Direct Distribution of Oil Revenues in Venezuela: A Viable Alternative?

Pedro L. Rodríguez, José R. Morales, and Francisco J. Monaldi

Abstract

Venezuela is a textbook example of a resource-dependent country—between 1950 and 2008, oil generated over a trillion dollars of income for the state. Nevertheless, Venezuela currently combines an economy that is stagnant, despite high oil prices, with an increasingly authoritarian government. The authors argue that large oil rents that accrue to the state, together with a lack of formal and transparent mechanisms to facilitate citizen oversight, are a large part of the problem. They consider the nature of the fiscal contract between the Venezuelan government and its people. This has been characterized by increasing discretion of the executive; only a small share of the rents is now subject to political oversight within the framework of the budgetary system. The authors consider the case for direct distribution of rents, distinguishing it from a populist approach to transfers as effected through Venezuela's misiones. They also report on focus group discussions of the direct-distribution approach and the political viability of direct transfers.

JEL Codes: D73, N46, H0, H30, Q30, Q34, Q38

Keywords: oil, natural resources, accountability, transfers, Venezuela, governance.

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Foreword

The discovery of oil in a developing country is both potentially beneficial and potentially calamitous. While countries could put oil revenues toward building much-needed schools and roads, fixing and staffing health systems, and policing the streets, many resource-rich states fare little better—and often worse—than their resource-poor counterparts. Too often public money is misallocated and funds meant to be saved are raided, and those living in poor resource-rich countries pay the price. While this so-called resource curse is well established in the literature, solutions to counteract its corrosive effects remain highly elusive.

CGD's Oil-to-Cash initiative is exploring one policy option that may address the root mechanism of the resource curse: using cash transfers to hand the money directly to citizens and thereby protect the social contract between the government and its people. Under this proposal, a government would transfer some or all of the revenue from natural resource extraction to citizens in universal, transparent, and regular payments. The state would treat these payments as normal income and tax it accordingly—thus forcing the state to collect taxes, fostering public accountability and more responsible resource management.

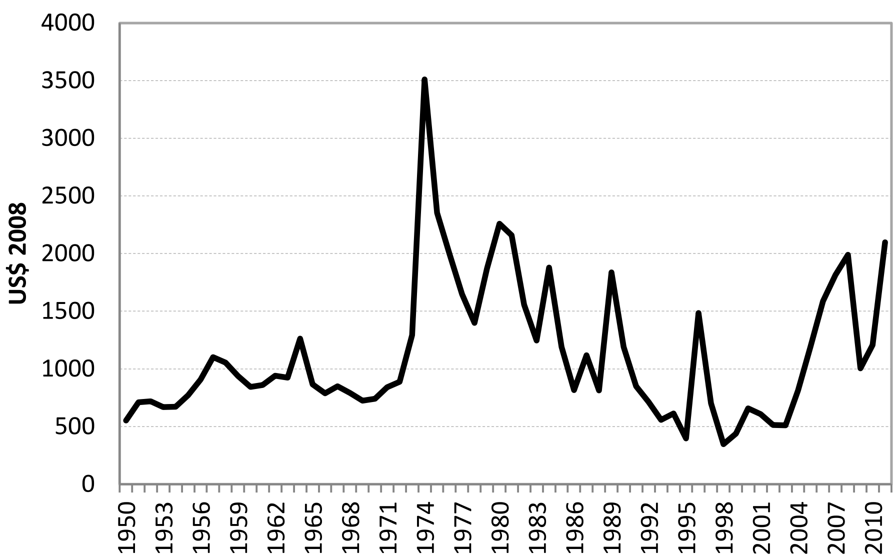
This paper by Pedro Rodriguez, Jose Morales and Francisco Monaldi, commissioned by CGD as part of Oil-to-Cash, examines the possibility of adopting such a scheme in Venezuela, today the country with the largest oil reserves/head in the world. It shows how the government has diverted an ever-larger share of spending to avoid the oversight of parliament, further reducing accountability. It also reports on focus-group discussions of the option of transferring oil rents to citizens, and considers the important distinction between populist discretionary transfers and citizen dividends made on the basis of ownership of the oil reserves. The issues discussed in the paper are especially relevant to Venezuela, considering its forthcoming elections, but also to other resource-rich countries.

Alan Gelb
Center for Global Development

Introduction

Venezuela is a textbook example of a resource dependent country. Oil income accounts on average for 61% of total government revenues, over 88% of exports and 14% of GDP.[1] Between 1950 and 2008 oil has generated over a trillion dollars (US$ 2008) of income for the state coffers, a third of these over the past eleven years. In 2011 alone oil income amounted to over US$ 60 billion, the equivalent of US$ 2097 per person (see Figure 1).

Figure 1: Per Capita Oil Receipts (1950 – 2011)



Source: PODE (several years) and official financial reports for PDVSA.

Note: Oil receipts refer to all income received by the state in the form of royalties, income taxes, dividends and other contributions from the oil sector, including social spending by the state owned oil company and its contributions to the National Development Fund (FONDEN).

Furthermore, according to OPEC's Annual Bulletin (2010/2011 edition), Venezuela has the world's largest reserves of crude oil, with 296.5 billion barrels.[2] That's over 7 million barrels per Venezuelan and 32 billion barrels more than Saudi Arabia, the country with the second largest reserves. At current production levels it would take over 270 years before Venezuela

[1] These averages refer to the period 2004-2010. Averages for the period 1958-2010 are: 60% total government income, 86% of exports and 28% of GDP. We refer to total government revenues since a large proportion of oil receipts are spent outside of the budget. If we were to use only budgeted oil income then the proportion of fiscal income it represents falls (46% in the period 2004-2010).

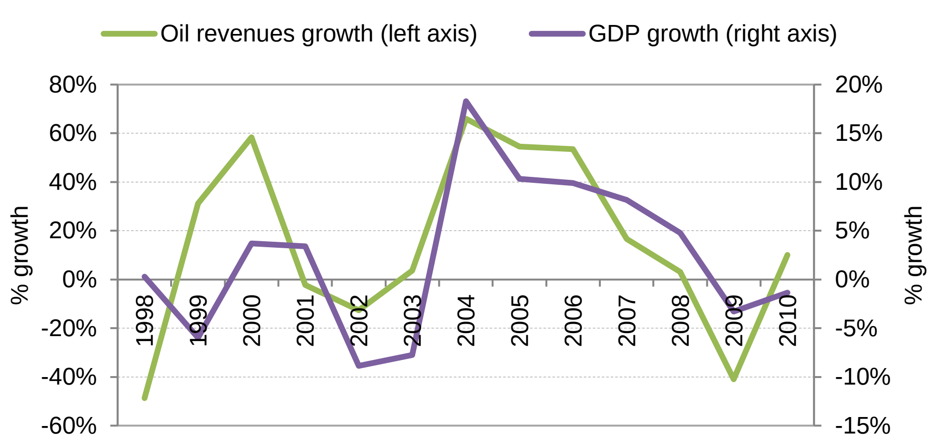
[2] This figure presupposes a recovery rate of 20%. According to industry experts the current recovery rate is closer to 10%.

runs out of oil.[3] In other words, Venezuela is and will remain an important oil producing country for the foreseeable future.

Looking back however, Venezuela's experience managing its vast oil wealth has been mixed. Having been hailed a success story between 1935 and 1978, with a robust economy and, beginning in 1958, an apparently equally robust democracy in a region where dictatorships were the norm, Venezuela, beginning in 1978 found itself trapped in a downward economic spiral with increasing social conflict. Rising poverty and inequality together with a broken political system led to the election in 1998 of the then political outsider, Hugo Chávez.

Between 2004 and 2008 Venezuela benefited from a prolonged oil boom, showing strong economic growth and a substantial decrease in poverty rates, yet the government's chosen economic and social policies increased the country's dependence on oil revenues making them extremely vulnerable to a fall in prices. While in 1998 oil exports represented 31% of fiscal revenues and 64% of export revenues, by 2008 these figures reached 64% and 92% respectively.[4] After peaking at US$ 126 in July 2008, oil prices collapsed as a result of the financial crisis, reaching a trough of US$ 31 by December 2008. The economy briskly followed, growing by less than 1% in the first quarter of 2009, thereafter displaying negative growth for six consecutive quarters. In 2010 Venezuela, despite a renewed increase in oil prices, was the only country in the region, together with earthquake stricken Haiti, with negative growth. In effect, Venezuela's economic performance has been and remains highly contingent on oil revenues (see Figure 1).

Figure 1: Oil Revenues Growth and GDP Growth (1998 – 2010)



Source: Venezuelan Central Bank, Petróleo y Otros Datos Estadísticos and own calculations.

[3] According to PDVSA's Annual Report (2011), Venezuela produced on average 2.991 MBD in 2011.

[4] To estimate the participation of oil revenues in total fiscal revenues, we include in oil fiscal revenues all out of budget expenditure done by PDVSA, including transfers to FONDEN. As will be shown below, much of the oil revenue is spent outside of the budget thus a more precise measure of dependence should take both budgeted and non-budgeted fiscal oil income into account.

In terms of governance, Venezuela has fared much worse over the previous decade as will be shown below. We will argue that large oil rents accrued by the State together with a lack of formal and transparent mechanisms that make citizen oversight possible, allows for wasteful spending at best and oppressive governments at worst. We then present the case for direct distribution mechanisms as a way of enhancing governance by giving citizens a direct stake in the country's vast oil resources. The paper is organized as follows. The first section introduces the link between natural resources, taxation and governance. The second section describes the composition of government revenues in Venezuela while the third section discusses the institutional framework that determines how oil rents are spent. The fourth section analyses governance outcomes in Venezuela over the past decade following the recent windfall. The fifth and final section introduces direct distribution mechanisms, describing their advantages and possible critiques as well as design issues that should be taken into account. The paper concludes with a discussion of the political viability of direct distribution mechanisms in Venezuela.

Taxation and Natural Resources

In theory, access to large external rents should facilitate development by alleviating the state's budget and credit constraints. Most states in developing countries lack the resources to effectively deal with wide-ranging deficiencies in infrastructure, housing, nutrition not to mention basic health and education. One oft heard recommendation is that countries should invest in modernizing their tax administrations and expand their tax base in order to increase the amount of resources available. However, recent findings in the economic development literature suggest that taxation, in addition to increasing a state's resources can have a significant impact on governance.[5] Taxation, by forcing citizens to forgo part of their income to finance the state, generates incentives for them to demand accountability and an efficient use of what is essentially their money. Furthermore, when forced to rely on broad taxation, governments are more compelled to provide something in exchange, be it representation or public goods and services that benefit all. Resource rents on the other hand, do not accrue from broad based taxation but rather from a narrow economic base that often consists of foreign companies or state owned companies. They are therefore not associated with the positive governance dividends described above. Indeed, according to social contract theory, to the extent that natural resources rents allow states to forgo taxing their citizens, they can be harmful for development.[6]

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[5] See Bräutigam et al. (2008), Moore (2007), Fjeldstad and Moore (2007) and Karl (1997). For empirical evidence on the relation between taxation and governance see: Berger (2009), Timmons (2006), Gervasoni (2010), Daude and Melguizo (2010), Ross (2004), Ross (2009), Shaltegger and Torgler (2005) and McGuirk (2010).

[6] This does not invalidate the notion that resource rents can be good for development by allowing for greater investment, it simply highlights the possibility that such benefits do not materialize due to a weak incentive structure that facilitates wasteful spending.

When governments have discretionary power over assigning resource rents and are accountable to no one over their use, rent-seeking, patronage and clientelism often become the main vehicles via which resource rents are assigned and distributed. Political criteria rather than economic criteria are used to determine the best use of resources and corruption becomes pervasive. Labor unions and producers have incentives to divert resources towards gaining political clout rather than to productivity enhancing investments, thereby harming long term growth. The state becomes the main conduit of economic success, with the power to make or break businesses with the stroke of a pen.[7] Assigning rents based on political criteria can be a particularly inequitable method of distributing oil rents since those likely to be most successful are those with greater political connections and economic weight, favoring the better off.

One particularly damaging side effect of unlimited discretion in the use of oil rents in the absence of a stable institutional framework is the inability of governments to pursue stable policies both at the macro and microeconomic level. At the micro level policies regarding subsidies, import tax exemptions and cheap credit shift depending on who's in power while at the macro level, insofar as unspent income diminishes the probability of remaining in power stabilization and savings mechanisms are unlikely to be successfully implemented.[8] The volatility that ensues does not only hamper growth directly, as is well documented, but likely also further encourages private agents to focus on rent-seeking rather than market competition as a means of increasing returns or just to guarantee economic survival.

In terms of democratic consolidation, an incumbent's control over oil rents may create an unbalanced playing field when it comes to elections thereby increasing the stakes of holding office and the probability of civil conflict.[9] Moreover, patronage and clientelism create entrenched interest groups that can make it extremely hard for institutions and policies to adapt to changing environments such as a drastic fall in oil prices. When the legitimacy of the state rests largely on its ability to extract rents from foreign or state owned oil companies and distribute it amongst the population, a sudden collapse in oil prices does not only compromise the economy but can jeopardize the entire political order as occurred in Venezuela after the fall in oil prices in the mid-1980s.

Government Revenues in Venezuela

Venezuela is a classic example of an oil exporting country with substantial resource rents and low taxation. In 1943 the government of Isaías Medina Angarita drafted a new Hydrocarbons Law unifying the existing concessions under a new tax and regulatory framework, increasing royalties and extending existing concessions for forty years. The previous year Medina had also passed the Income Tax Law, which became effective in 1943.

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[7] See Moises Naím's chapter in Goodman et al. (1995) for a discussion on the Venezuelan private sector and its relationship with the state.

[8] See Janet Kelly's chapter in Goodman et al. (1995).

[9] See Ross (2004), Snyder and Bhavnani (2005) and Humphreys (2005).

Both laws set an important precedent for all future governments by formalizing the state's role in maximizing oil revenues.[10] The mixture and magnitude of the taxes has changed significantly over time, with the state invariably trying to maximize the amount of rent it captures (Table 1). In the previous decade, following unilateral increases in oil taxation, the state's share of oil income has increased significantly to above 87%.

Table 1: Government Share of Net Oil Revenues

1936-1942	38.8%
1943-1957	54.5%
1958-1975	73.3%
1976-1990	80.6%
1990-2004	67.6%
2004-2008	87.3%

Source: Manzano and Monaldi (2010), PODE (various years) and own calculations.

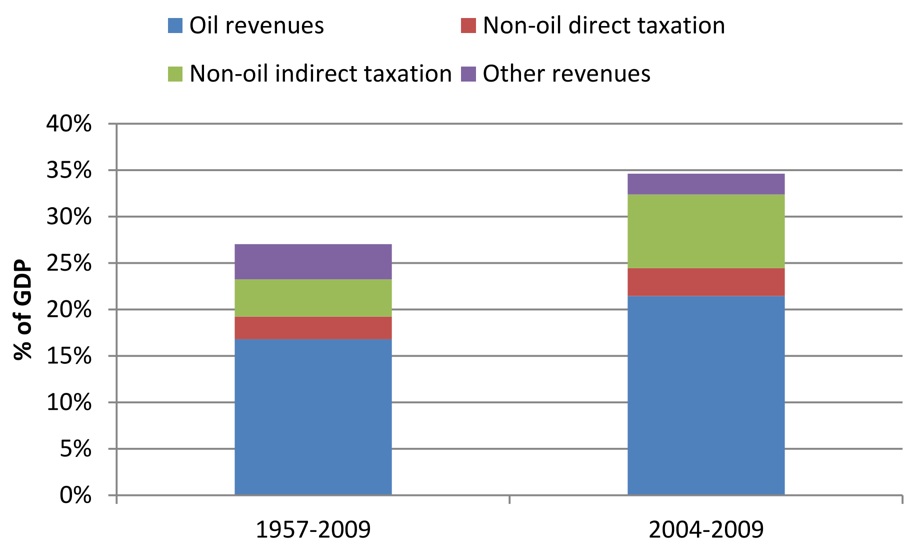
Note: The average government share for the period 1943-1957 excludes the years 1950-1954 due to lack of data.

Oil revenues allow the Venezuelan state to largely forgo taxing its citizens. Naturally, the higher the oil price, the less dependent the state is on non-oil taxation. In the period 2004-2009, characterized by historically high oil prices, total public revenues, including oil revenues, reached almost 35% of GDP, higher than the historical average of 27% (see Figure 2). Both figures are higher than those observed in high-income countries (see Table 2)[11]. However, when excluding oil revenues, the percentage drops to 13.2%, lower than the regional average and even that of low income countries (Venezuela is considered an upper middle income country in the Collecting Taxes Database).

[10] While the new framework increased the state's participation in oil revenues, it also helped establish a stable institutional and fiscal environment for the oil industry to prosper. This would not always be the case with future changes in the fiscal framework.

[11] Averages for upper income countries are not shown in the table. According to the Collecting Taxes database upper income countries, excluding oil producing countries, average 25.26% of tax revenues as a percentage of GDP.

Figure 2: Sources of Revenues (% of GDP)



Source: ONAPRE (several years) and PODE (several years).

Table 2: Tax Revenues and its Components as a Percentage of GDP (Average 2007 - 2010)

	Latin America & Caribbean1/	Low Income Countries1/	High Income Countries1/
Personal Income Tax	2.24	1.88	6.83
Corporate Income Tax	3.40	2.01	3.83
Net VAT Collections	6.47	4.14	6.77
Total Tax Revenue	20.63	14.31	25.26

Source: Collecting Taxes (2007-2010) – Fiscal Reform and Economic Governance.

1/ Averages exclude oil producing countries.

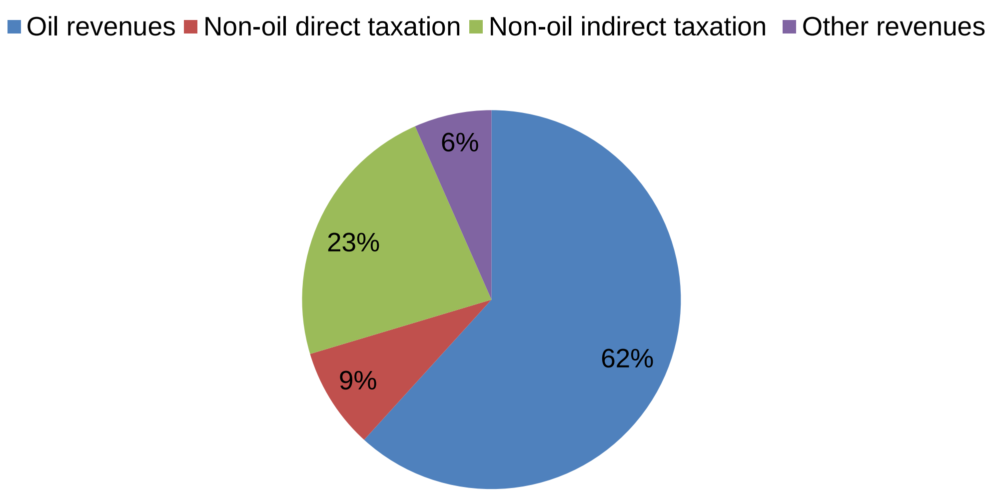
Oil revenues are by far the largest single contributor to the public purse, representing on average over 60% of total revenues (see Figure 3). The second largest contributor is non-oil indirect taxation representing 23% of total revenues and 60% on non-oil revenues for the period 2004-2009 (see Figure 3 and Figure 4). Almost three quarters (73%) of the non-oil indirect taxation in the period 2004-2009 is accounted for by the VAT tax introduced in 1993 (see Figure 4). In other words, net VAT collections reached roughly 5.7% of GDP in this period. This figure is slightly lower than the regional average but higher than that of low income countries (see Table 2).

Table 3: Tax Revenues and its Components as a Percentage of Total Tax Revenues (Average 2007 - 2010)

	Latin America & Caribbean[1/]	Low Income Countries[1/]	High Income Countries[1/]
Personal Income Tax	9.69	13.19	26.73
Corporate Income Tax[1/]	16.55	14.29	16.68
Net VAT Collections[2/]	37.62	29.28	25.92

Source: Collecting Taxes (2007-2010) - Fiscal Reform and Economic Governance
1/ Averages exclude oil producing countries.

Figure 3: Sources of Revenues (% of total revenues) – Average 2004-2009



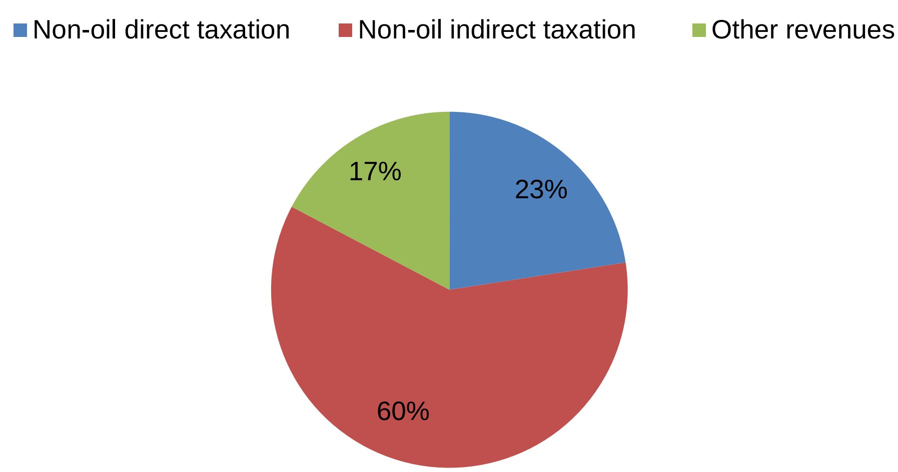
Source: ONAPRE (several years) and PODE (several years).

However, as a percentage of overall non-oil taxation, net VAT tax collections represent a much larger share both in Venezuela and Latin America as they do in upper income countries (see Table 3). The large average observed for Venezuela and Latin America is a result of tax reforms implemented in the 80s and early 90s, which sought to rapidly increase public revenues while also reducing distortionary taxes on trade.[12] Value added taxes have the virtue of being less costly to implement and charge to a larger tax base than direct taxation, yet they tend to be regressive, as the poor consume a greater share of their income.

[12] See OECD (2009).

Upper income countries tend to therefore rely more on other forms of taxation, particularly direct taxation, including personal and corporate income tax (see Table 3).
Due to the high costs of implementing direct taxation, lower income countries tend to rely more on indirect taxation. Direct taxation however is generally considered more equitable. Moreover, direct taxation is arguably more conducive to better governance outcomes in that they involve a more observable and indeed often coercive transfer of resources from citizens to states. [13] In Venezuela, non-oil direct taxation, including personal and corporate income taxes, only accounts for 9% of total revenues and 23% of non-oil revenues (see Figure 3 and Figure 4). This is lower even than the average observed in low income countries. In other words, the Venezuelan state not only taxes less but also relies more on indirect taxes.

Figure 4: Sources of Non-Oil Revenues (% of total non-oil revenues) – Average 2004-2009



Source: ONAPRE (several years).

Historically there have been attempts to implement broad tax reforms, however, with the exception of the VAT reform in the early 1990's all attempts collapsed under political pressure. It is a widely held belief that non-oil taxation is unjustified as long as the government has access to easy oil revenues. In times of need, instead of pushing through wide-ranging tax reforms at a high political cost, governments have preferred to unilaterally raise taxes on the oil industry or increase borrowing.

In Use Discretion is the Rule

One particular trend that has characterized the current administration's handling of resource revenues is the ever-increasing discretion of the executive. While historically the president has always had a fair amount of leeway in determining the use of resource funds, the sheer

[13] See OECD (2010) and ECLAC (1998).

magnitude of resources that currently do not pass through any budgetary process is unprecedented.

This has been achieved by (1) redirecting part of the taxes to an off budget development fund, FONDEN, created in 2005 and directly controlled by the president and (2) using PDVSA as an extra-budgetary fund to manage several of the government's social programs.[14] In the period 2003-2011 PDVSA has deposited over US$ 44 billion in FONDEN and directed almost to US$ 80 billion towards various social programs (over 30 different programs according to the latest reports including all the *Misiones*).[15] That's roughly US$ 480 per person per year.

In March 2011, the government passed a new windfall tax for "extraordinary and exorbitant" prices. According to the new law, oil companies must pay 80% on the difference between the effective price and US$ 70. The rate increases to 90% for prices between US$ 90 and US$ 100 and to 95% for prices above US$ 100. Furthermore, a windfall tax of 20% also applies to the difference between the budgeted oil price, currently at US$ 40, and US$70.[16] A particularly attractive feature of the new law, from the perspective of the government, is that all revenues accruing from the windfall tax must be deposited in FONDEN. According to the new law, at the current price of price of US$ 115-120/barrel, over 50% of total contributions by PDVSA (including fiscal contributions and contributions to FONDEN) accrue to FONDEN and thus are managed at the absolute discretion of the government (see Figure 5). In 2011 the funds distributed to FONDEN and the various social programs amounted to US$ 30.1 billion, representing 61% of its total contributions to the government (see Figure 6).[17]

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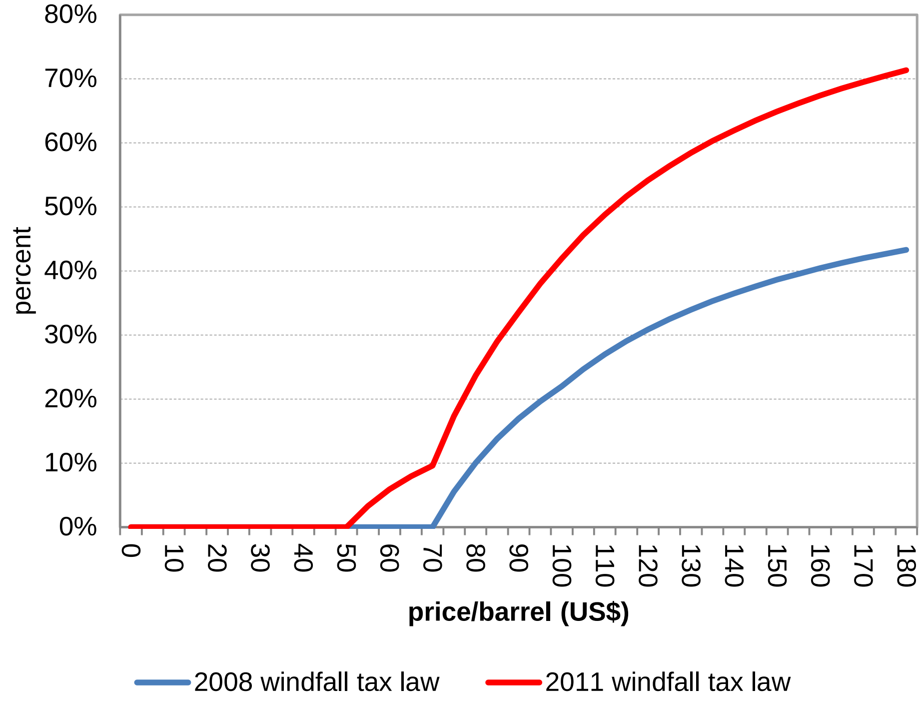
[14] Any "surplus" international reserves are also deposited in FONDEN.

[15] The CEO of PDVSA is designated by the president. Furthermore, under the current administration the CEO of PDVSA is also the Minister of Energy and Petroleum, in effect guaranteeing an absolute control of the oil company on the part of the executive branch.

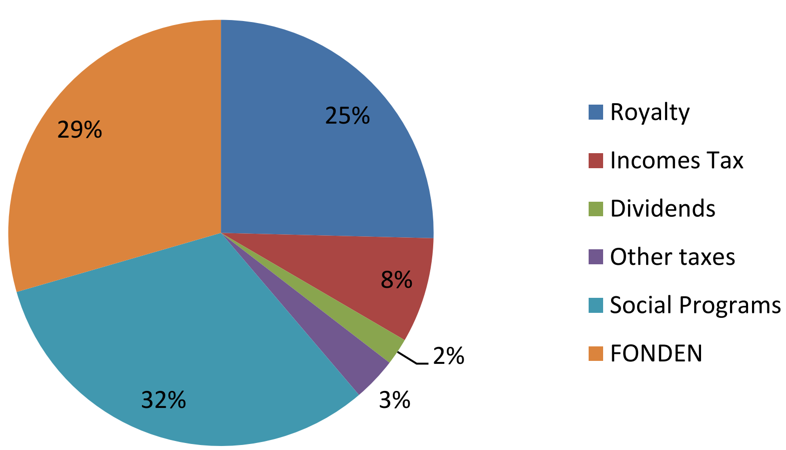
[16] According to the government, new projects on the Orinoco Oil Belt are exempted from the new law until investments are recuperated.

Figure 5: Contributions to FONDEN by PDVSA as Percentage of Total Fiscal Contributions



Source: own estimates based on the "law that creates a special contribution for extraordinary and exorbitant prices in the international hydrocarbons market" (Official Gazzette Nº 6.022, published 18th of April 2011) and the "law of special contributions for extraordinary prices in the international hydrocarbons market" (Official Gazzette Nº 38.910, published 15th of April 2008).

Figure 6: Fiscal and Other Contributions by PDVSA (2011)



Source: PDVSA's Annual Report (2011) and own calculations.

The share of oil income that does enter the budget is further restricted by the Law of Special Economic Allocations (LAE following its Spanish acronym) and by the *Situado Constitucional*. According to the *Situado Constitucional*, up to 20% of ordinary fiscal income (including both oil and non-oil revenues) must be distributed to the states and the capital district, 30% in equal shares and 70% according to population.[18] Additionally, the LAE stipulates that 25% of all fiscal income from oil and mineral resources (including royalties and other minor taxes but excluding income taxes and dividends) net of the *Situado Constitucional* must also be distributed to the states. How the LAE is distributed between the state government, the municipalities and the communal councils (or other forms of social organization stipulated by law) is determined by the Secretaría del Consejo Federal de Gobierno in which, at least in letter, the executive branch, governors, mayors and a representative of the communal councils all participate but which in practice is currently controlled by the executive.[19]

Note, the more PDVSA contributes to FONDEN and spends on social programs, the smaller the share of oil income that states and municipalities receive. The Chávez administration has used this to squeeze state and municipal budgets of opposition governors and mayors. Moreover, it has become common practice for the government controlled legislature to underestimate oil revenues when computing ordinary income since this reduces the amount that must be distributed to state governments. Allied regional governments are later compensated via additional credits.

Along with the Situado Constitucional and the LAE, there are several other legal pre-allocations which effectively further reduce the share of fiscal income which is actually allocated through budgetary discussions.[20] According to budget data for 2009, a third of current income was pre-assigned. In effect, only a small share of the oil rents is subject to political debate within the framework of the budgetary process. Taking all these pre-allocations and off-budget expenditures into account we have that at current prices roughly a third of total oil revenues actually go through the budget.

Oil Booms and Governance

From an efficiency perspective, lower non-oil taxes sustained by oil revenues could be considered desirable. However, as suggested above, the decoupling of state revenues from citizens can have adverse consequences on governance indicators. This decoupling can be particularly harmful if the central government has discretionary control over spending, as is

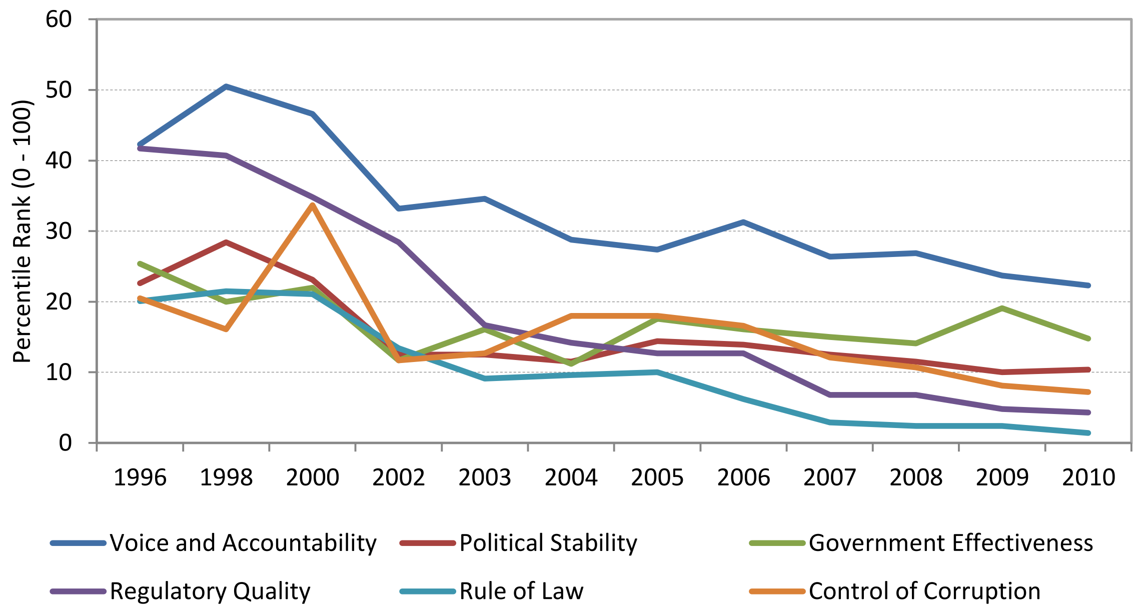
[18] The individual states in turn must transfer 20% of their ordinary fiscal income (including the transfers received from the federal government) to the municipalities.

[19] Previously, 5% went to refining states according to amount refined, of the remainder, 70% went to oil producing states according to the amount produced and 30% to the remaining states. However, the law was recently changed giving the executive greater discretion in the distribution of revenues. See: http://www.asambleanacional.gob.ve/index.php?option=com_content&task=view&id=24047&Itemid=63.

[20] See Puente et al. (2009) for more detail on the Venezuelan budget process and its evolution since 1974.

the case in Venezuela. According to the World Bank's Worldwide Governance Indicators, Venezuela shows a clear deterioration over the past several years (see Figures 7).

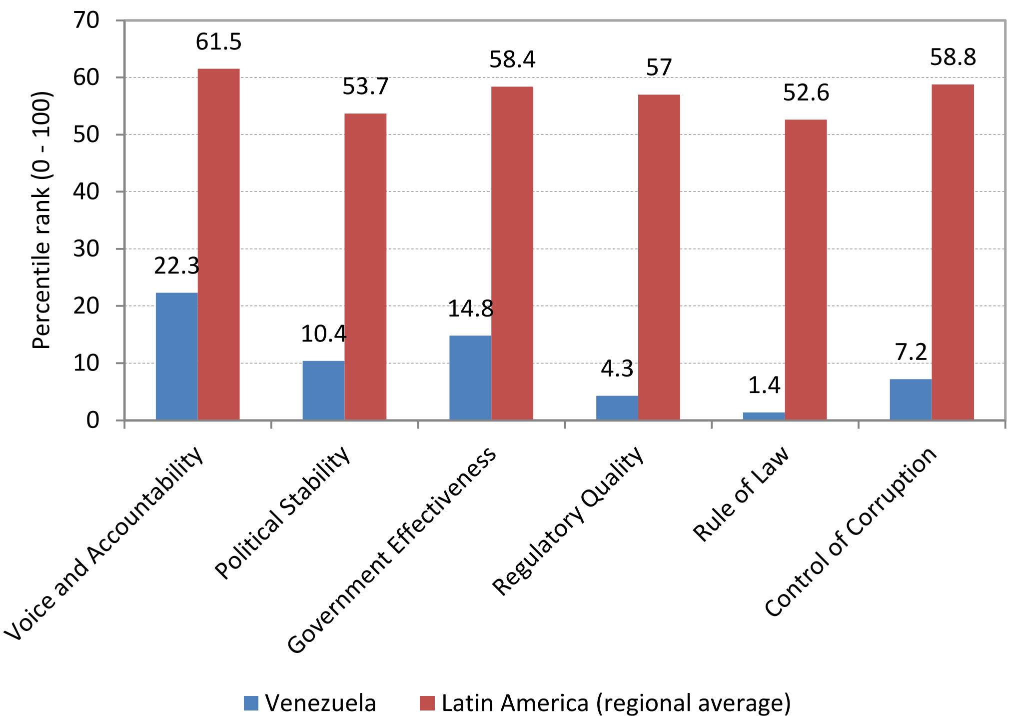
Figure 7: Worldwide Governance Indicators for Venezuela (Percentile Rank 1996-2010)



Source: World Bank Group (2012).

When compared to the region, the gap in all indicators is striking (see Figure 8). In all measures Venezuela shows worse governance outcomes than the average for Latin America, doing particularly badly in rule of law and control of corruption. Despite the government's arguments to the contrary, it is clear that disseminating a dissenting opinion has become increasingly hard. From early on in Chávez's administration Media and Civil Society Organizations have been under intense pressure from the government. The "Law of Social Responsibility in Radio and Television" has allowed the government to harass TV channels and Radio stations with an independent editorial line. Many media outlets have resorted to self-censorship in order to avoid confrontation with the government. Moreover, Watchdog and human rights NGO's, as well as Political Parties have been deprived of part of their revenues, as international fund-raising has been prohibited by the "Law of Political Sovereignty Defense and National Self-Determination". Domestic funds are scarce due to fear of retaliation. Under these conditions opposition parties have found it extremely hard to compete against a government awash with petrodollars.

Figure 8: Worldwide Governance Indicators (Percentile Rank 2010)



Source: World Bank 2012.

The budget making process has not been exempted from this overall institutional deterioration. Transparency International, an international NGO focused on budget transparency and management issues, ranked Venezuela 172 out of 182 countries in its 2011 Corruption Perceptions Index. Venezuela ranked alongside Burundi and Equatorial Guinea and well below all other countries in the region, with second lowest ranked Paraguay at 154.[21] According to the Revenue Watch Institute, an international NGO focused on revenue transparency in countries with significant natural resource extraction, Venezuela in 2010 was a "partially transparent country", with an overall evaluation of 63%. However, its management of natural resource funds is evaluated at 33.3% while the availability of reliable and timely information is evaluated at 11%.[22] Similarly the Open Budget Index 2010 published by International Budget Partnerships, another NGO, evaluates Venezuela's budget

[21] See Transparency International (http://www.transparencia.org.ve/AreasEstrategicas-(2)/Sector-Privado-(1)/CPI_2010_Table-1-.aspx).

[22] See Revenue Watch Index 2010 (http://www.revenuewatch.org/rwindex2010/pdf/RevenueWatchIndex_2010.pdf).

transparency at 34%, lower than all other countries in the region except Bolivia at 11% and below the average score of 42% for the 94 countries surveyed.[23]

The lack of transparency is directly correlated with the lack of effective oversight on the part of the National Assembly. The Open Budget Index 2010 Country Report for Venezuela underscores the fact that the Executive's Budget Proposal lacks information on major fiscal activities, such as extra-budgetary spending and quasi-fiscal activities. Furthermore, this report suggests that the National Assembly's budget oversight effectiveness is "Moderate", underscoring the lack of public budget hearings where the public can testify on the Budget presented by the Government.[24] Indeed, for the past seven years the National Assembly has passed the executive's proposed budget without any major changes neither to the use of funds nor to the flagrantly biased assumptions used for its estimation (for example, the budget's assumptions on oil prices, production, and expected income).[25]

The capacity for discretional management of oil rents; the lack of independent controlling institutions; extreme political polarization and a citizenry indifferent to the aggregate budget discussion; are features that allow for rent-seeking behavior and patronage networks to permeate most layers of public decision making, undermining the economic rationality of fiscal policy and opening the doors for widespread corruption.

In light of the arguments above and the failed experience of several oil exporting countries, including Venezuela, an increasing number of academics have suggested that direct distribution of oil receipts to all citizens may help avoid these perverse outcomes. In the following section, we evaluate the relevance and political viability of a direct distribution proposal for Venezuela.

Direct Distribution

A direct distribution mechanism (DDM) would work as follows: oil rents would accrue to an autonomous agency, which would be in charge of distributing it as lump-sum cash transfers to all citizens. The government can then tax back a given percentage of each citizen's "oil-income". Alternatively, the cash transfers can be distributed after the government has collected its tax share, a type of a priori tax or virtual tax. By broadly taxing citizens rather than an isolated and usually foreign group of oil companies, direct distribution schemes aim to replicate the beneficial effects of regular taxation. Indeed, there are several reasons why direct distribution can lead to better outcomes than the status quo described above.

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[23] See Open Budget Index 2010 (http://internationalbudget.org/wp-content/uploads/2011/04/OBI2010-Venezuela.pdf).

[24] http://internationalbudget.org/what-we-do/open-budget-survey/country-info/?country=ve.

[25] http://www.transparencia.org.ve/AreasEstrategicas/Petroleo/Transparencia-Presupuestaria/hojas-detalles/Nuestro-Presupuesto-2010.aspx

DDMs encourage general taxation: By divesting the government from part of its resources the government either decreases spending or broadens general taxation. As noted above, the incentives generated from broadly taxing citizens are different to those associated with oil fiscal revenues, particularly in terms of citizen demands for efficient, equitable and accountable spending. Moreover, unlike exogenous oil prices, general taxation is closely associated with non-oil GDP growth.[26] Negative economic outcomes result in fewer resources for the government. Reliance on general taxation thus ties more closely government's economic fortunes with that of the economy as a whole, fostering a more productive instead of redistributive role for economic policy.

DDMs reduce discretionary spending: The discretion with which successive administrations have managed the country's natural resource wealth has led widespread patronage and clientelism. Direct distribution mechanisms, by reducing the amount of resources accruing to the government, limit the resources available for discretionary spending. Indeed they guarantee that a share of the country's natural resources is distributed equally to all citizens instead of through mechanisms that require citizens to court state officials or promise loyalty in exchange. What's more, tightening the government's budget constraint effectively makes wasteful spending more costly, generating incentives to improve efficiency and rely more on cost-benefit analysis.[27]

DDMs are a powerful mechanism of formalization and inclusion: Direct distribution mechanisms require all citizens or households to acquire a bank account. In 2007, only 28% of the adult population had access to some form of financial service.[28] This is well below the regional average of 38% and below what would be expected given Venezuela's GDP per capita.[29] Expanding access to bank accounts for the entire population is a tremendous mechanism of formalization and inclusion.[30] While certainly no easy feat, the task is made easier as all unregistered citizens will have an incentive to voluntarily sign up. Additionally, a reliable public registry is necessary to avoid corruption, identity theft and leakage. As will be discussed below, new advances in biometric technology and mobile financial services have proven to be very useful in this respect. This technology can also help implement carefully targeted social policy instead of the shot-gun approach that has been common in Venezuela, in which all citizens, regardless of income, benefit from wide ranging subsidies.[31]

DDMs can help align citizen interests with other policy objectives: Alaska is widely cited example. The manner and speed with which the legislature had spent US$ 900 million resulting from the Prudhoe Bay oil lease sale in 1969 led to the creation via constitutional amendment of the

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[26] Certainly, non-oil GDP growth is related to oil prices via the government spending effect but the direction of causality is in the opposite direction to that of taxation and non-oil GDP growth.

[27] See Gillies (2010).

[28] See Beck et al (2007).

[29] See Arreaza and Rodríguez (2011).

[30] In Iran, 16 million new bank accounts were created between January and December 2010 for the purpose of distributing to each household the savings from reduced gas and energy subsidies. See Guillaume (2011).

[31] See Janet Kelly's chapter in Goodman et al. (1995).

Alaska Permanent Fund in 1976. At least 25% of all proceeds must be deposited in the fund and must only be invested in income producing assets. In 1980, the permanent fund dividend program is approved as a way of protecting the fund's integrity from political interference. By distributing half of the fund's realized earnings to all Alaska residents, the program effectively gives citizens a stake in the fund's administration. According to readily available financial reports in 2011 the fund's assets amounted to US$ 38 billion and an annual dividend of US$ 1174 was distributed to all Alaska residents that applied.[32]

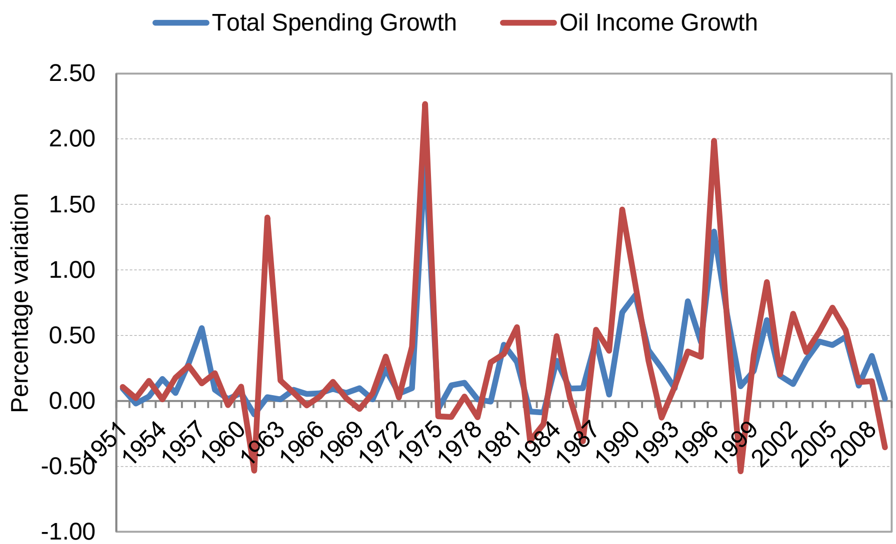
This experience contrasts sharply with Venezuela's own attempts at establishing funds. Towards the end of 1973, after the sudden increase in oil prices, president elect Carlos Andrés Pérez infamously announced that he would "administer abundance as if we were administering scarcity".[33] The Venezuelan Investment Fund (FIV in Spanish) was created in 1974 with the stated objective of protecting the economy from over-absorption by accumulating 50% of oil proceeds abroad. However, the fund was designed in such a way as to guarantee majority control by the president, such that it soon became a mechanism via which the president could spend at his own discretion bypassing normal budgetary procedures. In its first ten years of existence, the fund averaged a return of -2.0%. The FIV later became BANDES, a state owned development bank.

The Macroeconomic Investment and Stabilization Fund (FIEM for its Spanish acronym) established in 1998, unsurprisingly by an outgoing administration during a period of low oil prices. According to its original setup, the fund would save 50% of all oil proceeds in excess of a five year moving average with a symmetric spending rule. Seven months after its creation the rules were modified, and would undergo four more modifications between 1999 and 2003 after which it was replaced by the Macroeconomic Stabilization Fund (FEM in Spanish). All modifications either exempted the central government from having to save in a given year or loosened spending restrictions. After accumulating over US$ 6 billion by 2001, the funds capital began to rapidly diminish despite increasing oil prices. According to official figures the fund's capital now stands at a meager US$ 3 million. Under the current legislation the government is required to save "no less" than 20% of fiscal surplus, effectively eliminating the fund. The lack of a functioning stabilization mechanism means fiscal spending literally goes with the flow, with dire consequences in terms of macroeconomic volatility, investment and growth (see Figure 9).

[32] http://www.pfd.state.ak.us/.

[33] It would later be said mockingly that the Pérez government administered the windfall with a "scarcity of judgment".

Figure 9: Growth of Fiscal Oil Income and Public Spending (1951-2009)



Source: ONAPRE (several years).

Venezuela's failed experience with macroeconomic funds suggests that such funds are ineffective insofar as they do not modify political incentives regarding spending and saving decisions. By tying a funds' integrity to direct distribution mechanisms, politicians that sought to modify saving and spending rules would have to incur a political cost. Indeed, in Alaska it is considered political suicide to even suggest any modifications to the dividends program.

Box 1: Making Gas Price Increases Popular

Venezuela currently boasts the lowest gas prices in the world. At the official exchange rate, the domestic price of gasoline in 2011 is 2.1 cents per liter. This is over 30 times less than the international price (63.6 cents per liter) and does not even cover PDVSA's breakeven price of 7 cents. With a total consumption of 17.6 billion liters last year, the subsidy amounts to US$ 10.8 billion or 5% of GDP.[34] Using average consumption data from household surveys, Grisanti (2011) estimates how much of the subsidy accrues to the top and bottom 25% of households. His numbers show that in 2010 the richest 25% of households received US$ 3,318 in gasoline subsidies while the poorest 25% only received US$ 479.

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[34] Prices and consumption data are taken from Grisanti (2011).

However, reducing the gasoline subsidy is a prickly business in Venezuela. In 1989 the newly elected Pérez administration, faced with an unsustainable fiscal outlook, increased gas prices as part of a wide-ranging economic reform package. The unexpected increase in bus fares sparked a wave of massive rioting and looting that left hundreds dead and severely compromised the political viability of the government's reform package. This episode left a lasting impression on the Venezuelan political landscape, making any serious attempt at reducing the gasoline subsidy politically unpalatable.

Recently, Iran resorted to direct cash transfers as a means to build public support for the elimination of a number of regressive and distortionary subsidies including that on gas. At least half of the savings from reduced subsidies were to be distributed to all households. With support from the banking sector the government managed to substantially expand the ATM network and open the necessary number of bank accounts to successfully implement the reform. The first transfer was made two months in advance and remained frozen until the day of the price increase. This not only gave the reform the necessary credibility but actually made the population eager for gas prices to increase such that they could gain access to their funds.

Some form of direct cash transfers along the lines of the Iranian reform could help Venezuela reduce its huge energy subsidies without facing political turmoil. If prices were increased to 32.85 cents, that's half the international price, and the difference with the break-even price distributed across all households, each household would receive US$ 674 yearly.

Eliminating energy subsidies in this manner can also help gain early support for a direct distribution mechanism tied with a stabilization and savings fund as proposed above. Such a fund would need to delay payments while it accumulates enough reserves to accomplish its macroeconomic stabilization objective. The reduction of energy subsidies followed by direct distribution of part of the income generated can occur almost immediately, not obviating of course the need to stabilize payouts as mentioned above.

See Guillaume et al. (2011) for further detail on Iran's reform.

Naturally, as with all policy proposals, there are a number of objections that can be leveled against direct distribution mechanisms. In what follows we address some of the most common objections that have been raised in Venezuela.

Direct Distribution is Populism on Steroids: Many skeptics argue that DDMs would effectively endorse Venezuela's longstanding culture of dependency, according to which citizens expect the government to solve all their problems with little effort on their part. Such culture of dependency is in large part a result of the common misconception that the country's resources are infinite, and as such the government should be able to deal with most issues.

According to Latinobarómetro a regional public opinion survey, 48% of Venezuelans believe the government can solve "all of society's problems", compared to a regional average of 14%. Including respondents who believe that the government can solve "the majority of society's problems" the percentage increases to 81%, compared to 44% for the region as whole.[35] DDMs, as proposed in this paper, far from endorsing a culture of dependency can help mitigate it in several ways. First, by distributing and then taxing each citizen's share of her *oil income*, DDMs effectively transform every citizen into an active contributor rather than a passive receptor. Moreover, by increasing transparency, DDMs can help align expectations with reality. Each citizen will know exactly how much oil income she contributed to the government coffers and measure the provision public goods and services according to this yardstick. Also, direct distribution mechanisms, if universal, limit the government's ability to discriminately assign property rights over the country's oil revenues, thereby diminishing its power to co-opt support in exchange for rent. Despite these key factors, DDMs can fall prey to populist agendas and be developed in ways that bolster clientelism and patronage, especially if guarantees of transparency, association and dissent are lacking.

Box 2: Misiones and Direct Distribution Mechanisms (DDMs)

First launched in 2003, the Misiones were to overcome the "inefficiencies" of the state apparatus. At present there are 32 *Misiones* operating in a wide range of areas including basic education, health and job-training as well as music, agriculture, reforestation and energy efficiency among others.[36] Some of these programs are similar to conditional cash transfers in that participants are often given a small cash handout at the end of the day. The *Misiones* were initially an instant hit amongst Venezuela's poorest as they felt they were now benefiting directly from the country's natural wealth.

While perhaps similar in appearance, the Misiones differ markedly from the direct distribution mechanisms (DDMs) studied in this paper. Instead of complimenting the existing institutional framework and increasing transparency in the use of resources, the *Misiones* essentially created a parallel bureaucracy, outside of the traditional policy making process, much less transparent and accountable exclusively to the president, making them increasingly inefficient and prone to corruption.

Moreover, the discretionary distribution of resources via Misiones has allowed the government to favor supporters and punish dissent. After a failed recall referendum on the president in 2004, a congressman and member of the ruling party published the list of citizens who had signed in favor of the referendum. Those who were on this list were generally excluded from all government jobs and contracts as well as many of the social programs. Using household survey data Miguel et al. (2009) find a significant drop in earnings and employment for those voters who were on the list.

[35] http://www.latinobarometro.org/latino/LATDatos.jsp. Latinobarómetro's sample includes 18 countries.

[36] See MPPCI (2007): http://aristobulo.psuv.org.ve/wp-content/uploads/2008/09/misiones_bolivarianas.pdf.

In contrast to the Misiones that mirror transfers or policies with social goals to be received by segments of the population with specific needs, DDMs as proposed in this paper are likely to best reach their governance-enhancing objective through universal transfers that convey individual stakes in public finances. By motivating higher taxation and an understanding of the opportunity costs of public spending of oil revenues, these mechanisms are designed to grow a citizenry engaged in demanding accountability from the public sector. Moreover, in contrast to the Misiones, DDMs proposed in this paper are intended to limit government discretion in the distribution of rents, universally assigning a relatively constant share of income to all citizens, strictly bound to a year's oil revenue, to potential rules on savings and stabilization, and to the oil-income tax rate agreed through the political process. By limiting this discretion and increasing transparency, DDMs aim to limit the amount of revenues available for rent-seeking, patronage and clientelism.

Nevertheless, the Misiones are evidence that direct distribution mechanisms can easily fall prey to populist agendas and be designed and implemented in such a way as to increase patronage, clientelism and dependency. Further below we highlight some key aspects that can help thicken the line between populist based and governance improving mechanisms.

Scarce Resources: It could be argued that direct distribution mechanisms deprive the government of scarce resources that can be put to better use in the provision of public goods and services. However, this critique fails to recognize the political economy problems associated with resource wealth management. While it is certainly imperative that the government focuses on improving the provision of public goods and services that are so direly lacking in Venezuela, the main obstacle does not seem to be a lack of resources. The recent oil bonanza, while temporarily improving the lot of Venezuela's poorest households, did not translate into better public services, in fact quite the opposite occurred despite the huge increase in resources. Some skeptics do accept that public spending is often inefficient and prone to corruption, yet see direct distribution mechanisms as an extreme solution that essentially throws the baby out with the bath water. However, this critique is often based on the misconception that direct distribution mechanisms deny the government any role in managing the country's natural resource wealth. Direct distribution mechanisms, by providing incentives for greater transparency and government accountability aim to facilitate the efficient and effective provision of public services.

Wasteful Consumption: It is often argued that direct distribution mechanisms will simply promote wasteful consumption by the poor and undermine individual incentives to work. This is particularly costly for developing countries, since consumption of resource revenues would mean forgoing potentially large returns from investments in human and physical capital. Several studies however, suggest that cash transfer programs in several countries have led to increased access to health and education services. Evidence on improved outcomes is not quite as robust.[37] Moreover, direct distribution mechanisms could also contemplate distributing vouchers for specific purposes, such as health and education, rather than cash, as long as certain characteristics are maintained. Universality, as will be discussed below, is one of these crucial characteristics to distinguish governance oriented direct distribution mechanisms, as proposed here, from social policy oriented cash transfers. As mentioned above, governments must fulfill their role as guarantors, though not necessarily providers, of access to quality health and education services. Cash transfers should thus be complimented with supply side interventions such as teacher evaluation and training that help improve delivery. Regarding work disincentives, modest cash transfers do not seem to have much of an effect, indeed they can help loosen credit and time constraints that often limit an individual's chances of obtaining work in the first place. [38] Although conditional cash transfers have been shown to have a number of desirable effects, evidence on the need for conditionality is inconclusive.

Design Issues

Any direct distribution mechanism needs to answer three basic questions: how much to distribute, whom to distribute to and how to distribute. The answers to these three questions will vary depending on both economic and political considerations proper to each country. Below we discuss some considerations for the Venezuelan case.

How Much

If oil income accruing from taxation and other contributions had been uniformly distributed to all Venezuelan citizens in 2008, each would have received US$ 2480, that's roughly 22% of average per capita GDP at the official exchange rate and at least double that at the parallel exchange rate. Naturally, the percentage is much higher for the lower end of the income distribution. At the official exchange rate, US$2480 represents roughly 31% of per capita income for those at the bottom 25% of the income distribution, 15% for the next quartile and 8% and 3% for the top two quartiles respectively.[39] Using the official exchange rate however, 2.15 BsF/$ in 2008, widely underestimates these percentages. In 2008 the parallel exchange rate went as high as 7 BsF/$.[40] Therefore, in real terms, these percentages are over twice as large. Moreover, the amount transferred would be much larger if one were to also include fuel subsidies and the current administration's oil giveaways to Cuba and other

[37] See World Bank (2009) and Yanez-Pagans (2008).

[38] See DFID (2011).

[39] Data on per capita income distribution are obtained from household income surveys. See: http://www.bcv.org.ve/epf0809/epf.html?id=359. The most recent available data was for 2005. For simplicity we assumed no real income growth between 2005 and 2008 and only adjusted it for inflation. Although per capita income did grow in real terms during this period, the percentages should not be too far off. If the same computation is done with 2005 oil income per capita data, the respective percentages are: 35%, 17%, 10% and 3%.

[40] Currently Venezuela has two official exchange rates (4.30 BsF/$ and 5.30 BsF/$) and a parallel (illegal) exchange rate that hovers around 8.5-9 BsF/$.

countries in the region. In 2008 the gasoline subsidy reached US$ 8.8 billion while the giveaways, just taking into account Cuba, amounted to US$ 3.7 billion.[41] Taking both these figures into account, the total average per capita transfer in 2008 would have topped US$ 2928 or 26% of per capita GDP at the official exchange rate.

The question is then, how much should the government tax back? On the one hand, the more the government taxes back the fewer incentives it has to increase non-oil taxation, undermining the governance effect of direct distribution. Furthermore, tightening the government's budget constraint effectively makes wasteful spending more costly, generating incentives to improve efficiency and rely more on cost-benefit analysis.[42] Moreover, the public's support for the mechanism is likely correlated with the size of the transfer. Theoretically, the transfer must be at least as large as the expected value from the subsidies and transfers that would be eliminated under the new system, supposing households are risk neutral.[43]

On the other hand, few politicians would support a mechanism that distributed the entire resource income. Indeed, this is arguably undesirable for several reasons. First, while evidence suggests that small transfers do not seem to undermine work incentives, this is likely not the case for much larger unconditional transfers.[44] The size of the transfer of conditional cash transfer programs in Latin America range from 9% of pre-transfer per capita expenditure in Honduras and Brazil to 27% in Nicaragua. While Parker and Skoufias (2001) and Skoufias and di Maro (2006) find no significant effect on work incentives resulting from the Oportunidades program in Mexico which transfers an average amount of 20% of pre-transfer per capita expenditure, Maluccio and Flores (2005) do find a significant reduction in hours worked by adult men resulting from the cash transfer program in Nicaragua. Although large, the size of the transfer in Nicaragua is small compared to the amount that each Venezuelan household would receive if oil receipts were to be distributed in their entirety and not taxed. The potential for strong work disincentives should therefore not be ignored. The magnitude of oil receipts relative to the size of the population imply that a fairly large share of the transfer can be taxed without undermining support for the mechanism while also mitigating labor disincentives. Indeed, as will be discussed below, the mechanism could consider a mix of direct cash distribution together with some type of voucher system for basic services in education and health.

Second, supplementing non-oil taxation with oil income can help states expand public service provision beyond what non-oil tax receipts permit. However, as argued above, the poor quality of public goods and services in Venezuela is not so much a result of lack of

[41] Own estimates based on data from PODE (2008).

[42] See Gillies (2010).

[43] Risk aversion is perhaps a more plausible assumption in which case the transfer need not be as large, as households would value the certainty of direct distribution relative to the uncertainty of some of the current distribution mechanisms.

[44] See World Bank (2009).

resources but lack of incentives for efficient spending. In this respect, the size of the transfer should place greater weight on governance than on protecting the state's opportunity set. As will be discussed below, Venezuela has the added advantage of counting with huge reserves that could support a substantial and sustainable increase in production, supposing oil prices remain high, such that in absolute terms, transferring a large share of the added oil income need not be as traumatic from a fiscal standpoint.

To Whom

In a country as unequal as Venezuela, where a large percentage of the population lives in poverty (24.1 %) and a non-trivial percentage in extreme poverty (8.9%), the most obvious answer seems to be: to the least well-off as determined by proper means-testing mechanisms.[45] As in Brazil with Bolsa-Familia, a means-tested direct distribution mechanism would likely help reduce extreme poverty and improve income distribution.[46] Nevertheless, there are several reasons why in the case of direct distribution mechanism of resource rents universality might be preferable.

It is important to differentiate between two possible policy objectives of direct cash transfers (1) improve social outcomes (2) improve governance outcomes. While both objectives are certainly not exclusive, ignoring their differences can severely hinder the mechanism's ability to achieve its goals. Crucial to the success of a direct distribution mechanism designed to improve governance outcomes is that citizens come to perceive the country's oil income as their own personal property, a sort of inheritance from Mother Nature if you will. It is only after they perceive it as such that they will have incentives to demand efficiency and accountability in its use. If the government is allowed to discriminate, citizens will continue to perceive the transfer as a government favor and act accordingly. That is not to say that direct distribution mechanisms designed to improve governance cannot also lead to improved social outcomes. They most likely will, but in their conception, they are fundamentally different from social policy and must remain so when presented to the public.

There are other advantages associated with universality or, alternatively, less government discretion as to who can participate in the mechanism. First, lower implementation costs. Means testing mechanism are extremely costly and difficult to implement.[47] Second, less discretion leaves less space for corruption and clientelism. Once the government can choose who participates and who does not, political considerations come into play. Assigning the

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[45] Percentages refer to 2011 values. Both are official figures from the Instituto Nacional de Estadística (INE).

[46] Note that a lump-sum transfer, by definition, is income neutral in absolute terms while in relative terms, by representing a greater share of households' income, they are progressive. Alternatively, transfers can be made progressive in absolute terms as well by distributing a greater share of the oil income to poorer households which, following our definitions above, is equivalent to imposing a higher oil-income tax on richer households.

[47] Means testing is nonetheless necessary to implement well-targeted social programs. Governments in developing countries, including Venezuela, should invest in improving their means testing methods. Again, Brazil, first with Bolsa-Escola and then with Bolsa-Familia is a particularly successful example of a well-targeted social program.

targeting responsibilities to an independent agency could contain these pressures, but they will not disappear, and as suggested by the governance indicators presented above, the Venezuelan record for *de facto* autonomy of formally independent institutions is not encouraging. Third, universality can help lend credibility to the proposal. One particularly surprising result from the focus groups described above is that even the poorest households favor a universal distribution of rents. As noted above, participants remarked that otherwise there was no guarantee that they would not be left out. Universality, contrary to what one might expect, can make the proposal more appealing across all socioeconomic groups.

How

As mentioned above, direct distribution can occur prior to the government collecting its share of the oil income or afterwards. There are tradeoffs associated with both mechanisms. On the one hand, distributing rents prior to taxing them likely generates a greater sense of citizen ownership and understanding of the individual opportunity costs associated with the public management of oil revenues. This is a precondition for citizen demand of greater accountability in exchange of taxes. On the other hand, distributing rents and taxing them back from citizens seems highly inefficient, costly and prone to evasion and all the difficulties associated with general taxation. Given Venezuela's high level of informality (50%) and low levels of personal income tax collection, such a mechanism is likely impracticable. The alternative is to tax rents a priori or, as referred to by Sandbu (2006), to apply a virtual tax. This would be much less costly and would eliminate any possibility of evasion. For such a mechanism to mirror the desired effects of a regular tax citizens must have easy access to information regarding their individual share of oil revenues and how much they were taxed. The obvious disadvantage is that citizens might understand the difference between individual shares of revenues and taxes as just another government transfer. In this the case, the scheme would yield incentives to protect the transfer, but not to demand greater accountability on the share remaining in the government's hands.[48]

Having decided the order the flow, thought must be given to how to distribute the cash. Direct distribution mechanisms of the type proposed in this paper can be highly susceptible to corruption, identity theft and leakage, potentially compromising the program's impact on governance. Recent developments in identification technology as well as mobile financial services can help minimize such risks. Biometric technology such as fingerprint scans, face or iris recognition are effective control mechanisms that permit unique identification of individuals. According to Gelb and Decker (2011), biometric technology has helped reduce leakage rates of cash transfer programs in a number of countries. Notable examples are those of Nigeria and Botswana, where the creation of citizen registries with biometric data helped eliminate *ghost beneficiaries* from existing databases, reducing total beneficiaries by 40%

[48] In this respect, framing is crucial. Citizens' take on a given direct distribution mechanism will in no small part depend on how the policy is explained and sold to the public which in turn will circumscribe the policy's potential impact on governance.

and 25% respectively.[49] Developing a biometric database can prove expensive but the costs of corruption and leakage, in monetary as well as reputational terms, can also prove enormous. Regarding distribution mechanisms, expanding the existing ATM network and adapting it to biometric technology would be optimal but also costly. ATM penetration in Venezuela, both in terms of population as well as geographically is currently below the regional average.[50] Mobile financial services or branchless banking services are an attractive alternative in this respect, particularly considering Venezuela's high mobile phone penetration (104%).[51] Recent developments allow customers to access balance statements, transfer money and pay bills all through their cells phones. Alternative mechanisms that atomize the disbursal nodes among private parties interested in providing the service for a fee is another option that can help minimize costs. In any case, while it can prove expensive, investing in safeguarding direct distribution mechanisms from corruption, identity theft and leakage is imperative.

Further Design Considerations

Stabilization

As was mentioned earlier, if oil income accruing from taxation and other contributions had been uniformly distributed to all Venezuelan citizens in 2008, each would have received US$ 2480.[52] However, in 2009 the transfer would have amounted to US$ 1290 as a result of a slump in oil prices.[53] Such volatility in transfers is as undesirable for households, assuming the average household is risk averse, as it is for governments.[54] Any direct distribution scheme should contemplate some form of stabilization, which necessarily implies accumulating part of the revenue in the first few years of implementation.[55] This can be achieved delaying payouts in the first few years yet this will likely erode popular support for

[49] In 2010 India began a massive identification program that seeks to provide each of its 1.2 billion citizens with a unique identification card based on biometric information. Through the use of competitive contracting to different firms, it aims to register 600 million people over four years.

[50] According to CGAP's 2009 Financial Access Report, Venezuela had 28 ATMs per hundred thousand adults while the regional average was 36. In terms of geographic penetration, Venezuela had 6 ATMs per thousand km^2 while the regional average stood at 27. Venezuela did however have more commercial bank branches per hundred thousand adults than the regional average (19 against 15). See Arreaza and Rodríguez (2011) for an overview of access to financial services in Venezuela and the region as a whole.

[51] Mobile phone penetration refers to number of active mobile phone numbers as a percentage of the population. See the Mobile Communications and Mobile Data Market Report for Venezuela.

[52] This figure is computed using data from and official statistical report named PODE (Petróleo y Otros Datos Estadísticos). The figures in the PDVSA's official financial report differ by close to US$ 2 billion. Per capita oil income in 2008, according to PDVSA's financial report, would have been US$ 2480.

[53] For 2009 and 2010 only the contributions made by PDVSA are available, not those of the entire industry. The 2009 value here reported is extrapolated dividing PDVSA's contributions for 2009 and 2010 by PDVSA's average percentage of total contributions for the period 2004-2008 (86%).

[54] Arguably households would be better at smoothing consumption since they bear the entire costs of not doing so unlike individual politicians. This of course would be conditional to having access to smoothing mechanisms.

[55] The Alaska Permanent Fund uses a five year moving average to estimate the annual dividend.

the mechanism. Another option is to reduce the size of the payout. As highlighted above, the magnitude of oil receipts relative to the size of the population is large such that there is significant space to reduce the overall size of the payout without making it insignificant. Naturally accumulation of oil revenues, be it at home or abroad in a stabilization and savings fund, can in and of itself be an unpopular policy, particularly in a country with a large proportion of its population living in poverty. Nevertheless, focus group studies suggest that the population is not averse to saving in "good times" in order to sustain spending in "bad times". The results of these focus groups will be discussed in greater detail below.

Transparency, Voice and Exit[56]

If direct distribution mechanisms are to be implemented under the rationale of improving governance, transparency is crucial; otherwise citizens will not have the necessary information to evaluate government actions. All citizens should receive yearly statements summarizing how much each citizen received and how much each citizen contributed to the government via the "oil-income tax". Moreover, citizens must have the necessary guarantees and mechanisms to voice their concerns, demand accountability and, if judged appropriate, withdraw their support for a particular party or representative, that is, exit a given political relationship. It follows that direct distribution mechanisms should go hand in hand with policies that aim to promote transparency and freedom of information as well as strengthen mechanisms via which citizens can express their grievances and influence policy. Without these features in place, the argued link of DDMs with improved governance might pale to the concerns of increased populism[57].

Do not mix how oil industry is taxed from how it is distributed

Some proponents of direct distribution mechanisms have proposed distributing royalties rather than the entirety of the oil income. While attractive from a historical and legal point of view, there are several reasons why direct distribution mechanisms should not focus on royalties. First, by construction royalties are the least volatile component of oil income. Government revenues consisting of only income taxes would be significantly more volatile. As argued above, the Venezuelan state has been capable of handling a volatile income stream. Second, the mix of royalty and income taxes should be based on technical and not on political considerations. Focusing only on royalties can potentially generate a number of perverse incentives. On the one hand, the government has incentives to alter the mix of royalties and income taxes such that most of the oil income revenues consists results from income taxes. On the other hand, citizens would have the incentive to protect the amount royalties, independent of its desirability from a technical and efficiency standpoint.

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[56] This naturally refers to Albert O. Hirschman's famous treatise: Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States written in 1970.

[57] See Gillies (2010) for a deeper discussion on the systemic prerequisites for DDMs to improve governance outcomes in a resource rich country.

Direct Distribution: A Viable Proposal for Venezuela?

As noted by Gilles (2010), the feasibility and indeed desirability of direct distribution is highly context specific. The proposal's feasibility depends both on the size the revenue stream as well as political constraints. Below we evaluate whether direct distribution is currently a feasible policy in Venezuela.

Size and Sustainability of the Resource Rent

As mentioned above, Venezuela holds twenty percent of the world's crude oil reserves, which at the current production rate implies over 270 years of production. The vast majority of this oil is extra-heavy crude which lies in the Orinoco Oil Belt and which requires relatively high prices to be economically viable (~US$ 50). Most estimates point towards increasing demand in the foreseeable future, particularly from the large emerging economies, such that prices will likely remain above the necessary threshold. Nevertheless, despite its huge reserves and high prices, Venezuela currently produces less than 3 MBD, less than 4% of total global demand. In other words, there seems to be ample space for a significant and sustainable increase in production without a drop in prices that would make the Orinoco Oil Belt unprofitable. [58] This would imply an increase in the country's oil revenue stream, which could be used to implement some form of direct distribution mechanism. However, when all is said and done, an excellent policy is no policy at all, if is not politically viable.

Not Politically Viable?

In 2006, opposition candidate Manuel Rosales proposed to distribute a share of oil revenues directly to poor households through the use of specially designed debit cards nicknamed "*Mi Negra*" in reference to the color of crude oil. The proposal was intended to outshine the government's popular *Misiones* described above. To the surprise of Rosales and most political analysts, the proposal was met with pervasive rejection, particularly amongst the poor, suggesting that Venezuelans adverse direct distribution of oil rents. However, with the benefit of hindsight, this conclusion now seems unwarranted. It turns out that prior to Rosales launching *Mi Negra*, a majority of the population favored some form of direct distribution according to polling studies. When Rosales launched *Mi Negra*, support for direct distribution fell dramatically, suggesting that *Mi Negra* was not judged according to its merit but instead according to who proposed it.[59] While conjectural, the explanation is consistent with the political polarization that was prevalent at the time. Results from focus

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[58] All potential candidates including Chávez agree that Venezuela should and can significantly increase production.

[59] Admittedly it was also hard to judge it according to its merit given the lack of specifics and contradicting statements that characterized its political sell. It has been suggested that this helped erode its credibility and left it powerless against the government's continued warning that a Rosales victory would mean the end of the *Misiones*.

group studies conducted by IESA's Centro Internacional de Energía y Ambiente (CIEA), suggest that direct distribution could be a politically attractive proposal (see Box 3).

Box 3: Focus Group Studies

In June 2011 CIEA conducted five focus groups to analyze citizen perception of the oil industry, the current administration's use of oil income and different policy proposals regarding resource wealth management. Participants were aged 20 to 40 years old and all belonged to low middle income and low-income households. Participants were asked to evaluate five different policy proposals including three which involved some form of direct distribution either through cash, the creation of pension accounts or through education and health vouchers. The other two involved government discretion in the use of funds and a greater share of resource rents for regional governments.

At first, participants rejected the proposal that would "distribute oil rents to the population", some remarking that it was "the same as Mi Negra". The proposal was then modified to "directly depositing a share of oil revenues in the personal bank account of every Venezuelan citizen". This slight modification completely changed the participant's perception of the proposal, with many voicing their support. Inquired as to why they found the proposal attractive most highlighted the benefit of receiving the deposit directly but most importantly that no one would be excluded. Later in the discussion it became clear that it was not out of a sense of altruism that policy's universality appealed to the participants, but rather the fact that any space for selective discretion would "likely leave them out".

Nonetheless, despite the improved reception, direct distribution of oil rents was not the preferred choice, coming second to the proposal that would distribute a share of oil revenues directly to every Venezuelan citizen in the form of health and education vouchers *that could be used at the institution of their choice*. This proposal responded to the concern raised by several participants that direct distribution mechanisms would lead to wasteful spending by citizens. Once again, participants highlighted the proposal's universality but also the fact that they were free to choose at which institution they could use their voucher.

The proposal that would create pension accounts for every citizen was not very popular. This result is perhaps unsurprising given that all participants were below 40. Nevertheless, almost all participants agreed with the notion of "saving part of the oil revenues in periods of high oil prices in order to sustain spending in periods of low oil prices". This suggests that long term or "indefinite" accumulation might not be a popular policy yet accumulation for stabilization purposes could be accepted as necessary.

The other two proposals concerning the best use of oil revenues were also widely rejected in favor of direct distribution or vouchers. Although certainly not representative, these results suggest that despite the experience of *Mi Negra,* Venezuelans would be inclined to support some form of direct distribution mechanism, although preferably in the form of vouchers limited to health and education.

Another interesting result from these focus group studies relates to the gasoline subsidy. All participants acknowledged that gasoline is highly subsidized and that the subsidy favors those with cars, that is, wealthier households. However, all participants agreed that the poorer households also benefit through public transportation. When asked whether they would be in favor of increasing gasoline prices and redirecting these resources to education and health, most disapproved. Their reasoning: nothing guarantees that the additional resources would be well spent, indeed experience strongly suggests otherwise. Despite being costly and regressive, the gasoline subsidy is a guaranteed benefit safe from corruption.

Propitious conditions?

According to Gilles (2010), direct distribution mechanisms are more likely to be implemented when a new political order comes into existence, or when revenues have not yet accrued to the government, as is the case in Ghana and Uganda. Once interest groups capture the existing rent and patronage and clientelistic networks become entrenched, few politicians are likely to endorse direct distribution. In this respect, Venezuela is arguably at present at its most propitious time to implement a direct distribution mechanism.

On the one hand, as noted above, Venezuela has ample space to significantly increase production in the near future. This increase, assuming oil prices remain high, could provide substantial additional revenues, helping relax budget restrictions and giving future administrations greater flexibility in deciding optimal policy for managing resource wealth without overly compromising existing interests.

On the other hand, according to a recent poll 67.5% of Venezuelans don't believe they have benefited from country's oil income during the Chávez administration.[60] This opens up the possibility for a long overdue debate in forthcoming electoral processes on how best to manage the country's natural resource wealth, including the possibility of directly distributing a share of the oil income.

[60] Consultores 21, Perfil September 2010.

Concluding Remarks

Unlike Ghana or Uganda that are only now beginning to exploit their oil resources, Venezuela has been exporting oil for almost a century now. While initially allowing the country to leap frog over its neighbors both in terms of economic development as well as democratic consolidation, the past four decades have been characterized by corruption, economic stagnation and political instability. A growing body of literature links governance outcomes with weak fiscal contracts. By allowing governments to finance expenditure without the need to tax citizens, natural resource rents weaken the link between taxes and greater demands for representation and quality public goods and services. Moreover, discretionary use of natural resource rents allows governments to compensate supporters and punish dissenters. Direct distribution offers an alternative that could go a long way to changing the country's perceived inability to effectively manage it vast natural wealth. By diminishing political discretion in the assignment of rents, direct distribution mechanisms aim to reduce the adverse consequences of clientelism and patronage. Furthermore, by taxing citizens, including their share of the oil rent, direct distribution mechanisms both increase transparency and foster a healthy citizen-state relationship in which the state depends on the citizens and not vice-versa as has been the case heretofore. Nevertheless, direct distribution mechanisms should not be considered a panacea. On the one hand, if not designed carefully, direct distribution mechanisms can easily fall prey to populist agendas. This paper offers some basic guidelines that should be taken into consideration. Additionally, direct distribution mechanisms should be compared to the alternatives, particularly, the possibility of improving oil revenue management via greater transparency without necessarily resorting to distribution. Unfortunately, experience has shown that such institutional reforms aren't always successful. In terms of political viability, the magnitude of Venezuela's oil reserves suggest that some form of direct distribution could be both financially and politically viable.

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