

CEPAL

REVIEW

NUMBER 63
DECEMBER 1997
SANTIAGO, CHILE

OSCAR ALTAMIR
Director of the Review

EUGENIO LAHERA
Technical Secretary



UNITED NATIONS

CONTENTS

The public sector's role in Latin American development <i>Ricardo Carciofi</i>	7
Equity in the public budget <i>Juan Martin</i>	17
Pension system reforms, the capital market and saving <i>Andras Uthoff</i>	29
Public institutions and explicit and implicit environmental policies <i>Nicolo Gligo</i>	51
Non-market valuation of natural and environmental resources in Central America and the Caribbean <i>Steve Shultz</i>	65
An integrated macro-model for the Caribbean subregion <i>Lucio Vinhas de Souza</i>	77
Swerves and skids by the Venezuelan economy <i>José Miguel Benavente</i>	85
How non-traditional are non-traditional exports? The experience of seven countries of the Caribbean Basin <i>Alberto Gabriele</i>	99
Trade openness and structural change in the Brazilian motor industry <i>Ruy de Quadros Carvalho, Sérgio Robles Reis de Queiroz, Flávia Luciane Consoni, Ionara Costa and Janaína Pamplona da Costa</i>	115
The ongoing history of a Chilean metal products and machinery firm <i>Jorge Katz and Héctor Vera</i>	129
The importance of local production and small-scale enterprises for Latin American development <i>Francisco Albuquerque</i>	147
Recent ECLAC publications	162

Swerves and skids by *the Venezuelan economy*

José Miguel Benavente

*Economist, Economic
Development Division,
ECLAC.*

Now that the neoliberal economic model, under whose sway Latin America is seeing out the present millennium, has been in force for several years, this is a particularly good time to take stock of the experience accumulated so far. Economists normally set about this task by breaking down and analysing the characteristics and components of the programmes applied in the various countries. An aspect which is often neglected in these assessments, however, is that of the social and political viability of the measures adopted, which does not only depend on their technical merits. The acceptance of these measures by the various sectors of the population has come to be equally important in this respect, especially since the replacement of military regimes by democratic systems which are under the obligation to take more account of popular opinion. This is what might be called the "social" factor (or even perhaps the "psychosocial" factor) of the reforms. A better understanding of the variables affecting popular reactions to the economic policy measures applied would facilitate the prior evaluation of their possibilities of success. A stock of experience is already available for this purpose in respect of various countries. One of the most interesting experiences is perhaps that provided by the repeated application of the model in Venezuela. The different reactions of that country's population to the two neoliberal-style programmes applied in 1989 and 1996 could well be due to the different performances of the real values of the economy (growth of the product and employment), despite the similarity of the macroeconomic imbalances in both cases.

I

Resistance to change

In recent years there have been important economic, social and political changes in Latin America. Beginning with the Southern Cone countries in the 1970s, governments have gradually been abandoning economic policies based on import substitution and development models based on the domestic market and have instead applied reforms and embarked on policies inspired by neoliberal economic doctrines, whose influence has been growing all over the world. The countries acted in this way in response both to domestic circumstances (especially the limitations of the strategies applied in the past) and to the external situation, because of the opportunities and demands presented by more rapid growth in world trade and investment flows. The debt crisis of the 1980s was an important catalyst in this process.

The term neoliberalism is used here to refer to the economic doctrine which is based essentially on the assumption that the functioning of the market and the power of the State are inversely related to each other and therefore advocates less intervention by the latter in order to boost the virtues of the former. In this respect, it fits in perfectly with its 19th-century forerunner.¹ In its current version, the neoliberal philosophy is well represented by the so-called Washington Consensus,² which is endorsed by many of the institutions (both public and private) based in that

city (especially the International Monetary Fund, the World Bank, and the United States government and agencies). This Consensus groups together established "orthodox" economic policy recipes around the key principles of macroeconomic stabilization, deregulation of markets, reduction of external trade barriers, and privatization of State assets.

In current neoliberalism, as in its forerunner, distributive aspects are very far from the centre of its concerns and studies.³ This failing has often been a crucial factor in limiting the applicability of this model, since it divorces it from a reality in which such aspects are unavoidable. It is true that the initial version of the Washington Consensus included some elements with a certain social sense, such as giving priority to public expenditure in the areas of health and education, and also that in recent years there has been growing agreement on the need for a second generation of reforms (or "Washington Consensus Mark II")⁴ which would take more account of social aspects and the distribution of the benefits of reforms in order to increase their political stability, as well as on the need to strengthen State institutions.⁵ Valuable though they may be, however, these considerations have to do with the medium and long term and not necessarily with the immediate social cost of the policies applied, which may prevent the necessary

¹ An interesting difference between old liberalism and modern neoliberalism is that the first-named met with opposition in the developing world at the time, namely, in the 13 young states of North America which had just won their independence from Great Britain, whereas neoliberalism – whose champions are now those same North American states which have become the leading world power – is now also accepted by the countries on the periphery too. See in this respect the classic study by Clairmont (1996), which gives a thought-provoking description of the historical development of liberalism. For those who interpret the economy within its historical context linked with the real world of the forces of production, this difference is undoubtedly connected with the demands of the greater globalization characteristic of the present time. Arguments in favor of this explanation are set forth, for example, in Vacs (1994).

² See Williamson (1990) and Williamson, ed. (1994).

³ Perhaps we could also apply to present-day neoliberalism the criticisms which Keynes made of the old brand of liberalism when he said, referring to Ricardian doctrine, "That its teaching, translated into practice, was austere and often unpalatable, lent it virtue. That it was adapted to carry a vast and consistent logical superstructure, gave it beauty. That it could explain much social injustice and apparent cruelty as an inevitable incident in the scheme of progress, and the attempt to change such things as likely to more harm than good, commended it to authority" (Keynes, 1936, p. 33).

⁴ The Economist Intelligence Unit (1997).

⁵ A notable influence on this evolution of attitudes has probably been exerted by ECLAC, which has repeatedly stressed that the emphasis placed by the economic liberalization process on growth of the product and reduction of inflation is not enough, since growth alone cannot guarantee better distributive effects: a fact which explains the discouraging social picture observed in Latin America and may adversely affect the sustainability of the development process (ECLAC, 1997).

stabilization of an economy, no matter how correct those policies may be from a longer time perspective.⁶

The present article does not aim to make a normative assessment of neoliberal economic policies in general, but to explore one aspect of the tension that may arise between the fulfillment of their basic purpose, especially with regard to the objective functioning of markets, and the real conditions of their application, which are linked with the social context in which they are applied, when popular reaction to the policies becomes decisive in determining their viability.

1. Popular reaction to the reforms

Neoliberal policies involved radical changes in the balance of economic interests between the different strata of society. The man in the street could not remain indifferent to these changes, which affected him directly in his multiple roles as consumer, wage-earner, employer, investor, saver, etc. and which therefore had a direct impact on his living conditions. Generally speaking, however, the change in the economic environment did not immediately give rise to strong resistance on the part of those sectors of the population adversely affected by this new balance.

It is true that the first cases of these reforms (in Chile and Argentina) took place under authoritarian military regimes which made it difficult if not impossible for those who were adversely affected to express their discontent. In Chile—the first country to persist with the application of neoliberal structural reforms—the prevailing lack of freedom prevented the social cost borne by large sectors of the community from being reflected in any decisive political form. After the return of the Latin American countries to formally democratic political systems, how-

ever, governments continued to apply the reforms without giving rise to active and generalized opposition from their citizens.⁷ Mexico, Bolivia, Colombia, Peru and Brazil all followed this path without running into serious trouble on the way. It was only later, when there was a resurgence of social tensions, that dissident voices were raised on behalf of those adversely affected by the reforms. In Mexico, Honduras, Bolivia and Argentina, these voices have gradually become louder. More recently, there have been mass meetings (in Chiapas and Montevideo) which have openly rejected the neoliberal paradigm in its various Latin American forms.

From the northernmost to the southernmost limits of the region, these expressions of rejection have included a wide variety of formally organized and informal sectors and bodies directly or indirectly representing the popular strata. Thus, for example, the Thirty-ninth Conference of the Latin American Confederation of Ministers of Religion, held in November 1996 in Tegucigalpa, denounced the neoliberal economic model as one of the causes of the poverty affecting the region. Various Central American bishops and archbishops (for example, those of El Salvador and Honduras) have made pronouncements in the same sense.⁸ At the other end of the continent, trade union organizations of the MERCOSUR countries have identified neoliberalism as the cause of the deterioration in workers' living conditions.⁹ With regard to privatizations in particular, which are one of the basic ingredients of the neoliberal recipe, the people of Uruguay (in a 1992 plebiscite) and of Ecuador (in a similar vote in 1995) rejected the transfer to the private sector of the telephone company and the social security system, respectively. At a meeting held prior to the annual assembly of the Inter-American Development Bank, held in Barcelona in March 1997, a number of mayors of Latin American cities questioned the process of privatization of public services.

There has thus been a growing current of opinion which holds that the application of neoliberal policies has resulted in an increase in inequality and even poverty, a consequent resurgence of criminality in the

⁶ Other authors have made the same point. Bresser, Maravall and Przeworski (1994, p. 182), for example, note that "Stabilization attempts generate social costs that make the continuation of reforms politically unpalatable under democratic conditions. Moreover, the technocratic style in which these policies are often formulated and implemented tends to undermine the consolidation of democratic institutions." This general assertion may be tempered in the light of the distinction made by Haggard and Kaufman (1995) between two phases of reforms: their initiation and their consolidation.

⁷ The phenomenon of the adoption of reforms of this type under democratic regimes has given rise to various theoretical explanations for what Navarro (1995) considers as the "anomaly" of popular toleration of the economic adjustment processes. These explanations are analysed in the present article.

⁸ In Honduras, declarations against the social effects of neoliberalism have been made not only by the Catholic Church but also by such representative institutions as the trade unions and the College of Economists.

⁹ The trade unions of the four member-countries of this trade bloc held a coordinated day of protest in this respect in December 1996.

big cities, and even an increase in the political violence suffered by some countries where there are guerrilla movements (such as Peru, Colombia and Mexico).

In an era of new democratic regimes, this perception held by the population is an element of crucial importance which must be taken into account when applying economic policy reforms. Within this context, the social factor has acquired undoubted political weight. It has been argued that the adoption of these policies has become more difficult in the absence of the previous authoritarian governments and that this has brought with it a tendency towards what might be considered a certain autocratic type of behaviour on the part of the new democratic regimes.¹⁰ The granting of extraordinary powers to the Presidents of Argentina and Brazil by the respective Parliaments and the dissolution of Congress by the President of Peru may be interpreted in this sense. In other countries, this social factor may have worked against Presidents in a weaker position; examples in this respect include the removal of the Presidents of Guatemala and, more recently, of Ecuador, as well as of the President of Venezuela, which will be referred to later. The President of Honduras, who began to apply a neoliberal economic scheme in 1994, stated in April 1997 that he had not signed a letter of intent with the International Monetary Fund because of the harshness of the measures that he would have had to apply.

These developments make it necessary to take account of the social circumstances of the countries in the design and application of economic policies if these are to be politically viable.¹¹ In particular, the reaction of the population, or the social factor, is of decisive importance. It seems reasonable, for exam-

ple, to believe that the removal of the President of Ecuador by his country's Congress was due largely to the rapidity with which he tried to apply a drastic reform programme for which the population was not prepared.

In seeking to explain the reaction of the population to reform programmes, reference is often made to the importance of the prevailing economic context;¹² one aspect of the latter concerns the performance of the economy before the adoption of the measures in question, especially in situations of economic crisis. Gamarra (1994), for example, is not the only author who emphasizes this factor when he notes that the experience of Bolivia and Argentina—which did not managed to stabilize their economies in the early 1980s—suggests that stringent austerity measures only work when the economy has sunk to an all-time low.¹³ In the same line of thought, it may be assumed that the acceptance of similar programmes in Argentina (a decade later), Brazil and Peru was due to the population's strong rejection of the previous situation of hyperinflation, which was absent in the case of Ecuador¹⁴ and also in that of Venezuela. In this respect, the experience of the latter country, where neoliberal policies have been applied on two occasions, with different reactions by the population, could be very enlightening.

2. A special case: Venezuela

In 1989, the first exception to the peaceful acceptance of the neoliberal model in Latin America took place: in Venezuela, the announcement of a package of drastic measures of this type was received by the population with violent disturbances which are among the worst that ever happened in that country's history. Venezuela was the country with the longest background of formal democracy in the whole region: the last authoritarian military government went back to the 1950s, and three decades later most Venezuelans had grown up in a system of political parties and free elections where there was freedom of expression.

Yet it was these same Venezuelans who reacted violently and massively in February 1989 to the announcement of the economic measures adopted by

¹⁰ This is the line taken by, for example, Haggard and Kaufman (1995, p. 360), who also note that in Mexico the corporative-type system of representation of interests also played an important role, but likewise within an authoritarian institutional context. See also Heredia (1994) and Kaufman, Bazdresch and Heredia (1993) on Mexico, as well as Cavarozzi (1994) on the relationship between reforms and authoritarian regimes. In view of these situations, some authors have questioned whether the Latin American democracies can really be considered as "consolidated" (see, for example, Gamarra (1994) and Acuña and Smith (1994)).

¹¹ This need has been pointed out by various authors. Rodrik (1996), for example, states in this respect that most economists have already realized that a good economic recipe requires an understanding of the political economy of the situation in question (p. 38). De Janvry, Fargeix and Sadoulet (1991) have even prepared an index of the "political feasibility" of economic policy results.

¹² The relation between economic performance and sociopolitical tensions has been explored by Acuña and Smith (1994).

¹³ Gamarra, 1994, p. 4.

¹⁴ See *Latin American Weekly Report*, 1997a.

the government of recently elected President Carlos Andrés Pérez: a set of measures presented under the title of "The Great Turning-Point of the Venezuelan Economy". Although there are discrepancies about the actual material cost of the disturbances in the streets, there is consensus on their seriousness: they resulted in hundreds of dead and extensive damage to property. From one moment to the next, the enormous popularity of the President, who had been elected two months earlier with the biggest popular majority in 25 years, was turned into one of the biggest rejections ever suffered by a President of that country. This situation paved the way for two attempted coups d'état three years later and finally for the removal of Carlos Andrés Pérez from office in 1993 on charges of corruption.

The political fate of the President also sealed the economic fate of the reform programme. Although some important components such as trade liberalization would continue, others, such as certain fiscal reforms, either did not survive the need for approval by Congress, or else their application was cut off half way. In 1994, President Rafael Caldera, elected on a platform based on rejection of his predecessor's economic programme, reacted to a sudden crisis in the financial system by imposing price and exchange-rate controls in the best pre-1989 tradition.

Fifteen months later, in April 1996, after the financial crisis had been largely solved but serious imbalances in the economy persisted, the same President announced to his country his decision to return to orthodox neoliberal measures through an

adjustment programme entitled "Agenda Venezuela", which, like the previous programme, enjoyed the endorsement and financial support of the International Monetary Fund. This time, however, the much-feared social explosion did not take place. Something had changed in Venezuelan society.

It is easy to explain this change on the basis of what might be called the social psychology of the country. Such a psychological mutation does not have any roots in economic reality, however. Parallel observation of the circumstances preceding the announcement of the two reform programmes could shed some light on what Moisés Naim, a former Minister of Industry of President Pérez, calls the political aspect of economic change.¹⁵

Such observation, which is summed up in the following pages, fits in with the explanations of the influence of economic crises on popular acceptance of the austerity which accompanies reforms and stabilization programmes. Venezuela's experience makes it possible to overcome a certain ambiguity which is inherent in these explanations¹⁶ and shows in particular that, out of the various components of the economic mosaic, it is the existence of macroeconomic imbalances (pressures on prices and the external accounts) that leads the authorities to take corrective measures, but it is the performance of the real variables (the product, employment and the purchasing power of the population) which conditions the population's acceptance of such measures. When the pressures on these two sides take temporarily divergent directions, the social fabric is in danger of being torn apart.

II

A tale of two adjustments: the economic context

In Venezuela, the periods just before 1989 and 1996 were marked by serious macroeconomic imbalances; in both cases, an attempt was made to bring the economy back into balance by applying voluntaristic measures which ran counter to the functioning of the markets. The imbalances showed themselves in the fiscal, monetary and external areas. Albeit with substantial differences, in both periods substantial fiscal and balance of payments deficits, overvalued exchange rates, inflationary pressures that were hard to

contain and negative real interest rates all existed side-by-side. These coincidences concealed rather different situations of the "real" economy, however; in particular, the short-term changes in the product and employment were more obviously unfavourable

¹⁵ For a very clear description of the 1989 adjustment programme and its historical context, see Naim (1993).

¹⁶ This ambiguity was pointed out by Rodrik (1996).

in the months before 1996.¹⁷ The greater incidence of these latter variables in the population's perception of the economic situation of the country may explain its different reactions to the two adjustment programmes, together with other factors such as the awareness of the inability of heterodox measures to solve the growing crisis of a country used to oil bonanzas.

1. Macroeconomic imbalances

In both 1988 and 1995, the imbalances that the Venezuelan economy had been suffering for some time past made it urgently necessary to adopt suitable adjustment measures. Albeit in different contexts and with different backgrounds, on both occasions the loss of international reserves had become unmanageable in spite of the prevailing exchange controls, while inflationary pressures, further increased by the deficit in the public accounts, had escaped from the grasp of the price control policy.

a) *The drain on the international reserves*

It seems appropriate to begin to unravel the Venezuelan macroeconomic tangle by starting with the external sector. In Venezuela, the country's place in the world economy, which, as in other countries, has increasingly conditioned its economic policy options, is of a special nature because of the dependence on oil. This dependence has had a decisive influence on the country's economic structure and, ultimately, on its social fabric.

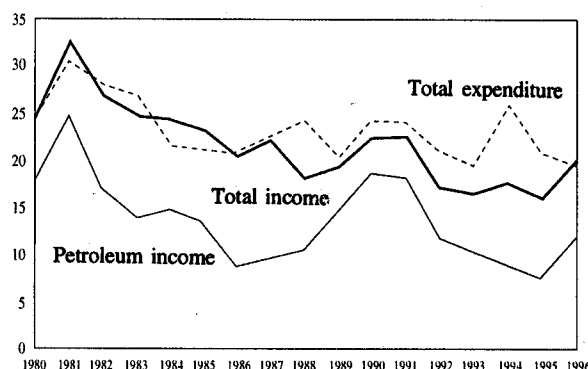
In 1988, Venezuela's income from oil exports accounted for over 80% of the total value of the country's external sales, and this was not even a particularly favourable year in the volatile trajectory displayed by crude oil prices since 1973. The central government obtained around 60% of its current resources from the State operation of the oilfields. In 1995, the weight of oil in exports of goods remained as high as ever, and in spite of the recent diversification of the sources of fiscal revenue, oil still provided half the government's budgeted income (figure 1).

The importance of this foreign currency income for the financing of the State means that fiscal policy is very closely linked with exchange policy. Variations in the exchange rate of the bolívar are immediately reflected in the availability of State resources

FIGURE 1

Venezuela: Petroleum and the public finances, 1980-1996

(Fiscal income and expenditure, as percentages of GDP)



for financing local currency expenditure. The evolution of the external sector thus conditions the achievement of the domestic balances even more than in other countries.

Both in 1988 and in 1995, the balance of payments was running a deficit and the Central Bank of Venezuela (BCV) had to cope with a constant loss of international reserves. In 1988, these losses were occurring for the third year running and came close to the enormous amount of US\$ 4 billion, or 30% of the existing reserves. In 1995, the drain on the reserves came to US\$ 1.9 billion, likewise after three years of negative figures. The position with regard to foreign assets in the hands of the Central Bank was more critical in 1988. In both years, the authorities were unable to avoid running into arrears on their external debt service.

These situations marked the final failure of the policy adopted with the aim of preserving the country's external payments capacity: exchange controls at the officially fixed exchange rate. The restrictions on the free availability of foreign exchange helped to keep external capital away and encouraged the flight of domestic capital. Thus, capital inflows were unable to offset the unfavourable evolution of current transactions. In 1988, the situation was made worse by the fall in oil prices on international markets, unlike the position in 1995, when the evolution of those markets favoured export income and helped to achieve a trade and current account surplus. In contrast, in 1988 the current account had registered an enormous deficit equivalent to 10% of GDP, fostered by a merchandise trade balance that was negative for the first time in 10 years.

¹⁷ See ECLAC, *Economic Survey of Latin America and the Caribbean* (various issues).

The other factor common to both periods which had an adverse effect on the external accounts was the boost given to imports by the unsustainable maintenance of the official exchange rate, which resulted in the speculative accumulation of stocks due to expectations of devaluation. In 1988, the value of external purchases shot up by 24% and in 1995 by 30%, despite the sluggishness of economic activity in the latter year.

The exchange-rate system in force in 1988 was based on a multiple system of official exchange rates whose average levels at the end of the year were only half that prevailing on the parallel market. At the end of 1995, there was a single official exchange rate (devalued in December), after the authorities had experimented for a short time with a different exchange rate for travel, deriving from the virtual free market implicit in the transactions of Brady bonds, whose trading had been authorized on the Caracas stock exchange. The ratio between the official rate and the rate on this free market reflected an overvaluation of more than 50% for the former, which went down to 18% after the devaluation.

b) *The fiscal imbalance*

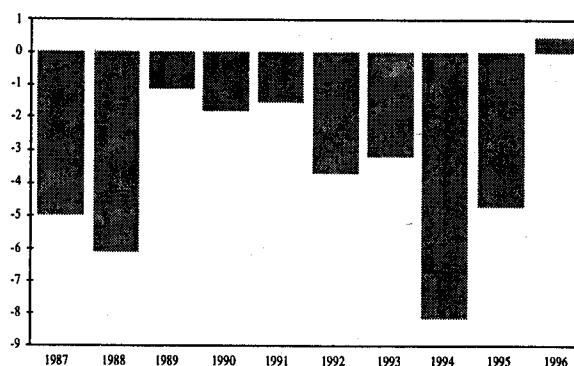
Despite the enormous resources generated for the State by oil sales, the government's difficulties in financing its expenditure and achieving balanced accounts has emerged as one of the main factors of macroeconomic imbalance in Venezuela. In contrast with the rigidity of expenditure, the variability and uncertainty of its income, which depends on the volatile international oil markets, has often faced the government with the need to contract debts in order to close the gap between the two. In 1988, it proved impossible to finance the expansion in expenditure with ordinary resources because of the unfavourable evolution of oil income in dollars and the maintenance of an overvalued exchange rate, even though the 1987 devaluation had led to a substantial increase in revenue in bolívares. As a result, after two years of slight deficits on the accounts, the fiscal deficit increased considerably to 5% of GDP: a level which had not been registered since 1982 (figure 2).

The fiscal situation was even more alarming in 1995. The acute crisis in the banking system which had broken out at the end of 1993 had obliged the State to intervene in a number of financial establishments while also providing huge amounts of financial aid to avoid the collapse of the banking system. Some two million million bolívares had to be

FIGURE 2

Venezuela: The central government in the red, 1987-1996

(Financial position, as percentages of GDP)



paid out to settle the financial emergency. In 1994, this aid was equivalent to 13% of GDP, and although smaller in 1995 it still represented a heavy burden on the budget in that year. Despite the efforts to obtain additional fiscal resources and the rise in the value of oil sales, the government still registered deficits equivalent to 8% and 5% of GDP in 1994 and 1995, respectively. The public sector deficit as a whole amounted to 14% and 6% of GDP in those two years.

Because of the serious difficulties in gaining access to international credit markets mentioned earlier and the limitation of the resources available on the domestic market, these deficits could only be financed through the sale of public securities. It was necessary to make very extensive use of credit from the Central Bank of Venezuela. In 1988, most of the deficit was financed by using the Treasury reserves, which went down by almost 50% and by the end of the year stood at their lowest level for the past four years. Central Bank credit to the public sector also played a prominent role in financing the deficits in 1994 and 1995. The expansion in the money supply resulting from this form of financing was only partly offset by the contraction in the international reserves, so that often the monetary authorities had to make costly interventions in order to absorb the liquidity injected into the system. Finally, this further increased pressure on prices.

c) *The increase in inflationary pressures*

The expansionary financing of the fiscal deficits gave rise to pressures on prices which put an end to the long period of low inflation in Venezuela: a country which had been free of the hyperinflationary ex-

cesses typical of other Latin American countries. In 1987, the increase in consumer prices reached the unprecedented level of 40%, which only went down by five percentage points in the following year, when the rate of inflation was twice the average for the 1970s. The situation prior to 1996 was still worse. The year before, the increase in inflation had amounted to 57%, after the 71% increase registered in 1994, while in April 1996 the rate of inflation for the previous 12 months came to 86%.

Although these figures are extremely unfavourable against the historical background of Venezuela, they still do not reflect the seriousness of the pressures on prices, since the authorities had opted for a system of official price controls. This policy came up against the difficult task of concealing the tensions created by the abundant liquidity and, from time to time, by maxi-devaluations or expectations of devaluation of the currency which resulted in a decline in the demand for money.

The magnitude of these underlying pressures was made clear by the evolution of prices after controls were lifted, which was also furthered by the respective devaluations of the bolívar. In May 1989, the twelve-month cumulative increase in prices reached three digits for the first time in the history of Venezuela, and inflation at the end of the year stood at 81%. This story was repeated in 1996; in September, five months after the initiation of the adjustment programme, the 12-month inflation reached a new peak of 115%. On both occasions, the authorities were facing an inflationary spiral that was increasingly difficult to control without causing fatal distortions in the functioning of the economy.

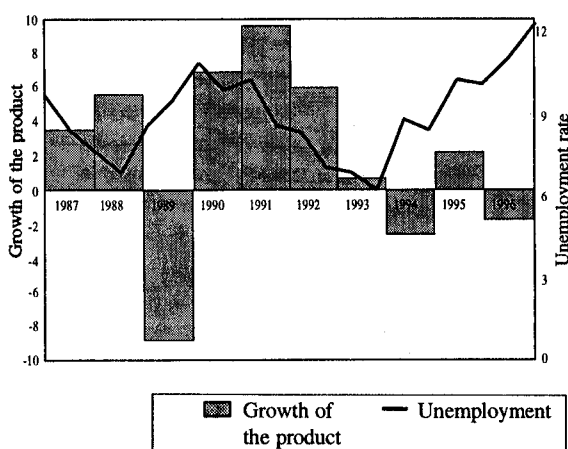
The evolution of the general price level also affected other key relative prices of the economy, such as interest rates, which had negative real values in both periods, thus discouraging private saving and making the financial establishments' work of intermediation more difficult. In the last quarter of 1988, real interest rates on loans and deposits, which had been going down since 1986, were close to -40%. In 1996 the situation was similar, although the spread between interest rates on loans and deposits had increased to approximately ten percentage points.

2. The "real" economy

Although there were clear similarities between the periods before 1988 and 1996 as regards the macro-economic imbalances and the policies applied, the two situations also displayed significant differences as regards the performance of the real variables of

FIGURE 3

Venezuela: Ups and downs of the economy, 1987-1996
(Growth of the product and unemployment rate, %)



the economy: the product and employment. This performance was notably worse in the second period than in the first (figure 3). It would not be unreasonable to suppose that, outside the circles of economists and the government, those variables had much more influence than the balance sheets of the Central Bank and the Ministry of Finance on the Venezuelan population's general perception of the situation.

a) The evolution of economic activity

Economic growth had different characteristics, both quantitatively and qualitatively, in the months preceding the adoption of the two adjustment programmes. Quantitatively, growth was higher in 1988, when the product grew by almost 6% in spite of the fragile nature of the bases for that growth which was already referred to.¹⁸ This followed three consecutive years of growth after the crisis of the early 1980s, so that in 1987 the GDP had recovered its pre-crisis level, and the growth registered in 1988 made possible a 3% increase in the per capita product. In 1994, in contrast, economic activity fell by 2.5% and barely recovered the lost ground in the following year, so that the per capita GDP deteriorated.

Even more significant are the qualitative differences regarding the composition and forms of economic growth. Presidential elections were held in

¹⁸ The figures on the growth of the gross domestic product were prepared by ECLAC on the basis of official figures of the country. The latter may differ somewhat from those given in this article because the weighting used had a different base year.

December 1988. In the previous months, the authorities continued and even increased the expansionary line they had taken in economic policies since 1986. Fiscal expenditure, especially that devoted to investment, was considerably increased, and monetary policy was gradually eased. As a result, domestic demand (both public and private) became the main factor in the growth of economic activity; private demand was partly due to the accumulation of stocks in the light of the uncertainty generated by the exchange policy.

This led to a generalized and increasingly rapid expansion of domestic activity, except for oil and gas extraction, which were affected by severe external restrictions, and, to a lesser extent, agriculture and transport. Except for the non-petroleum mining sector, whose strong growth was due to the surge in external demand, the other branches of production of goods were propelled by domestic consumption and investment. Public expenditure on infrastructure made up for the contraction in private housing construction, giving rise to growth of 6% in the construction sector as a whole. Manufacturing activity recovered by 5% after the poor results of the previous year, especially in the case of industries producing consumer goods. The financial sector showed great dynamism, as in the previous year, thanks to the diversification of banking services in response to the stagnation of the traditional credit market. The expansion in purchases of goods was a powerful stimulus for commercial activity. The community and personal services sectors also grew, although not so strongly.

However, over half the increase in domestic demand was satisfied with imported goods, so that the volume of external purchases increased by 20% to account for one-fifth of total supply: the highest proportion since 1982. This in turn increased the balance of payments imbalance already referred to.

The situation was radically different in 1994 and 1995. Against a background of domestic sluggishness, it was external demand which was the driving force in the economy and allowed the product to grow (although only slightly) in 1995. The petroleum sector, in particular, grew steadily at a rate of nearly 6% per year. In contrast, although the oil industry's investments in the country stimulated the activity of some domestic industries, the non-petroleum sector as a whole contracted significantly in 1994 and barely grew at all (less than 1%) in 1995, suffering from the stagnation or decline in consumption (especially by the public sector) and the marked fall

in public and private investment. The group of non-tradeable sectors as a whole went into a recession, with the worst result being that of the construction sector, which contracted for the third year running in 1995 (by 11%). Activity also slackened in commerce, restaurants and hotels, and motor vehicle manufacture.

These differences in the economic growth pattern between the two periods directly affected the living conditions of the population, which, as we shall see below, markedly deteriorated in the years before 1996, in contrast with what had happened in 1988.

b) Employment and wages

In 1988, the increased production activity, together with the concentration of growth in sectors which generated large amounts of jobs (construction, commerce, etc.), caused employment to grow by 6%, thus making a total increase of nearly 20% in three years. Employment grew in all sectors except agriculture and basic services. As a result, the rate of open unemployment continued its downward trend and went down to 7.3% –its lowest level since 1982 and only half the level registered four years earlier. The reduction was particularly marked in the metropolitan area of Caracas and in Guyana, due in the case of the latter region to the investments in mining and electrical infrastructural works.

Within the framework of the usual collective negotiations, wages increased on average by 15% in the cities and 18% in rural areas. An 8% increase in the minimum wage was also decreed. These increases made up to some extent for the generalized rise in prices, but even so the purchasing power of workers went down for the second year running (by 11% in the case of urban workers and 10% in the case of rural workers), although the more plentiful employment opportunities meant that the deterioration in real family incomes was not so severe.

In 1995, in contrast, the expansion of the petroleum sector was not sufficient to absorb the nearly 600,000 workers entering the labour market, many of them induced to do so by the deterioration in real wages and living conditions in general. Thus, although the level of employment increased somewhat, so did the rate of open unemployment, whose upward trend culminated in a level of 11% for the country as a whole (12% in the cities) at the beginning of 1996 (figure 3).

In 1995, too, efforts were made to make up for the deterioration in the living conditions of the popu-

lation through wage adjustments and specific government measures, which included special allowances for the lowest-paid private sector workers, increases in public sector wages by 30% in accordance with the labour regulations, and readjustment of the urban

minimum wage from 21,000 to 31,000 bolívares. Because of the higher rate of inflation in this period, however, these measures were not able to prevent real wages in the cities from going down (by 14%) more than in 1988.

III

From the "Great Turning Point" to the "Agenda Venezuela"

These macroeconomic imbalances, which were similar in both periods, led the respective governments to apply measures of the same orthodox type in order to stabilize the economy,¹⁹ as a necessary prerequisite for returning to a situation of sustained growth. The results corresponded both to the measures adopted and to the reaction that these provoked in Venezuelan society: a reaction which was also influenced, as already noted, by the evolution of the real variables: the product and, above all, employment.

1. Same ills, same remedies

The cornerstone of the two adjustment programmes was liberalization of the economy: elimination of controls on prices (except for some staple goods), on the exchange rate (allowing the currency to float freely) and on interest rates. The 1989 programme also provided for the liberalization of foreign trade, with reduction of tariffs and elimination of controls and subsidies; against this background, Venezuela entered GATT in September 1990. Since this situation was not subsequently reversed, the 1996 programme did not include measures of this type and the policy of openness was continued.

Fiscal reforms, aimed at balancing the public accounts, were also a basic component of the two programmes, and were undoubtedly the element which had the greatest immediate impact on the living conditions of the population and their reaction. The measures to increase fiscal income included in particular the raising of the subsidized gasoline prices,

which were among the lowest in the world and which represented a particularly sensitive issue for the population of Venezuela and hence a question of high political voltage. These prices were doubled in February 1989, whereas in April 1996 they were increased almost fivefold, with future readjustments scheduled in both cases. In 1989, a start was made on the gradual introduction of a value added tax, the rate of which was raised from 12.5% to 16.5% under the 1996 programme. It was decided to increase the charges for such public services as electricity, water and garbage collection (by between 30% and 40% in 1989 and by between 35% and 65% in 1996). The privatization of public enterprises and State assets was promoted. Reforms were announced in the public sector, especially with regard to the system of pensions and benefits (in 1996) and the regulation of the financial system (in 1989), and in 1996 a capitalization fund was set up for the banking system in order to help rehabilitate the private financial establishments with funds lent by the World Bank and other agencies.

In addition to their fiscal objectives, both programmes included guidelines for the application of a restrictive monetary policy designed to further the objective of drastically reducing inflation after the freeing of prices, in line with the goals agreed on both occasions with the International Monetary Fund.

An important new feature of the 1996 programme was the greater emphasis placed on social expenditure, with the aim of reducing the unfavourable impact of the measures on the poorer sectors, thus reflecting a greater awareness of the importance of the "social factor" for the viability of the economic measures. Among other measures, it was planned to double the existing food subsidy, to provide a system of scholarships for the vocational train-

¹⁹ For a synoptic comparison of the two adjustment programmes, see Bottome (1996).

ing of young people who failed to continue their studies, to double the pensions provided by the Venezuelan Social Security Institute, and to introduce a strategic food programme under which poor families would be provided with certain staple foods at only 60% of their market prices. In addition, because of the increase in fuel prices, a subsidy was provided for public passenger transport in order to prevent that rise from affecting fares. It was envisaged that altogether social expenditure would increase from the equivalent of 0.45% of GDP to 2%. Many of the measures were to receive financial support from the World Bank and the Inter-American Development Bank.

2. ... but different results?

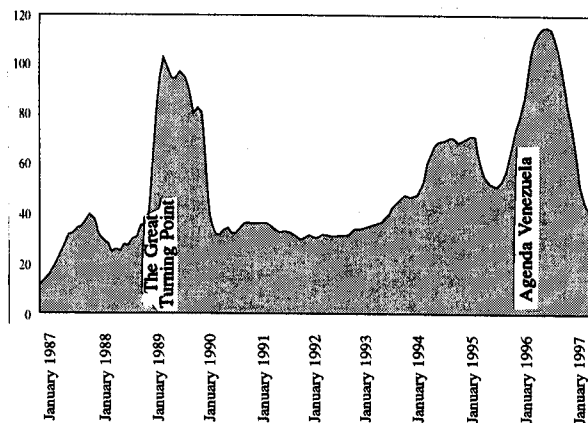
Initially, both programmes gave rise to an increase in inflation and a contraction in domestic demand which adversely affected the growth of the product. The increase in inflation (figure 4) took place immediately after the announcement of the measures. After the first shock, however, the monthly rate of inflation began to go down. In 1989, it went down from a maximum of 21.3% in March to 1.7% in December, while in 1996 it went down from 12.6% in May of that year to 1.6% in March 1997.

The adjustment in the product in 1989 was extremely abrupt. Thus, the gross domestic product registered an unprecedented drop of nearly 9% due to the contraction in domestic demand and above all the collapse of investment, which went down by 40%. Almost all sectors suffered the impact of the increase in the cost of inputs, mostly imported, the elimination or reduction of subsidies, and the rise in interest rates. The only exceptions were the petroleum industry, electricity production and community and personal services, which remained more or less unchanged. The first of these sectors was benefited by its orientation towards external markets, as also occurred with some manufacturing sectors, including certain foodstuffs and textiles. Manufacturing as a whole contracted by 10%, however, with the most seriously affected sector being the motor industry, which suffered a decline of 80% in domestic sales and an acute shortage of liquidity due to the exchange losses suffered in connection with letters of credit taken out during the previous year to pay for imports. There was also a considerable decline in the production of machinery, consumer durables and inputs for the construction sector, in line with the 30%

FIGURE 4

Venezuela's roller coaster ride: Inflationary outbursts, 1987-1997

(Twelve-month cumulative monthly
variation in consumer price index)



contraction in construction, which was particularly hard hit by the rise in interest rates.

The decline in domestic activity was reflected in a reduction in employment, even though the government decreed a freeze on dismissals up to December and an emergency public employment plan was begun in the last quarter of the year. Many unemployed sought refuge in the informal sector of the economy, where employment grew by 7% in 1989 and over 9% in 1990. Open unemployment increased by two percentage points, affecting over 9% of the economically active population in 1989. The situation got worse in early 1990, when the decree prohibiting dismissals expired, and the unemployment rate rose to over 11%.

The recessionary adjustment in the economy was apparently smaller in 1996, first of all because non-oil economic activity was already showing a downward trend and secondly, because the petroleum sector kept up a strong growth rate thanks to the favourable external market conditions. It was thus possible to keep the drop in the total gross domestic product down to 1.6%, although the non-oil sector contracted by 3.6%. The already high rate of urban unemployment, which was close to 11%, rose to over 12% in the second half of 1996. Almost half the working population of Venezuela was subsisting in the informal sector of the economy, and living conditions were becoming more and more precarious.

On both occasions, once it had got over the first shock economic activity began to recover in the

course of 1990 and 1997, respectively. In 1990, the gross domestic product grew by 7%, although this partial recovery was due above all to a big increase in petroleum sector activity (14%) and public investment. The recovery in private consumption was much more timid, and private investment continued to be depressed. The recovery was confirmed in the following two years; in 1991 the product once again grew vigorously (by almost 10%), and in 1992 it increased by 6%. The unemployment rate began to go down as from the second half of 1990, and stood at less than 7% in 1993.

Popular opposition to the economic programme begun in 1989 was reflected in a climate of political instability, however, which ended up by spoiling the expectations on which private consumption and, above all, private investment were based. At the political level, the government's difficulties prevented the full and complete application of the set of measures. The new regulations governing the banking system came into force with a considerable delay, at the end of 1993, too late to avoid the crisis in the banking system which broke out in December of that year. The rise in gasoline prices and the privatization process were interrupted in February 1992. The projected value added tax never reached the retail level, and all attempts to reform the social security system failed.

In this unfavourable climate, the upward phase in oil prices came to an end. As a result, the economy ran out of steam in 1993, so that the product stagnated and all components of domestic expenditure turned in negative figures. Economic policy lost much of its leeway for action and could not prevent a substantial rise in interest rates. In this context, towards the end of the year a series of bankruptcies of banking establishments began which very seriously burdened the State budget in the following months. In view of this emergency, as from June 1994 the new government imposed controls on the key variables of the economy: prices, the exchange rate, and interest rates. This marked the end of the first attempt to apply neoliberal reforms in Venezuela.

Would the second attempt suffer the same fate? One year after the adoption of the "Agenda Venezuela", the application of this programme of measures continued in a situation of stoical resignation on the part of the population. The privatization programme entered on its final stage after having registered some notable achievements, especially the sale of the State's shares in the CANTV telecommunications company, and the sale of companies in the alu-

minium, iron ore and steel sectors was scheduled for the following months. The economic measures had aroused the confidence of foreign investors: heavy inflows of external capital had turned the Caracas stock exchange into the star of the Latin American securities markets and, together with the favourable trend in oil prices, had fostered a heavy accumulation of reserves (which reached an all-time high in August 1997) and shored up the level of the bolívar, which had appreciated in real terms. In these circumstances, it had not been necessary to disburse the last two tranches of the standby credit agreed with the International Monetary Fund, which nevertheless continued to endorse the policies applied by the government. Several months of negotiations between the government, the trade unions and the business sector culminated in March 1997 with an agreement to improve the social security system and establish new pension funds, which was reflected in June in a reform of the Basic Labour Law.

On the other hand, however, the high social cost endured by a resigned Venezuelan population kept social tensions alive. When the country was celebrating 39 years of democracy, in January 1997, the public universities were paralyzed by a strike of professors, and the doctors, who had already obtained an increase in their salaries, used the same expedient to demand more equipment for their hospitals. The government had had to give way to similar demands by public officials. Other professional sectors, including the employees of the CANTV company and the school teachers, were considering going on strike to demand higher wages. Two months later, the trade unions took to the streets of Caracas to demand higher wages and respect for human rights and to oppose the privatization of State enterprises. A survey carried out in June of that year revealed that public opinion was heavily unfavourable to the government and pessimistic about living conditions and their prospects.²⁰

The wage readjustments granted in the first half of 1997, which were necessary in order to make up for part of the accumulated lag and to relieve the heavy cost borne by the population, continued to burden the public finances, which had been stabilized for the moment thanks to the new boom in the oil market. The allocation of part of the extraordinary

²⁰ *Latin American Weekly Report*, 1997b.

resources obtained from that source in order to finance the increase in current expenditure for the wage adjustments shed doubts on the long-term credibility of the fiscal adjustment. In the final analysis, it was still not clear whether Venezuelan society

could definitively leave behind the cyclical fluctuations which have characterized it since the 1970s in line with the variations in oil income, swinging from expansionary phases financed with that income to periods of painful adjustment.

IV

Conclusions

In Venezuela, the drastic reforms undertaken in 1989 affected a population which, because it attached less importance to the macroeconomic imbalances than to the actual conditions of daily life, was not prepared to bear the sacrifices demanded of it, for although those imbalances made the reforms necessary, the deterioration in living conditions was not yet as serious as it would be some years later, so that the shock imposed by the reforms seemed excessive and made the reform process politically inviable. In order to forestall this, it would have been necessary, not to maintain the status quo, but to conceive more imaginative solutions which took account of the social reaction and the balance of forces at the political level.

In 1996, the "opportunity cost" of the reforms was markedly lower, because the population had personally suffered the consequences of other types of policies in the form of inflation and unemployment. Moreover, leaving aside the absolute level of living conditions, the immediate deterioration in those conditions brought about by the reforms was not as drastic as on the previous occasion.

This observation serves to highlight a fact which is apparently obvious but is often neglected or simply ignored, even by the politicians and international financial agencies actually involved in seeking a solution: i.e., the fact that economic reforms do not take place in a vacuum or in a sterile laboratory but in a

concrete social and political context which interacts with the economic content of the measures and affects their viability just as much or even more so than the latter. This element cannot be left out when appraising the viability of economic policies. It makes it necessary to take into account both the objective circumstances being faced by the population of the country and their subjective perception of those circumstances. While this crucial task may not be the responsibility of the average economist, it certainly is the responsibility of a good politician, who is ultimately responsible for all proposed social changes.

Explicit consideration of the "social factor" has thus been assuming increasing importance now that a fuller analysis of the neoliberal experience is beginning to be made in the region. This is recognized in one way or another by multilateral agencies such as the Inter-American Development Bank and has been clearly stated by leading personalities in the region.²¹ Political leaders who still ignore this fact do so at their own risk. In Venezuela, these considerations are of decisive importance for the achievement of a social consensus which will finally make it possible to stabilize the economy around a growth model from which nobody is excluded and which leaves behind forever the fluctuations associated with the oil market cycles.

(Original: Spanish)

Bibliography

- Acuña, C. H. and W. C. Smith (1994): The political economy of structural adjustment: The logic of support and opposition to neoliberal reform, in W. C. Smith, C.H. Acuña and E.A. Gamarra (eds.), *Latin American Political Economy in the Age of Neoliberal Reform: Theoretical and Comparative Perspectives for the 1990's*, New Brunswick, NJ, Transaction Publishers.
- Bottomo, R. (1996): ¿Nuevo comienzo?, *Veneconomía mensual*, vol. 13, No. 7, Caracas, April.

- Bresser, L. C., J. M. Maravall and A. Przeworski (1994): Economic reforms in new democracies: A social-democratic approach, in W. C. Smith, C.H. Acuña and E.A. Gamarra (eds.), *Latin American Political*

²¹ Statements in this sense were made, for example, by the Minister of Finance of Chile when he chaired the October 1996 meetings of the International Monetary Fund and the World Bank.

- Economy in the Age of Neoliberal Reform: Theoretical and Comparative Perspectives for the 1990's*, New Brunswick, NJ, Transaction Publishers.
- Cavarozzi, M. (1994): Politics: A key for the long term in South America, in W. C. Smith, C.H. Acuña and E. A. Gamarra (eds.), *Latin American Political Economy in the Age of Neoliberal Reform: Theoretical and Comparative Perspectives for the 1990's*, New Brunswick, NJ, Transaction Publishers.
- Clairmont, F. F. (1996): *The Rise and Fall of Economic Liberalism*, Penang, Southbound and Third World Network.
- De Janvry, A., A. Fargeix and E. Sadoulet (1991): The political feasibility of rural poverty reduction, *Journal of Development Economics*, vol. 37, Nos. 1 and 2, Amsterdam, The Netherlands, Elsevier Science Publishers, B. V.
- ECLAC (Economic Commission for Latin America and the Caribbean) (1997): *The Equity Gap: Latin America, the Caribbean and the Social Summit*, LC/G. 1954(CONF.86/3), Santiago, Chile, 18 March.
- (several years): *Economic Survey of Latin America and the Caribbean*, Santiago, Chile.
- Gamarra, E. A. (1994): Market-oriented reforms and democratization in Latin America: Challenges of the 1990s, in W.C. Smith, C.H. Acuña and E.A. Gamarra (eds.), *Latin American Political Economy in the Age of Neoliberal Reform: Theoretical and Comparative Perspectives for the 1990's*, New Brunswick, NJ, Transaction Publishers.
- Haggard, S. and R. Kaufman (1992): Institutions and economic adjustment, in S. Haggard and R. Kaufman (eds.), *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts and the State*, Princeton, NJ, Princeton University Press.
- (1995): Estado y reforma económica: la iniciación y consolidación de las políticas de mercado, *Desarrollo Económico*, vol. 35, No. 139, Buenos Aires, Instituto de Desarrollo Económico y Social (IDES).
- Heredia, B. (1994): Making economic reform politically viable: The Mexican experience, *Democracy, Markets and Structural Reform in Latin America*, London, North-South Center.
- Kaufman, R. R., C. Bazdresch and B. Heredia (1993): *The Politics of Economic Reform in Mexico: The Solidarity Pact of 1987-1988*, Papers on Latin America, No. 28, New York, Columbia University, Institute of Latin American and Iberian Studies.
- Keynes, J. M. (1936): *The General Theory of Employment, Interest and Money*, New York, Harcourt, Brace and Company.
- Latin American Weekly Report* (1997a): Is the "Fujimorazo" a dead duck?, London, Latin American Newsletters, 11 February.
- (1997b): London, Latin American Newsletters, 8 July.
- Naim, M. (1993): *Paper Tigers and Minotaurs. The Politics of Venezuela's Economic Reforms*, Washington, D.C., A Carnegie Endowment Book.
- Navarro, M. F. (1995): Democracia y reformas estructurales: explicaciones de la tolerancia popular al ajuste económico, *Desarrollo Económico*, vol. 35, No. 139, October-December.
- Nelson, J. M. (1992): Poverty, equity, and the politics of adjustment, in S. Haggard and R. Kaufman (eds.), *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts and the State*, Princeton, NJ, Princeton University Press.
- Przeworski, A. (1993): *Democracy and the Market. Political and Economic Reforms in Eastern Europe and Latin America*, London, Cambridge University Press.
- Rodrik, D. (1995): Las reformas a la política comercial e industrial en los países en desarrollo: una revisión de las teorías y datos recientes, *Desarrollo Económico*, vol. 35, No. 138, Buenos Aires, IDES.
- (1996): Understanding economic policy reform, *Journal of Economic Literature*, vol. XXXIV, No. 1, Nashville, TN, American Economic Association.
- The Economist Intelligence Unit (1997): *Country Forecasts* (CD-Rom), Latin American Business Intelligence, Oxford, Knight Ridder, 2 May.
- Vacs, A. C. (1994): Convergence and dissension: Democracy, markets, and structural reform in world perspective, in W. C. Smith, C. H. Acuña and E. A. Gamarra (eds.), *Latin American Political Economy in the Age of Neoliberal Reform: Theoretical and Comparative Perspectives for the 1990's*, New Brunswick, NJ, Transaction Publishers.
- Williamson, J. (1990): What Washington means by policy reform, in J. Williamson (ed.), *Latin American Adjustment: How Much Has Happened?*, Washington, D. C., Institute for International Economics (IIE).
- Williamson, J. (ed.) (1994): *The Political Economy of Policy Reform*, Washington, D. C., IIE.