate differential among different exchange rates seems to point toward an elevated shadow price of the constraint of access to currency.

Graph B5.1 - Official and non-official exchange rates (VEF/US$)



Source: BCV, Dolartoday (Note: Methodology to measure the black market exchange rate changed in June, 2016. Before that date, the main indicator was the exchange rate between VEF and Colombian peso at Cucuta. Currently, it measures the average exchange rate of some private transactions reported by users in Instagram).

The parallel market for currency exists since 2003, when this exchange control began. Up to June, 2010, that parallel market was legal. Through the "*permuta*" people and firms could buy and sell bonds and stock convertible from VEF to USD at an exchange rate that on average, for all this period, was 76% higher than the official exchange rate (the one defined by CENCOEX, known as CADIVI back then, was the only official FX system at that moment).

After June, 2010, the official exchange system became more complex, with multiple exchange rates and different allocation mechanisms (first SITME, where you could buy and sell bonds to acquire currency at an exchange rate fixed by BCV; then SITME was eliminated and substituted by SICAD, then complemented by SICAD 2, then substituted by SIMADI, all these last three mechanisms predecessors for DICOM, with a similar design). A particularly relevant change from 2010 was that the parallel market became illegal. Complexity and illegality added difficulties and frictions to the market of unregulated access to currency. This is consistent with a rise in the shadow price, such that from July, 2010 to July, 2016, the black market exchange rate has been in average 2753% above the strongest official exchange rate. Likewise, January, 2014 was the first time the rate differential between the black market exchange rate and the strongest official exchange rate was over 1000%. As shown in the graph above, distortions grew more after that.

Difficulties to access currency surged not only from the additional bureaucratic complexity, but also from an insufficient currency supply. A sign in this direction is the fact that from 2003 to 2011, the allocations from the official systems (CADIVI, and adding SITME from 2010) covered each year at least 70% of imports of goods (see Table B5.1). From 2012 official allocations (adding SICAD, SICAD II and SIMADI) as a percentage of imports fell, until in 2015 that proportion reached 26%. A smaller foreign currency supply from official mechanisms, for imports, travel, or other ends, while also high inflation deteriorated the value of the VEF (causing savings to try and move to a more stable currency), boosted demand for currency in the black market. In consequence, parallel exchange rate showed its largest yearly increase in 2015 [iii].

Table B5.1 - Exchange rates and currency allocations

	Average strongest official FX exchange rate VEF/USD	Average black market exchange rate VEF/USD	% difference black market and strongest exchange rate	Imports (fob, goods) USD millions	Currency allocations from official systems, USD millions*	Official allocations / Imports (%)
2003	1.63	2.28	40%	10,483	10,215.6	97%
2004	1.89	2.8	48%	17,021	17,777	104%
2005	2.15	2.29	7%	24,008	21,002.3	87%
2006	2.15	2.74	27%	33,583	27,368.6	81%
2007	2.15	4.52	110%	47,397	43,112.5	91%
2008	2.15	4.3	100%	51,193	48,029	94%
2009	2.15	6.05	181%	41,611	28,961.7	70%
2010	4.30	7.71	79%	41,734	34,241.3	82%
2011	4.30	8.65	101%	52,575	40,175.9	76%
2012	4.30	10.82	152%	65,951	42,593.9	65%
2013	6.13	35.17	474%	57,183	31,732.4	55%
2014	6.30	90.55	1,337%	47,508	31,212.5	66%
2015	6.30	517.85	8,120%	36,913.7	94,56.02	26%
Jan-Aug 2016	9.53	943.75	9,803%	n.a.	n.a.	

Source: BCV, Cadivi-Cencoex, MEFBP.

*Allocations add all official systems, including Cadivi-Cencoex, Sitme, Sicad 1, Sicad 2, Simadi. For 2015, Cencoex allocations are USD 8.5 billion, as reported by the Ministry of Economy, Finances and Public Banking in its yearly report *"Memoria y Cuenta".* Sicad 1 allocations are USD 300 million, from 2 auctions made (there is no official data of disbursements available). SIMADI allocations are USD 370 million, 4% of total allocations.

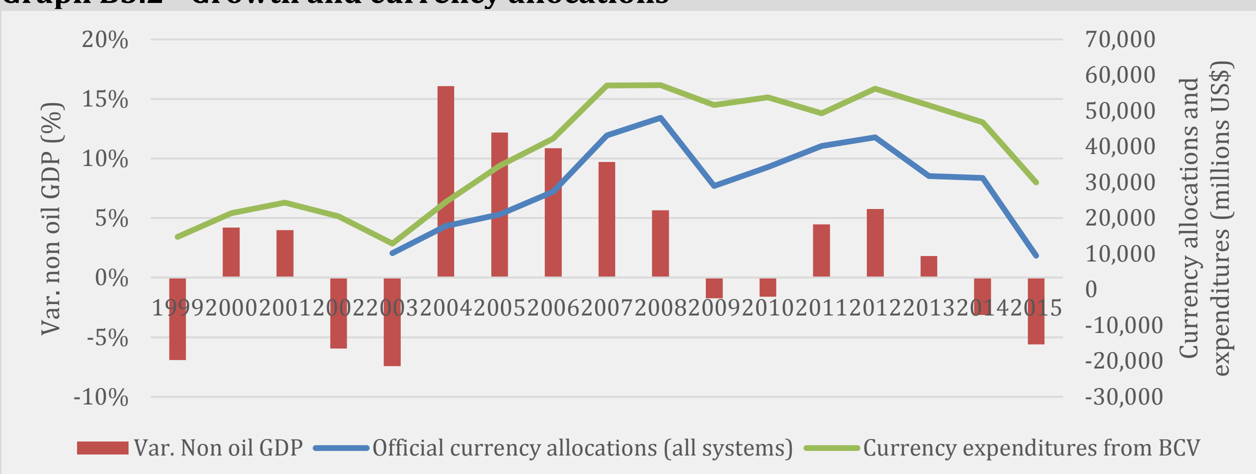
Businesses go to great lengths, and pay high prices, to overcome the constraint. Firms keep trying to buy currency from the official exchange systems, even when already in 2012, delays in payment reached in some cases 150 days[iv], and even when industries have over US$ 12 billion in pending ALDs. Large companies dedicate personnel and resources just to deal with currency requests. And also, there are cases of corruption[v]. The attractive exchange rate for foreign currency in official systems –and the illegality of the parallel market-, incentivizes many to incur in some of these costs.

Getting access to cheap currency (see Table B.5.1) became a way to buy cheap inputs or merchandise, which was attractive. As the gap between the official and parallel rate was larger, the benefit of accessing cheap currency and then resell it in the black market for a considerable profit significantly increased.

However, focusing on local production of good and services, it is key to remark that currency allocations are uncertain, untimely, and insufficient, more so in the context of the current crisis. In consequence, firms requiring imports might go to the illegal parallel market, where they pay a high price to access currency –in VEF and also in terms of associated risks associated to the illegality of the transactions. Others might also try to generate income in foreign currency, either by exporting, setting plants abroad, or trying to establish new sales practices, such as the sales done in foreign currency approved by the government to automakers (like Ford and Toyota). Other ways to deal with the FX restriction include the opaque practice of over-invoicing in order to compensate for the long waits and the rejected requests, and buying assets in the country that work better than VEF to preserve the value of their earnings, such as real estate.

Movements in the constraint produce significant movements in the objective function. Since the overall performance of the Venezuelan economy is highly dependent on imports, access to currency has a direct impact on our objective function: growth. Even before 2003, increases in currency expenditures from BCV moved usually in the same direction as growth. As showed in the graph below, alongside the imposition of an exchange control regime in 2003 came an increase in currency expenditures –for the most part, allocations from the official systems-. Up to 2008, while the oil sector was booming, growth managed to be positive. Then, the international financial crisis caused a fall in oil prices, a subsequent fall in currency expenditures, and a deeper fall in currency allocations trough the official system. This concurred with an economic contraction in 2009 and 2010.

Graph B3.2 - Growth and currency allocations



Source: BCV, Cadivi-Cencoex.

Official allocations grew for the next two years while oil prices reached historically high levels, as did local imports. In 2011 and 2012 the Venezuelan economy grew, but by 2013 it was noticeably decelerating. That year currency expenditures, official allocations and imports began to fall, and that tendency keeps going on 2016.

Agents less intensive in currency use perform relatively better. Changes in GDP composition are the result of many issues beyond exchange regime. However, we note that according to data from BCV, from 2003 to 2015, manufacturing is the sector with the largest loss in participation in the non-oil GDP: it went from representing 21.7% to 16.6% of non-oil GDP in that period). On the contrary, services like communications and financial institutions, gained participation in GDP. Communications went from representing 4.4% of non-oil GDP in 2003, to representing 10.5% of non-oil GDP in 2015. Meanwhile, Financial Institutions in that same period grew from 3.1% to 9.1% of non-oil GDP. Although some currency is required for the operations in both sectors (to buy technology, for example), their provision relies more on local resources such as labor, than the provision of other sectors such as manufacturing, requiring imported inputs and refractions.

Exports are also a relevant variable to find sectors most affected by constraints. In 2003, the largest non-oil export was metals and metal manufactures (for the most part iron and steel). That same year, this sector generated US$ 2.3 billion worth of exports, according to data from INE. By 2014 (last data point available), external sales fell to US$ 227 million. This fall, however, seems more related to the property of the industry than the currency availability, since exports kept growing up to 2006. After the government nationalized the industry in 2008, exports fell noticeably.

Chemicals and minerals are the only two sectors that managed to export in 2014 more than they did in 2003, and also, they register the top two export amounts in 2014. Chemical (largely organic) and minerals (mineral combustibles like naphthalene) have inputs that can be found locally.

Food, which has been heavily regulated for over a decade, shows the worst performance in terms of shortages, and also inflation. More specifically, primary agriculture shows very poor results, even when compared to food manufacturing. Reducing costs or simplifying production or changing varieties, might be a harder goal to achieve for primary producers (for example, for a farm traditionally producing corn, combining its production with a new plantation of passion fruit –not regulated- may take some months, or it may be impossible due to natural conditions).

---

[i] DICOM and DIPRO were announced as new exchange mechanisms in 2016. However, they are currently working exactly like CENCOEX and SIMADI used to, since no new norms for their functioning have been issued.

[ii] For example, by November, 2013, 27 airlines denounced pending ALDs for US$ 2.3 billion (El Mundo, November 15th, 2013).

[iii] After March, 2016, the black market exchange rate stabilized around VEF/US$ 1000. This is not the consequence of a larger supply from official mechanisms, since allocations actually fell. It is the result of a contracted currency demand: there is less economic activity, meaning for example less firms are operating, firms which are operating do so using less of their installed capacity, there is less available credit to leverage currency purchases (since credit is contracting in real terms), and households are not accumulating savings in foreign currency, but instead using their savings to sustain consumption.

[iv] According to Coindustria (El Mundo, November 13th, 2012).

[v] Cadivi officials charged a commission for the possibility to approve currency requests (Noticias24, May 11th, 2011).

4.1.2. Pricing and the possibility of profit

Prices are a fundamental source of information in markets. When markets are efficient and competitive, an increase in the price of rice, for example, signals more people want to buy it, so potential new producers can become suppliers of rice. This way, prices allow resources to be used for the production of a good the people need or want, -in this example, rice-. When the government introduces extensive controls of different economic variables, but particularly when it introduces widespread price controls, prices stop working as a signal. Hence, productive resources are allocated inefficiently, so there may not be additional rice production or resources may move to informal provision of the product. This is the case in Venezuela. Particularly price controls (see **Box 1**) have been harmful to production by reducing –and in some cases eliminating- profitability and the lack of profitability is an evident disincentive to investment.

Regulations have been more harmful to companies dedicated to the production of a single product with a fixed price (like a coffee, for example), or companies producing a basket of products widely affected by controls. Strategies to deal with fixed prices -and to reduce losses or guarantee sustainability of operations- include searching for opportunities of adjustments, trying to diversify production and lowering costs[41].

Among the requirements for private sector development, in the area of competitive markets, the currently flawed functioning of the price system is a key constraint. Although the functioning of prices is a wide issue to address, we assess some of the key elements in price regulation that represent discouragement to formal production and investment.

Price controls are easy to set but difficult to adjust. When a price is fixed under the current regulation, there is no explanation on how the price was set at any given level, there are no indications about when or under which circumstances a price can be adjusted, and there are no formal mechanisms for private producers to request a change of the fixed prices. More importantly, until the new Law of Fair Prices[42] was enacted, the potential of obtaining a profit in the regulated product was not mentioned in price controls. It became increasingly evident that price adjustments were a political decision, which means a lot of uncertainty over the possibility of obtaining returns on investments.

Enforcement of price regulation is uneven. The regulation is mostly enforced at the retail level of the production chain. In the interviews, some respondents mentioned that the ones who suffer the most from price regulation are supermarkets, because they are heavily controlled. Application is very inconsistent: some products don't get adjustment for months, and other get more or less regular adjustments, sometimes even above inflation.

Controls have been sustained for long periods of time. Some sectors have been under price controls for more than 20 years, making distortions deeper and harming firms' capacities to compete in international markets. As explained by a businessperson in the agricultural sector, some agricultural products have been under fixed prices long before Chavez came to power: *"In agriculture, price controls exist before chavismo. Before, it intended to protect producers from an industry trying to pay them less (supply was larger than demand). Nowadays, government fixes prices supposedly to protect consumers. It fixes prices below cost, or generating a small margin that then is lost to the cost of financing or inflation. Some products keep fixed prices (at the same level) for 2 or 3 years. Government doesn't account transport or depreciation as costs".*

Box 6. Price regulations from a growth diagnostics perspective

A high shadow price. As we explained in Box 1, the law of fair prices determines a 30% cap for earnings for all goods and services, but the enforcement of this regulation is uneven. In its most rigid version, the government fixes the price of a good and publishes it in Official Gazette, so that firms can only sell the good or service at the price set by the regulator, regardless of whether that price generates earnings or losses. In other cases, enforcement of regulation is about supervising particular firms, so that Sundde officials review the cost structure of a certain company to evaluate if its earnings, based on their current selling prices, are within the 30% cap. Any firm earning above that level could be sanctioned.

[41] According to Nicolas Maduro's government, lowering costs or "simplifying production", is an action from "economic war" that generates "induced shortages" by reducing the varieties and presentations of basic goods. MINCI, May 9th, 2016.

[42] See note 20.

Basic goods –for the most part, food- have been subject to price controls for the longest. As we mentioned, in some agricultural products price regulations are dated before 2003. Also, basic goods have the most rigid version of price control. In consequence, these goods should have higher shadow prices.

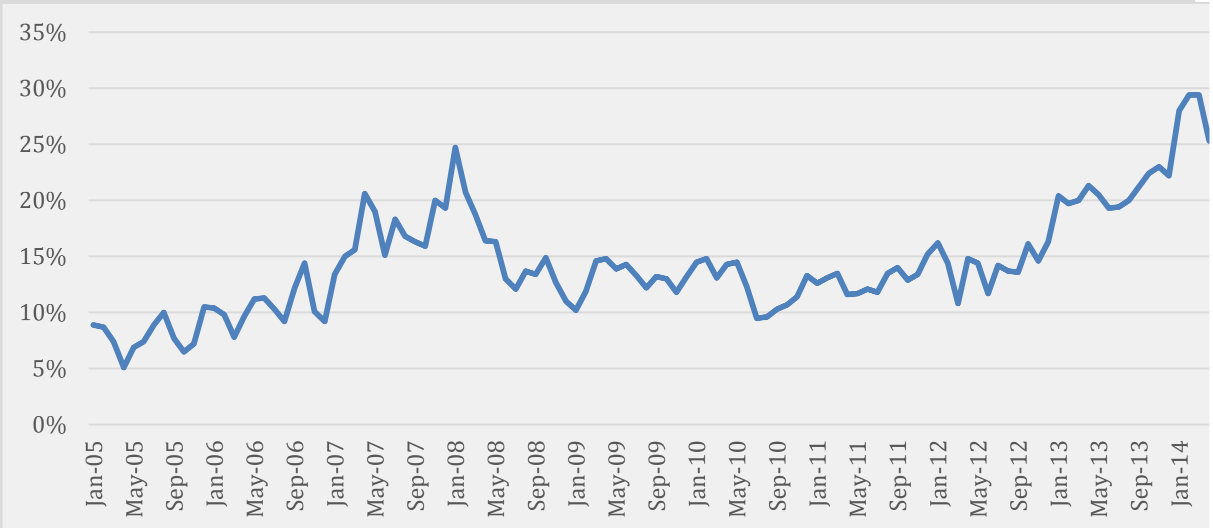
A sign of high shadow prices might be the high price of basic goods in informal markets, where regulation does not apply. For example, in August 2016, "bachaqueros" (people finding cheap regulated basic goods to resell them for several times the regulated price) sold basic products at prices 13 times higher than the regulated levels[i]. Also, it is worth highlighting that between 2003 and 2015 –the duration of the current price control system-, general price levels grew by a factor of 53, while food prices multiplied by 186. Only in 2015, general inflation was 181%, while food inflation reached 315%.

However, high prices in informal markets and inflation are the consequence of multiple factors affecting the Venezuelan economy as a whole that might weaken the causal claims we seek for explaining the constraints on the price system. Namely, aside from the existence of price controls, price levels might be also reflecting operating risks related to the illegality of informal markets, sellers taking advantages of information asymmetries, or expansive fiscal and monetary policies. Therefore, we look for another sign that points to high shadow prices for this constraint: shortages. Dealing with price controls that limit the possibility of profit is costly, and if that cost is high enough, firms will choose to leave demand unsatisfied rather than try to increase production levels.

The behavior of the scarcity index in Venezuela shows an overall increasing trend. A few years after the enactment of price controls, between 2006 and mid-2008, a noticeable rise in scarcity from a group of goods temporarily increased the average scarcity index. Wheat flour, oatmeal, corn oil, and milk were among the most affected products. All of them had been declared "of first necessity" in 2003 and had regulated prices since then. Also, all of them had over 70% of scarcity by January 2008. By then, government dealt with scarcity by increasing imports. Milk imports, for example, went from 1.13 million tons in 2007 to 2.83 million tons in 2008 according to FAO.

From 2009 to 2010, while imports grew, scarcity averaged 13%. The increasing trend for scarcity sharpened after 2011, the year when the government enacted the "law of fair costs and prices". In April 2014, milk, wheat flour and corn oil remained among the goods most affected by scarcity, but at levels over 90% sustained for months. Goods like baby food, floor waxes and toilet paper, which had no shortages before 2011, were showing over 80% scarcity in 2014, after they were included in the most rigid version price regulations. Although there is no official data for scarcity after April 2014, it is clear that from then on shortages worsened. According to surveys, on average people spend 35 hours a week in line to buy groceries in 2016, triple the time spent on average in 2014[ii], which was when the new "law of fair prices" was enacted. Shortages are now chronic: high, sustained, and affecting a wide range of goods in the economy.

Graph B6.1 - Scarcity index.

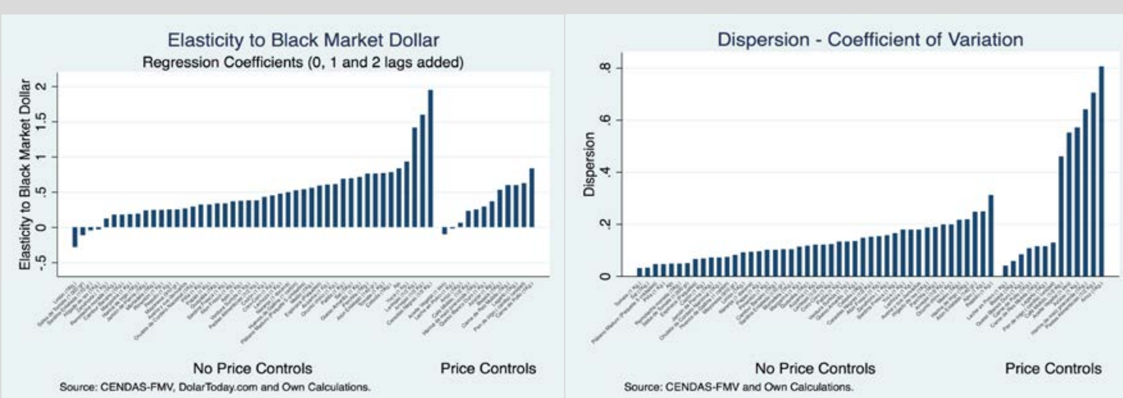


Source: BCV.

This phenomenon becomes even more evident when looking at the products with strict price controls on them. Namely, a study performed on the micro data from a monthly survey of price levels compiled by the Analysis Center for Workers (CENDAS) in Venezuela suggests that price-controlled products are less elastic to changes in the black market FX rate, and yet are more likely to experience higher scarcity levels and higher dispersion in price levels across different types of establishments (Barrios & Morales, 2016).

As can be seen in box B6.2, price-controlled products are less able to adjust prices, given the strict regulations on them. Nevertheless, it is true that the dispersion in prices of these products far exceeds that of products whose price is not explicitly set by the government. Furthermore, the only products that experience a lower price variation are perishable goods under price controls (namely, meat, bread, cheese, etc.) which suggests that the other non-perishable price-controlled products might be traded in informal markets that are able to avoid government regulations, therefore evincing higher shadow prices in the prices at which they are sold to consumers.

Graph B6.2 - Elasticity to Black Market FX rate (left) and dispersion in prices (right) by type of product.



Source: Barrios & Morales, 2016.

This behavior of price regulations affecting scarcity, also means ***movements in the constraint have produced significant movements in the objective function*,** since shortages are directly related to falling production. A clear sign in this sense, is that the reduction of imports seen after 2012 (see Box 5, Table B5.1), concurs with the increase in scarcity seen in the graph above.

Businesses go to great lengths and pay high prices to overcome the constraint. In order to deal with price controls, one of the strategies that have been followed is to produce either varieties of the controlled product, or different products, outside the regulation. This encouraged the production of products like vanilla flared coffee, or yogurt instead of fresh milk, as was explained in Box 1. Production moves towards the goods that can generate greater earnings, and due to the price control, greater earnings do not necessarily correspond to the provision of the good and services people need the most in an economy.

Also, when selling prices are fixed and costs keep rising due to inflation, reducing costs is a necessity so as to sustain profitability. Similarly, firms, especially after 2013, have "simplified" their production lines, either by reducing the diversity of the products made (less sizes, less colors) or by making the product simpler. According to workers from manufacturing companies of mass consumption products, for example, a company that used to produce 140 thousand units of fabric softener in different sizes, by 2016 -with the same amount of inputs- produces only 5 thousand units in the larger and more expensive varieties[iii].

Companies also allocate some effort to ask for price adjustments, they try to access inputs at the cheapest available option –considering as an option to import inputs at the official exchange rate-, or they assume the risk of not complying with existing regulations. Large formal firms, whether manufacturers or retailers, have limited access to this option since large actors are the most easily and frequently supervised by the government. Small but more clearly informal firms, probably find ways to sell their production above the regulated price.

Agents under the lighter versions of price control perform relatively better. Activities where price regulation is not strongly enforced –like luxury goods or informal markets- perform better in terms of growth than good and services with rigid fixed prices, which suffer more intense shortages than the rest of goods in the economy.

---

[i] "*Cesta Petare*" The local consulting firm Hinterlaces, follows the evolution of prices of a basket of 42 products and 60 varieties of those products in the informal market at Petare (Sucre municipality, Caracas). In August, 2016, the basket at informal prices was 13 times the basket at regulated prices. However, prices for an individual product could be up to 160 times more expensive than the regulated price. This measurement is useful, but limited in scope, since among informal markets there is a wide range of prices.

[ii] Local consulting firm Datanalisis, quoted by LaPatilla, July 12th, 2016.

[iii] La Iguana, May 10th, 2016

4.1.3. Labor Market

When labor markets are competitive, talent is allocated towards the production of the goods and services that the economies want or need the most. Accordingly, productivity and innovative capacity is rewarded and promoted through better salaries, benefits and working conditions. Competitive labor markets need a balanced regulation, where both productivity and the rights and benefits for workers are properly protected. In Venezuela, the most concerning issue about labor markets is precisely the lack of such balance.

Labor relations changed significantly since 2002. Since then, the government has decreed year after year labor immobility (dismissals are forbidden for workers earning below a certain level), which is policy routinely mentioned by guilds in their published documents as a relevant constraint to investment. Another milestone in labor relations occurred in 2012, when Venezuela's labor law[43] was reformed, substantially increasing labor costs and adding uncertainty to the calculations of these costs.

Since labor is a fundamental production factor, companies have found ways to overcome the obstacles by incorporating in their costs structures the high costs of hiring and dismissing an employee. However, labor regulation for years has not counted productivity as a goal, it is biased against private employers, and it is unevenly applied among firms – favoring state-owned firms and other political allies-. Hence, the greatest concerns for investment in this subject are in the way norms are applied (in the orientation of policy). Particularly, it is concerning that it is almost impossible to dismiss a worker, even if the worker incurs in one of the causes for dismissal set in the labor law. Decisions from the labor bureau are heavily biased against the employer.

The competitive markets required for private sector development find yet another constraint in the current regulation and functioning of labor market. Some particularly relevant issues are:

Lack of balance in the enforcement of labor immobility. Even though labor immobility seems to be a difficult issue as a regulation in itself, what makes it a greater obstacle is the way it is applied. To dismiss an employee, the law defines a process in which the employer has to demonstrate the misbehavior of the employee to a government entity (the "*Inspectoría del Trabajo*", from the Ministry of Labor). This entity then allows or denies the dismissal. However, in practice, with clear evidence of misbehavior (even felonies such as theft), the entity does not approve dismissals. This allows –and even promotes- misbehaviors such as absences, unwillingness to work or illegal strikes. The result is harmful to productivity, since companies have limited possible ways to penalize misbehaviors, and then there are no incentives for workers to try to excel at any task. Regulation destroys work ethics.

Little recognition of particularities of sectors. The reformed labor law forbids some types of contracts, and has little consideration for special schedules required in specific sectors, such as certain services and agriculture. Besides labor law, other regulatory measures related to labor, such as industrial security regulations, are a constraint for operations since some norms are considered inapplicable for some firms or sector. Compliance requires large expenses from the companies, and can imply discretionary penalizations for the firms. Farms, for example, can be required to own an ambulance for emergencies, even when the local authorities do not have ambulances (and currently is nearly impossible to buy an ambulance given shortages).

---

[43] "Law of labor and laborers". Extraordinary Official Gazette No. 6.076, from May 7th, 2016.

It is hard to find and to keep labor. Although the most pressing issues regard regulations and policy orientations, other elements about labor market are important. Finding and keeping workers for formal businesses is difficult. High inflation means a rapid loss of purchasing power for salaries in the formal sector. This creates an incentive for workers to move to informal activities, and particularly commerce (like "*bachaqueo*"). Other concerns about general wellbeing such as personal security, health or education, add to the loss in purchasing power and create incentives to emigration. According to the Global Competitiveness Report, Venezuela is the worst country in the world to attract talent (ranking 140/140) and the second worst to retain talent (139/140). For companies, this creates difficulties to find and retain workers with all sorts of skills from manpower to managerial. It is also relevant to mention as a constraint the lack of quality training, and particularly training in public institutions that used to provide knowledge on technical skills (like INCES, the now National Institute of Socialist Training and Education).

4.1.4. Financing

Another requirement for competitive markets is access to credit and other sources of financing. Access to finance has become a salient matter, since availability of credit is currently decreasing in real terms. This is affecting possible investment through credit for agriculture, mass consumption, manufacturing or any other sector. In this subject, the most concerning issues are:

The vulnerability of the financial activity. The financial sector is the one that grew the most in the last fifteen years in Venezuela. Driven by the increase in public spending and liquidity, this sector grew 445% between 1999 and 2014, while in this period the GDP grew 51%. Actually, in 2013 the growth of the Venezuelan economy began to slow down, but the financial sector grew 21.6%. Nonetheless, only two years after 2014 (the last year of expansion of the sector) the financial sector seems to be insufficient for the needs of the economy. In fact, in 2015 the sector decreased 12.7%.

Not enough availability of financing in Venezuela. This is a particularly worrying situation because in the middle of the longest and deepest recession in Venezuela, the health of the financial sector shows signs of debilitation. While in 2000 the financial sector stood for 2.2% of the GDP in 2014 it was 7.6%. To the little access to regular credit from national banks, we add that there are few options to get credit from banks abroad, there are not many derivatives, and a very small stock markets.

4.1.5. Taxes

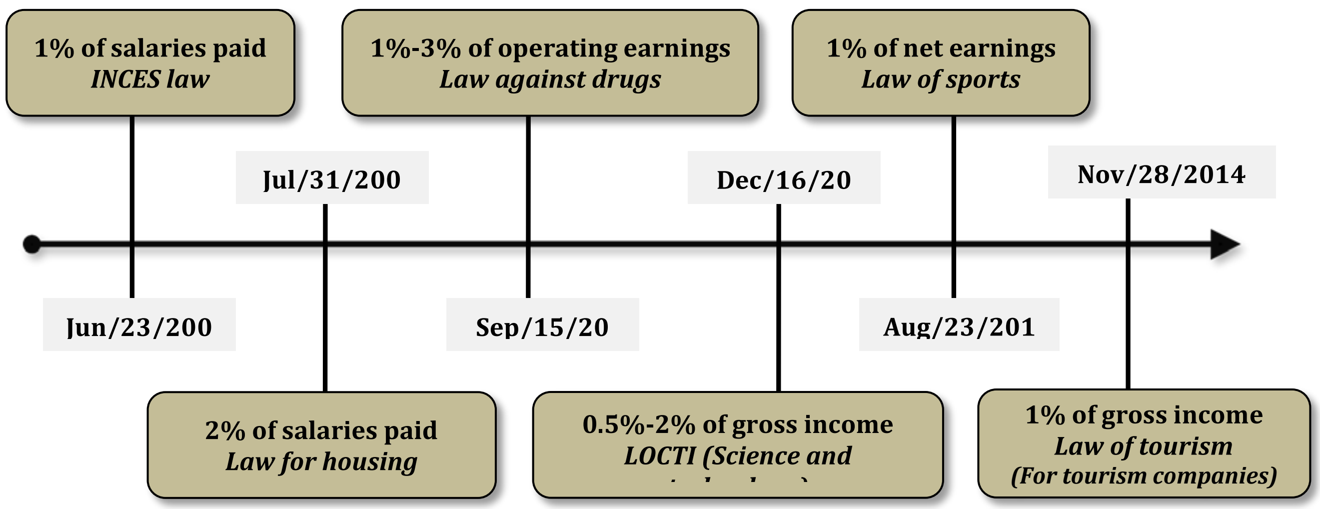
Although in the Doing Business Ranking for 2016, paying taxes is the worst indicator for Venezuela, many local businesspersons have found ways to deal with regulations in order to keep operations running. Private sector development requires predictability for fiscal policy design and application. The complexity and high fiscal burden for some companies is a significant potential determent for new investments or localization choices. Among the issues that most discourage investment, are:

A high tax burden. According to the Doing Business report, the total tax rate in Venezuela reaches 65% of profit in 2015[44]. This burden is above the Latin American average (47.7%), yet it is below the burden in countries like Brazil (69.2%) or Colombia (69.7%). However, that burden shows a considerable increase from the 48.9% it used to register in 2006. Even though the rate of the VAT and income tax –the two most important taxes in the country- have not

[44] See note 28.

changed significantly in recent years, private firms have faced an increase in the fiscal burden with the increase of "special contributions". These special contributions are not generally defined as taxes, and not controlled by the tax authority, but they are mandatory contributions by different laws and administered by different governmental entities. For example, the Law on Science and Technology (Locti); Law Against Drugs; Law of Sports, all implemented since 2008 and containing different contributions with rates levied between 0.5% and 2% of wages paid, net income, or gross income (see Figure 3). Although the rates of these contributions appear to be harmless individually, the sum of all that have been created in recent years -as well as their nature- have significantly increased the weight of the tax burden.

Figure 3 - Special contributions



Source: (Nagel, Raguá, & Obuchi, 2011)

The overall tax burden on businesses (accounting for the income tax, regional taxes, and special contributions) varies depending on the size of the companies. By 2011, companies with only 1 to 4 employees, would face a tax burden over earnings that could amount to 61%, while for large companies with over 100 employees, burden could reach 74% of earnings (Nagel, Raguá, & Obuchi, 2011).

Complicated and abundant payments. Beyond the burden of payments, the complexity of the tax system also means additional difficulties for firms. As we mentioned in previous sections, according to the Doing Business Report, Venezuelan companies have to make 70 tax payments a year: this is the largest amount of payments per year in the world. Having to comply with disaggregated tax payments adds costs not only by the disbursements directly, but by the need to hire teams just to deal with taxes, and to keep information up to date to deal with fiscal inspections. It should also be considered that some sectors are more heavily taxed than others, such as telecommunications and alcoholic beverages, which are among the sectors facing the heaviest burdens and most intricate tax structures. Furthermore, additional complications arise for some sectors from the mechanisms available for payment: a businessperson in primary agriculture, for example, mentioned that the need of internet service to pay some taxes was an obstacle in rural areas where the service is inexistent.

5. Infrastructure and public services

Infrastructure is our third category of microeconomic issues relevant to private sector development. Firms need proper infrastructure and public services to operate adequately. It is difficult for an agricultural producer to move a harvest if rural roads are in bad conditions. It is not possible for a manufacturer to start a plant where there is no electricity. It is hard for a hotel to open if it has no running water. When public services and infrastructure are deficient, firms face additional costs to start or keep operating.

The Global Competitiveness Report considers infrastructure one of the basic requirements to competitiveness, and it evaluates the quality and availability of transport (including roads, railroads, airports and ports), electricity and telephony infrastructure. According to the report, by 2016 Venezuela ranks 116th amongst 140 countries in infrastructure. This is the second worst result in Latin America, after Haiti (holding the 137th position).

From the elements evaluated for the ranking in this pillar, Venezuela's worst result is in the quality of air transport infrastructure (134th in 140), behind countries such as Chad (130th) and Myanmar (132th). In other issues, such as quality of roads and quality of port infrastructure, the country ranks 128th and 125th (3rd worst and 2nd worst result in Latin America respectively). In electricity the country ranks 131st, providing a service only better than the one in Haiti amongst countries in the region. Telephony shows the best results in this group, with Venezuela ranking 43rd by the amount of fixed telephone lines by 100 people, and 97th by subscription to mobile phones by 100 people.

An additional element worth noting is the availability and quality of internet access. According to a report by ECLAC about the situation of broadband connection in Latin America (NU. CEPAL, 2016), in the first quarter of 2016, the average download speed in the region was 4.7 Mbps. Venezuela had the worst download speed in the region (1.9 Mbps), followed by Paraguay (2.2 Mbps) and Bolivia (2.4 Mbps). In Venezuela, only 0.5% of connections are above 10 Mbps. However, we should note that in Venezuela 61% of people use internet, above the regional average of 54%.

Another requirement for competitiveness is primary health and education. In this aspect of the Global Competitiveness Report, Venezuela gets a relatively better result: the 85th position from 140 countries. Primary education enrollment and other issues such as life expectancy or business impact of malaria, show better performances for Venezuela than most of the other issues addressed by the ranking.

For Venezuela, an especially relevant issue among public services is personal security. The country has a serious crime problem, with the second highest murder rate in the world (after Honduras, according to the Global Study on Homicide 2013, by the United Nations Office on Drugs and Crime). Local actors consider the lack of personal security to be one of the most concerning problems for the country, and for some –for example in the agricultural activity, where theft, kidnappings and extortion is common- it is one of the main reasons not to invest in their sectors in the country.

5.1. Binding constraints

5.1.1. Deficient infrastructure

Large infrastructure projects in Venezuela, like a national train system, the second bridge over Lake Maracaibo or the cleaning up of the Guaire River in Caracas, meant large disbursements for the country, and were never finished. Maintenance of existing infrastructure has been deficient in many cases. Among other factors, this is due to the lack of effectiveness in key investments, the lack of cooperation with the private sector in developing infrastructure projects, and sustained financial deficits in key state owned services such as electricity or water (derived from operative problems and frozen tariffs). The result is a substantial decrease in the quality and reach of public services and key infrastructure.

Infrastructure is one of the broad categories of requirements for private sector development, since it reduces the costs of operating in the country. When a country keeps quality infrastructure, and it manages to provide quality public services, firms do not have to use part of their resources in either dealing with the consequences of the failing service (like needing refraction more frequently when roads are bad), nor trying to provide those services for themselves. Companies for example, can rely on the electric service and they do not have to depend on their own electric generation capacity; or they can trust in the constant provision of water and don't have to invest in drilling a well or pay for the constant supply or water from tankers.

Within the area of infrastructure, the issues that represent the largest constraints are:

Insufficient electricity supply. Electricity was the most mentioned issue as a constraint in the area of infrastructure. It is hard to keep operating a manufacturing plant, carry out commercial activities, or provide a service, when there is no electricity. The provision of this service is completely in state hands since 2007, and after accumulating years of delays in investment plans, by 2016 the country faces frequent and unscheduled power cuts, affecting noticeable less the city of Caracas than the rest of the country. Between April and June, 2016, the deficit in generation –that the government attributed to "El Niño" and the lack of rain- lead to scheduled rationing and other complementary measures such as the restriction of working hours for the public sector and other consumers (like malls). Restrictions in electrical consumption have been particularly difficult to the steel industry (one with strategic value).

Roads, ports and communications. A better capacity for transport of people and goods, both inside the country and abroad, translate into reducing transaction costs. The same applies for the availability of telephones, cellphones and internet. Businesspersons we consulted explained quality of these services was deficient, and in consequence they incur in additional costs to provide for themselves. Small firms or firms in rural areas, face grater difficulties since self-provision of these services is costly, and they may not count with enough resources for it.

5.1.2. Public services

Personal insecurity. This has been one the most problematic issues in the country for more than 20 years. When it comes to investment decisions, even if the issue is not mentioned a lot as a binding constraint for most sectors, all Venezuelans are affected by this problem. Insecurity is binding constraint especially in agriculture, the sector that seems most affected by theft, kidnappings, violence, and informal payments to delinquents or "*vacunas*". Lack of security in rural areas makes it harder to produce (for example, if you must collect a crop at night, you have to do it with the National Guard) and harder to attract workers. However, it is important to mention high crime is not only critically and negatively affecting the welfare of the population, but it is also a source of serious negative externalities such as emigration and increasing the cost of all kind of activities.

6. Public policy recommendations for private sector development

How can Venezuela increase its levels of private, local and foreign, investment? For almost two decades, public policies in Venezuela have had a negative effect on the development of private sector activities. Indeed, the negative results for the business environment and quality of life has no historic precedent in the country. The problem is way beyond poorly designed or implemented policies, because the problems arise from the basic premises or principles that guide policy making which have created severe distortions in the allocation of good, services, and productive resources like capital and labor.

In order to reverse this trend and move forward in the goal of promoting investment to improve economic conditions and achieve sustainable growth, it is necessary to implement a seemingly complex set of public policies. This includes reforming or creating laws and regulations, but this also means building institutions to restore the adequate functioning of markets, and undertaking large investment in public services and basic infrastructure. This is a very challenging task in the context of dismal economic conditions, and considering that the starting point for any policy implementation includes a set of regulations, public sector institutions and officials that have being aiming for a different policy goal for a prolonged period of time.

Kaufmann (1997), researching the case of Ukraine's transition to a market economy in the early 90s, argued that if the goal is to achieve sustained economic growth, regular performance indicators in macroeconomic stability, liberalization and privatization might not be sufficient. Policies and institutions need to promote private sector development by reducing the costs for operating formally in the country. Kaufmann also argued that in the context of reform, there are three "strategic imperatives" to achieve sustained economic growth. First, partial reforms -even if individually significant- do not translate into larger income and growth, only comprehensive reforms do. Second, attracting the unofficial economy to become official might be a relevant source for economic growth. Third and last, in order to achieve the two previous imperatives, limitations to public administration capacity need to be addressed. Complementing those three imperatives, the report of The Growth Commission (World Bank, 2008), highlighted that the thirteen economies that achieved high growth in the postwar period shared common elements beyond sustaining high investment. Those economies maintained macroeconomic stability; were able to exploit of international commerce and world integration; let markets allocate their resources; and had committed, credible and capable governments. A successful reform in Venezuela needs all of those conditions.

In this final section we discuss some key priority areas for policy design that could produce a high positive impact on private sector development in Venezuela. These priorities were chosen from the evaluation presented in the previous sections, which comes from interviews with local businesspersons, review of international experience, and the current set of regulations and institutions that govern private sector activities in Venezuela. These policy areas highlight the most pressing issues, and therefore potential priorities in terms of improving the functioning of private sector activities.

In general, based on the binding constraints identified in previous sections we choose areas for intervention that have an effect across sectors (horizontal measures) rather than those that are sector specific. We prioritize measures that foster conditions for a more competitive business environment, and that help correct clear market failures such as provision of public goods, information asymmetries, low competition, and externalities. In this sense, we avoid policies that create uneven economic conditions for a particular sector, that promote discretionary decision-making processes within the government, or that encourage rent capture.

6.1. A fundamental requirement: credible change in public policy orientation and the policy making process

In order to provide a basic structure for the set of actions required, it is convenient to differentiate between the orientation of public policies, and the mechanisms to implement these policies. As it was discussed in the previous sections, in the past decade and a half the government implemented new laws and institutions, but it also changed the way in which institutions operate. In some cases, such as the approvals for employee dismissals we mentioned before, change towards a more balanced and fair application of the existing law could have a large impact on labor relations and the business environment. In other words, a change in the orientation of public policy is as important as a change in the regulatory mechanisms.

After years of constant changes in rules -rules that allow more discretionary power, a decision making process from the top that rewarded political loyalty instead of efficacy, where much was done for the sake of short terms gains- it is unrealistic to expect that everyone on the government will switch automatically and begin working immediately toward new goals, particularly if these goals are not explicitly indicated. Therefore, to implement a policy reform that helps create an opportunity for a sustainable path for investment and economic growth, a fundamental requirement is to set basic goals and desired features of the public policy process.

Clear goals serve as a guide to navigate the complex policy reform process. The policy maker can highlight why some issues could be more important than others, what is a positive change, and what is not. In this way, each institution in the public sector apparatus is able to multiply the reform process beyond key initial steps and high level reforms. Ideally, this process could allow for a more rapid implementation of changes even in areas or sectors where conditions or obstacles are different. For example, if making expeditious the issuing of permits is desirable for reform, it is important to make it clear for all institutions, hence Seniat, INTI or the Ministry of Commerce may approach the issue in their own ways.

What are the desirable orientation and features of the public policy making process in Venezuela? A reasonable goal is to increase long term investment, in both oil and non-oil activities. This is a necessary conditions for economic recovery in Venezuela and it is the way the country could achieve important social results such increases in real income, poverty reduction, increase in employment (and quality of jobs) and decrease in inequality. In addition, it is necessary that the public policy orientation radically depart from the features that create the worst distortions and problems in the current model. For this purpose, we present a list of general principles in contrast with some of the most problematic features that have characterized policies in the last few years (see Figure 3).

Figure 4 - Desirable general principles and problematic features

Desirable feature of the public policy process	**Problematic feature of the public policy process**
Commitment to long term goals. Short terms goals should not hamper long term goals.	Short term orientation.

Evaluation of public officials based on effectiveness.	Evaluation of public officials based on political commitment rather than effectiveness.
No antagonism with the private sector, possibility of public-private partnerships.	Antagonism against private initiatives.
Market mechanisms allocate resources; regulatory interventions operate under a market oriented framework to correct market failures, and enhance and promote competition.	Regulatory mechanisms oriented toward direct control of means of production.
Preference for creating “rules of the games” rather than norms for institutions to discretionally allocate resources in private markets. Move from a command and control approach to a removing obstacles approach to policy making. Avoid creating opportunities or incentives for regulatory capture and rent seeking behaviors.	High degree or discretionary power by public institutions and officials.
Public institutions decision making process characterized by balance and fairness, promoting the creation of conflict resolutions mechanisms.	Biased or unbalanced decisions by regulatory agencies.
Simplify: avoid duplication and unnecessary procedures. Decrease regulatory lag. Institutionalization and capabilities building. Define knowledge and technical skills requirements.	Lack of effectiveness in the functioning of the bureaucracy.

6.2. First key steps

Policy action toward investment promotion should begin in areas that maximize the impact in terms of both achieving positive results and boosting credibility in the reform process. In this sense, first reforms should include: 1) measures aimed at solving the most harmful institutional constraints (as identified in previous sections: guarantees for property rights, and the arbitrary, unbalanced and unpredictable law enforcement); 2) measures addressing the functioning of markets, and particularly the functioning of the price system, in order to improve supply of inputs (both local and imported), and efficient allocation of resources in the economy; 3) measures to improve balance in labor relations, and 4) actions to improve the provision of infrastructure and public services (particularly electricity) and policy actions to improve security and reduce crime.

6.2.1. Bases for institutional reform: building up rule of law.

Key initial actions in this area relate to gaining trust in the law and public institutions through independent administrative decisions, fair and balanced application of norms, commitment toward stability of policy actions –in contrast to constant changes or uncertain goals-, and preference for clear rules rather than arbitrary decisions. It is important to implement formal mechanisms for consultation and participation in the design of key policies. Economic regulation should define appropriate sanctions to noncompliance of norms, instead of conceiving commercial decisions (like setting a price, handling inventories or choosing to produce cheese instead of fresh milk) as economic crimes. The law should not be used as a discretional coercion mechanism.

One of the single policies that considerably hampered trust in Venezuela, by weakening property rights, was the unpredictable nature of the expropriation policy. An example of a measure that could improve trust in the economy and in the reform, would be a commitment to stop unfair expropriations. The policy makers should clearly state the conditions[45] in which this policy would be used in the future, create mechanisms to settle disputes arising from this policy in the past and send strong and or costly signals that showcase this commitment (i.e.: Reorganization of hostile institutions, reverse unproductive expropriations, etc.) .

Another action that could improve trust and also would directly reduce some costs of operating in Venezuela, is to remove unnecessary permits and administrative requirements. Some formal administrative requirements are either arbitrary adjudicated or unnecessary cumbersome becoming an obstacle for production without a clear advantage for the country. Specifically, some of the most harmful administrative requirements, which should be subject to reforms, are: labor solvency (which encompasses seven other solvencies or requirements), mobilization guides of goods, certificate of no local production, and export/imports requirements (which are mostly related to the exchange rate control regime and customs requirements).

The general purpose of these initial reforms is to restore market institutions by allowing basic economic incentives to address shortages and quality problems in the supply of goods in the markets. These incentives should focus on removing the most salient obstacles for the possibility of obtaining return on investments such as: allowing price signals to allocate resources, and allowing access to inputs required for production and commerce activities. These regulatory changes also imply that the key governmental institutions to focus on –in the initial stages of policy reforms- are *Superintendencia Nacional para la Defensa de los Derechos Económicos (Sundde*, price controls); *Ministerio de Comercio* (permits), *Cencoex* (exchange rate control) and the aforementioned *Inspectoría del trabajo*.

It should also be noted that in the short term, private sector activities could benefit from geographic based interventions. Given that most of the manufacture and commerce-related activities are concentrated in specific regions (Zona Metropolitana de Caracas, Maracay, Valencia, Barquisimeto, Puerto Ordaz and Maracaibo) these clustered activities could rapidly yield benefits from targeted interventions.

Another element to consider is that since a successful reform needs credibility, a committed and capable team should lead policy making. And moreover, it should include clear mechanism of participation for all interested parties.

6.2.2. Shaping a comprehensive reform

Partial measures might not achieve the desirable outcome in increasing investment. In terms of regulatory measures, reform should address a wide range of issues, and prioritizing the issues that create severe distortions across the economy:

[45] Conditions for expropriation should consider: the justifiable goals, like solving market failures and providing valuable public goods; the process, including periods for evaluations and compensation; and conflict resolution mechanisms, considering that involving actors beyond local government –like international courts- can contribute to building up trust.

- *Exchange rate control.* This is a key policy that interacts with major macroeconomic reforms and that has a large effect on the process of adjustment and stabilization of the economy. From the point of view of investment promotion, a critical goal is to eliminate restrictions to legal access to currency and elimination of the multiple exchange rate system. The reform will aim to facilitate integration to international commerce and restore access to inputs, final goods, and flow of capital. In addition, an issue that requires a clear course of action, is what to do about the pending currency disbursements and commercial debt disputes with international providers.
- *Price controls*. In order to restore the basic functioning of the price system, a basic condition to overcome the most acute social and economic problems of Venezuela, it is necessary to commit to the goal of eliminating this kind of restrictions in competitive markets. On the case of regulated natural monopolies, regulation should allow for formal mechanisms of adjustments based on the economic realities of the firm. Clearly, this is a task in which in the implementation process could require other policy actions beyond changes in the regulation.
- *Labor relations dispute resolutions*. In order to achieve better quality jobs as well as employment expansion, it is important to discuss new schemes of labor contracts and a labor regime that is more predictable in terms of cost of liabilities and pensions. Another major actions among the first steps would be an independent and balance application of the Labor Law through the *Inspectorías del Trabajo*. In this sense, a meaningful policy action will be to apply with balance and fairness the current labor regulation.
- *Investment in infrastructure.* A critical factor for private sector development is the deterioration of basic services such as electricity and water supply, and also the high rates of criminal activities and criminal violence in the country. The latter factor not only has a substantial effect in every measure of quality of life of the population but is also a driver of the significant increase of emigration of talented Venezuelans. Improvements in public services such as electricity and water will benefit from a regulatory framework that allows for public-private partnerships and private sector participation, access to financing from development multinational organizations and an increase in focus of fiscal resources in combination with strategies to decrease the costs of contracting with the public sector.

6.3. Priority areas and action plan

In order to enhance private sector development and scale up investments, it is also necessary to address key policy issues that either complement basic reforms or create new opportunities if properly developed, in particular:

- *Public owned companies as key input providers.* There are significant operative problems related to state owned companies that serve as the main or sole providers of key inputs. For instance, state owned companies are the sole providers of steel (Sidor) and cement (Corporación Venezolana de Cementos), and their halt or decrease in production is restricting economic activities. Other key public owned companies that are inputs providers include: Agropatria (agricultural inputs); Corpoelec (electricity); Venvidrio (glass), and Pequiven (petroquemicals). Each company or sector has a particular economic reality in terms of technology, investment requirement, and recovery time, and there are as well different strategies that could be used to overcome the problems, including: improvement in effectiveness in executing key investments, improvement in management, imports, and private sector participation.

- *International trade*. Clearly, the most significant constraint to international trade is the exchange rate control and restriction to exports. Once these restrictions are lifted, it is important to analyze what is the impact of the exchange rate in international trade as well as what is the policy strategy of Venezuela regarding international trade agreements. During the Chavez's administration, Venezuela exited CAN ("*Comunidad Andina de Naciones*", an international commerce agreement with Colombia, Ecuador, Peru and Bolivia) and entered Mercosur (Brazil, Argentina, Paraguay and Uruguay). Given that this strategy was designed more on political than commerce benefits, it is important to evaluate what are the implications of the current conditions regarding international trade in the context of significant reforms.
- *Public-private partnerships.* Make transparent the possibilities of contracting with the government (both infrastructure project and other services and projects) by making available resources in a predictable way, clearly indicating priorities and contracting opportunities, standardizing requirements, and in general, decreasing risks and increasing competition, could bring not only new possibilities of achieving greater efficiency and effectiveness in public works and services but it could also help decrease the relative cost of these projects. In some areas, new schemes of public-private partnership could serve as an investment stimulus serving as well as source of financing to solve key problems such as energy provision, or new services.
- *Taxes*. As we mentioned in previous sections, according to the Doing Business Venezuela is the worst country in the world to pay taxes, with a high burden and a numerous payments per year. Under these conditions, the Venezuelan tax system should reach for simplicity, transparency, fairness and ease of administration. A simplified tax paying system would disincentive tax evasion, and at the same time improve transparency. In consequence, tax collection could improve, and in consequence could increase the availability of resources for the government. Beyond simplicity, it is also important to consider the tax burden. The high tax burden is a problem that has particularly affected large formal companies. Although many of the taxes apply to all companies, supervision has been more pressing for large companies, since it requires less effort from the government.

As the scope of these recommendations is investment promotion, some other key issues for economic and quality of life recovery in Venezuela, are not discussed. Nonetheless, it is very clear that reforms to foster investments should be fully coordinated with overall economic and social policies. For instance, rapid recovery of economic activities could help to increase the purchasing power of the population and it is the solution for shortages and decrease in quality and diversity in the provision of private goods. But beyond medium and long terms policy actions that could be design and implemented, there are additional short terms actions that could be undertaken to reduce the hurdles of the population to access goods in the short term. And there are also sustainability considerations in order to look for the most promising ways to implement these policy changes in order to avoid that short terms goals should debilitate long term goals. In this sense, the discussion of *how* to implement the policies is as important as the discussion of *what* policies should be implemented and this should be the focus of future efforts in this regard.

References

Abadi, A., Lira, B., & Obuchi, R. (2010). *Gestión en Rojo: evaluación de desempeño de 16 empresas públicas.* Caracas: IESA.

Aceglemou, D., & Robinson, J. (2012). *Why Nations Fail.* New York: Crown Publishers.

Akamai . (2016). *Akamai's State of the Internet 1Q 2016 report.* Cambridge, Massachusetts: Akamai.

Canova, A., Herrera, L. A., Rodríguez, R., & Graterol, G. (2014). *TSJ al Servicio de la Revolución.* Caracas: Editorial Galipan.

Curiel, C. (2015). The suppression of the competition policy agenda in the context of an over regulated economy: the case of Venezuela. En J. Drexl, & V. Bagnoli, *State Initiates Restraints of Competition* (págs. 213-238). Caracas: Edward Elgar Publishing.

Fedecamaras. (2014). *Compromiso con Venezuela.* Caracas: Fedecámaras.

Fedecámaras. (2015). *Compromiso en Libertad.* Caracas: Fedecámaras.

Ford Motor Company. (23 de January de 2015). *Form 8-K.* Obtenido de SEC: https://www.sec.gov/Archives/edgar/data/37996/000003799615000005/venezuela8-kdated1x23x2015.htm

General Mills, Inc. (28 de February de 2016). *Form 10-Q.* Obtenido de SEC: http://app.quotemedia.com/data/downloadFiling?webmasterId=101533&ref=10833634&type=HTML&symbol=GIS&companyName=General+Mills+Inc.&formType=10-Q&dateFiled=2016-03-23

Hausmann, R., Klinger, B., & Wagner, R. (2008). Doing Growth Diagnostics in Practice: a 'Mindbook'. *CID Working Paper*.

Kaufmann, D. (1997). The missing pillar of a growth strategy for Ukraine: reforms for private sector development. Washington: Harvard Institute for International Development.

Kimberly Clark Corporation. (31 de December de 2015). *Form 10-K.* Obtenido de SEC: https://www.sec.gov/Archives/edgar/data/55785/000005578516000138/kmb_2015x10k.htm

Nagel, J., Raguá, D., & Obuchi, R. (2011). *Contribuciones Especiales en Venezuela.* Caracas: np.

NU. CEPAL. (2016). *Estado de la banda ancha en América Latina y el Caribe 2016.* Santiago de Chile: CEPAL.

OECD. (1995). *Support of private sector development.* Paris: OECD.

Property Rights Alliance. (2016). *International Property Rights Index*. Obtenido de International Property Rights Index: http://internationalpropertyrightsindex.org/

Svejnar, J. (1991). Microeconomic issues in the transition to a market economy. *Journal of Economic Perspective,* , 123-138.

Transparency International. (2016). *Corruption Perception Index 2015.* Berlin: Transparency International.

WEF. (2015). *Global Competitiveness Report 2015-2016.* Geneva: World Economic Forum.

World Bank. (2008). *The Growth Report. Strategies for Sustained Growth and Inclusive Development.* Washington: The World Bank.

World Bank. (2015). *Doing Business 2016: Measuring regulatory quality and efficiency.* Washington DC: World Bank Group.

World Bank. (2015). *Worldwide Governance Indicators (WGI)*. Obtenido de Worldwide Governance Indicators (WGI): http://info.worldbank.org/governance/wgi/index.aspx#home

World Justice Project. (2015). *Rule of Law Index 2015.* Washington DC: World Justice Project .

Annex 1: Interviewing key players

Reviewing international experiences and references help identify problematic microeconomic issues, but it does not allow us to adequately assess the relative importance of every issue for local firms and individuals. Based on the information from the international rankings, you can derive that paying taxes is harder in Venezuela than it is in Panama, but you are not able to determine if a given decision not to invest in Venezuela was made because of how difficult it was to pay taxes.

To address the issue of relative importance, we conducted 10 individual interviews with members of guilds and managers at large companies in Venezuela. Each interview, conducted by one researcher, lasted approximately one hour.

Table A.1 - Profile from the participants

1	Businessperson related to the agro-industrial, construction, and financial sector. More than 30 years of experience.
2	Guild representative related to the chemical industry. More than 30 years of experience.
3	Businessperson in agriculture. More than 30 years of experience.
4	Guild representative related to manufacturing. More than 30 years of experience.
5	Businessperson related to construction and real estate development. 28 years of experience.
6	Businessperson related to cattle-raising. 35 years of experience.
7	Businessperson in the auto parts industry. Over 40 years of experience.
8	Businessperson related to industrial inputs. Over 20 years of experience.
9	Businessperson related to massive consumption. 14 years of experience.
10	Businessperson related to industrial inputs. Over 40 years of experience.
11	Businessperson related to real estate development. 20 years of experience.

Most of the interviewees have a long time working in their sectors, and come from large companies at least a decade old. The companies they work for -and most of the ones they represent-, belong to local private capital. Also, most of the interviewees so far have found ways to overcome the obstacles imposed by the regulatory framework and the lack of infrastructure.

These characteristics represent a bias of our sample. “Survivors” may fail to identify some of the issues that could have made other actors leave the market, or that could make others decide to invest in Venezuela. Also, “old” firms may fail to identify the reasons to invest that new companies saw when they decided to enter the market -in the last couple of years. However, firms that remain active provide key information about: 1) the characteristics of the firms and decisions taken to survive, 2) the problems preventing them from increasing production, and 3) interventions that may have the most beneficial effects on supply in the short run.

The interview had three main sections: first, an open exploration about the current situation of the country; this allowed to identify top of mind problems affecting their activities, their perceptions about economic concerns for the general population and their perceptions about possible differences amongst sectors and regions. Second, an exploration of the issues considered as main constraints to economic activity, as identified by themselves in the previous section, and also in the international rankings and other secondary sources (such as press releases by different guilds and documents diagnosing the economic crisis presented by guilds[46]); this allowed to find some additional detail to the specific aspects of regulation generating problems. And the third section, an identification of needed measures, and their general thoughts about their feasibility.

The processing of results identified broad issues mentioned in every interview, and counted the mentions both within the same interview as a proxy to intensity of the importance of the issue for the interview, and between interviews, considering whether issues are prevalent in interviews for most sectors as an indicator of transversal microeconomic constraints.

[46] In particular, "Compromiso con Venezuela" (Fedecamaras, 2014) and "Compromiso en Libertad" (Fedecamaras, 2015).

Annex 2: Initiatives, laws and regulations in the regulatory siege

Claudia Curiel reviews over 350 initiatives, laws and regulations enacted by the Venezuelan government from 1999, to July, 2016. Every measure is categorized in one of three large areas: constraints for trust, constraints for operations and competition, and hostile supervision. Regulations evaluated on a scale from 0 to 5, where 0 means the issue is not harmful in the considered subject, and 5 means it is very harmful in the considered subject.

Every regulation categorized in one of the three groups, and then is evaluated in a five-point scale (where 0 is not relevant and 5 means that it has a deep negative impact on the performance of economic agents) in the dimensions defined for each category. Then, evaluation in each dimension is aggregated meaning that the higher the total sum for each regulation, the greater the negative evaluation of the regulation. For example, *expropriations* is an initiative or public policy classified as a constraint for trust which is evaluated in the following subcategories in the 5 point scale: 1) Imposes institutional risks (5); 2) Creates additional transaction costs (5); 3) Makes companies subject to discretionary measures (5); 4) Increases operational costs (5); and, 5) Hurts confidence (5). In this example, the sum of all subcategories for the initiative of *expropriations* is 25. This is among the most harmful measures for private activities in its subcategory and overall.

From the full list of public policies evaluated, four get the top negative evaluation: expropriations, the Law on Fair Prices, the accumulation and non-recognition of debt in foreign currency with international suppliers from the domestic private sector, and labor solvency and labor release certificate. The first three are constraints for trust, and the fourth is a constraint to competition and operations.

Constraints for trust

This category is assessed under five subcategories. The criteria consider whether regulations impose institutional risks, add additional transaction costs, make companies subject to discretionary measures, increase operational costs and hurt confidence.

In this category, the regulations most harmful to trust are expropriations, the Law on Fair Prices and the accumulation and non-recognition of debt in foreign currency. Almost as harmful are the criminalization and severe penalization of noncompliance of economic regulation –a simple error in accounting can generate a heavy penalty fee, and what you could consider regular inventories might be evaluated as “hoarding”, which is a felony- as well as the expansion of the number of supervision and control entities.

Table A.2 – Initiatives, laws and public policies hindering trust

INITIATIVE, LAW OR PUBLIC POLICY	Increases Institutional Risk	Generates transaction Costs	Amplifies the exposure to discretionary	Increases the cost to operate of enterprises	Destroys trust	Total
Expropriations	5	5	5	5	5	25
Law on Fair Prices	5	5	5	5	5	25
Accumulation and non-recognition of debt in foreign currency with international suppliers of domestic private sector	5	5	5	5	5	25
Expansion of the number of Supervision and Control entities	5	5	5	4	5	24
Criminalization and Severe penalization of economic faults	5	5	5	4	5	24
Absence of Anti-Inflationary Policy	5	5	3	5	5	23
Enforcement of the principle of Social Control	5	3	5	4	5	22
Direct allocations in state procurement and contracting	5	4	5	3	5	22
Implementation of Land's Law (suppression of property deed)	5	5	5	2	5	22
Law of Banking Sector Institutions	5	4	5	4	4	22
Organic Law on Environment	5	4	5	3	5	22
Law of illegal exchange (penalization of purchasing foreign currency outside the official market)	4	5	4	5	4	22
Unified labor inspections	5	3	5	3	5	21
Law that promotes and regulates the new joint forms of association between the state, community organizations and private initiative for the development of the national economy	4	5	5	3	4	21
Hydrocarbons Law	4	5	5	3	4	21
Inspections and requirements duplicated and uncoordinated	5	4	5	3	4	21
Removing labor relations and collective bargaining agreements	5	3	4	4	5	21
Threatens to take paralyzed enterprises	5	4	5	2	5	21
Organic Law of Missions, Big Missions and Micro-Missions	4	4	5	4	4	21
Lack of accountability mechanisms regarding governmental activities	4	4	5	3	5	21
Application of Social Ethic Commitments	4	4	4	4	4	20
Reform of the Law of Electrical Service	3	5	4	4	4	20
Antimonopoly Law	5	3	5	2	5	20
Organic Law that reserves to the State the exploration and exploitation of gold and other energy minerals	5	3	5	2	5	20
Dismantlement stock market	4	4	3	4	4	19
Organic Law of Alimentary Security and Sovereignty	4	3	5	4	3	19
Barriers of access to public facilities	4	4	3	3	5	19
Procedure followed for the adoption of laws and regulations	5	4	5	0	5	19

Anti-business and anti-capitalism speeches (matrix of opinion that criminalizes employers)	5	3	5	1	5	19
Application of the concept of Relative Private Property	5	4	4	1	5	19
Organic Law of Communes	5	3	4	2	5	19
Suppression of tripartism (concerted decisions on labor issues between representatives of the sectors: private, public and labor)	5	3	4	2	4	18
Law for Integral Regionalization of Socio Economic Development	5	3	5	2	3	18
Law for Foreign Investiment	4	3	4	2	5	18
Organic Law on Science, Technology and Innovation	4	4	3	4	3	18
Organic Law of Security and National Defense	5	2	5	1	5	18
Organic Law of Public Goods	4	3	4	2	4	17
Rationales for expropriation and intervention of enterprises (over 1600 cases)	5	1	5	1	5	17
Bilateral agreements (Over 1300 cooperation agreements signed between the Venezuelan state and other countries)	3	3	3	4	4	17
Absence of channels of relationship with governmental entities	4	3	4	3	3	17
Creation of military enterprises in different sectors	4	3	3	1	5	16
Activation of the central planning system's instances	4	2	4	2	2	14
Reform of Law of Armed Force	4	1	4	1	4	14
Reform of Central Bank Law	5	0	4	0	5	14
Total	**200**	**158**	**195**	**126**	**196**	

Constraints for operations and competition

In this category, every initiative or public policy is evaluated under seven subcategories: creates unfair advantages for some actors in the marketplace, decreases decision making space, moves resources away from regular operations, decreases or restricts access to infrastructure or public services, creates market barriers, increases labor costs and denies access to export markets.

The most concerning issue in this category is “Labor solvency - labor release certificate”. Labor solvency is a permit that has as prerequisites seven other solvencies. Amazingly, the labor solvency is in it itself a prerequisite to get other permits, particularly to legally access foreign currency. Since approval of this requirement is discretionary, a given firm -for example, a state owned firm, or one with capital from strategic allies- can get the solvency faster than other firms. In addition to that, the discretionary nature of this very important regulatory requirement reduces the autonomous decision-making for the firms, increases opacity and creates additional market entry barriers.

Under these criteria, foreign exchange control is the second most important constraint for operations and competition. This policy has the most negative evaluation in terms of decreasing space for autonomous decision-making; creating opacity or market entry barriers; and losing export markets.

The assessment also indicates that a major constraint for operations and competition is the labor immobility decrees as well as the role of the state as a major importer.

Table A.3 – Initiatives, laws and public policies hindering operations and competition

INITIATIVE, LAW OR PUBLIC POLICY	It incorporates market actors under advantageous conditions	Reduce the space for autonomous decision-making	Moving resources inherent to the usual course of the activity	Suppress the access to infrastructure or public goods	They create opacity or market entry barriers	Increases labor cost	Lost of export markets	**Total**
Labor Solvency - labor release certificate. Requires 7 other solvencies and it's a requisite to access to exchange currency	5	5	4	3	5	3	0	25
Labor mobility forbidden (since 2003)	5	5	3	0	5	5	0	23
Foreign exchange controls	4	5	4	0	5	0	5	23
State as major importer: Law to create the National Center for Foreign Trade and the Foreign Trade Corporation	5	5	3	4	5	0	0	22
Politicization of the labor inspectorates	5	4	3	0	4	5	0	21
Price control regime (since 2003, applied to a specific group of products classified as essentials)	4	5	4	0	5	0	3	21
Organic Law for the Development of Petrochemical Activities	4	4	2	4	5	0	2	21
Fisheries and Aquaculture Law	5	5	3	2	5	1	0	21
Insurance business law	5	5	3	1	5	1	0	20
Over 550 state owned enterprises and over 200 social property units	5	4	3	3	5	0	0	20
Non Domestic Production Certificate	4	3	3	0	4	0	5	19
Parafiscal charges. In specific sectors these charges has a minimum of 3% of EBITDA	4	4	4	0	4	3	0	19
Criteria applied to determine fair profit, and regulation about margins in specific goods	5	5	4	0	5	0	0	19
Replacement of technical training centers with centers for socialistic formation	0	3	4	4	4	3	0	18
Merchandising Mobility 's Control Systems	3	5	4	0	4	2	0	18
Raw material supply agreements	5	4	3	2	3	0	0	17
Intervention of the portfolio of products in regulated sectors	5	5	2	0	5	0	0	17
Unilateral increase in the national minimum salary	4	4	0	0	4	5	0	17
Platforms for monitoring business activities in real time	4	5	4	0	4	0	0	17
Duties to disclosure information	4	4	3	1	4	1	0	17
Transfer of welfare obligations to the private sector	5	5	5	0	1	0	0	16
Discretionality in issuing solvencies	3	4	4	1	4	0	0	16
Law of socialist cestaticket	3	3	0	0	2	5	0	13
Deterioration of the supporting infrastructure	0	0	3	4	4	2	0	13
Reform of Law for Earnings Tax	3	4	0	0	3	0	0	10

Total	**99**	**105**	**75**	**29**	**104**	**3 6**	**1 5**	

Hostile supervision

The regulatory initiatives representing greater constraints in the category of hostile supervision are executive powers assigned to a new level of state organization created by the government at a community level. Functions assigned to the Socialist Workers' Councils (a new way of organization for workers within companies, promoting the workers control over productive processes); and the deployment of the principle of social control (allowing consumers and communities to oversee a firm's operation). Also relevant are the conditioning of investment to communities, creating patrols to supervise activities of the companies, and the incorporation of militia in councils and committees.

Table A.4 – Initiatives, laws and public policies creating hostile supervision

INITIATIVE, LAW OR PUBLIC POLICY	Incorporation of actors with powers of supervision	Lack of preparation and discretionality	The imposition a new institutional framework	Total
Deployment of the principle of social control	5	5	5	15
Assignment of functions to the Socialist Workers' Councils	5	5	5	15
Executive powers assigned to the State Community	5	5	5	15
Incorporation of militia actions Councils and Committees	4	5	4	13
Creating patrols on the activities of the companies	4	5	4	13
Conditioning of investment to communities	3	5	5	13
Recognition of a Single Central Organization of Workers	3	4	5	12
Federal Council of Government Act and its Regulations	3	3	4	10
Total	**32**	**37**	**37**	