Reversal of Fortune

The Ephemeral Success of Adjustment in Venezuela, 1989–93

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Contents

1. Introduction .................................................................. 1

2. Venezuela Before 1989 ................................................................. 5
   The 1980s: Oil Booms and Economic Mismanagement ............... 5
   The Politics of Economic Mismanagement in an Oil Economy......... 8

3. Initial Conditions and Adjustment Response: How Adjustment and Economic Reform Came to be Both Unavoidable and Embraced by the Pérez Administration ......................................................... 11
   Early Surprises and Expectations Management .......................... 11
   Early Signs of New Directions: From Unavoidable Circumstances to an Economic Reform Program ................................................. 12

4. Early Successes and Critical Shortcomings: The First Three Years .......... 15
   The Stabilization Measures of 1989 .......................................... 15
   Short-Term Economic Impact of the Stabilization Program ............. 16
   Launching Medium-Term Structural Reforms ............................ 17
   "The Great Turnaround" as a Vision ...................................... 19
   Initial Constraints and Subsequent Failures in the Articulation of an Effective Vision . 21
   The Political Economy of Fiscal Reform and the Problems of Medium-Term Stabilization ............................................................. 23

5. Unraveling Political Stability: Antiadjustment’s Political Entrepreneurs and the Triggering Effect of a Coup d’Etat .......................................................... 29

6. The Reform Program Derailed: Is Reform Irreversible? .................... 33
   Ramón J. Velázquez: Reluctant Reform and the End of Coherence ...... 33
   Irreversibility of Reform? ..................................................... 34


Bibliography ............................................................................ 41
Introduction

1.1 This paper will examine the political and institutional determinants of the early success and later derailment of economic reforms following the structural adjustment program put in place by the Venezuelan government in 1989. The focus will be on the effect of governance capacity on adjustment responses, in keeping with the hypothesis that government capacity is a prime determinant of successful economic reform in developing countries (Frischtak 1993). As an analytical category, governance capacity encompasses both the bureaucratic ability to design and implement reform and the leadership and the symbolic capability to build and sustain coalitions that can support reform effectively and sustainably. A crucial component of the effective exercise of leadership is thus the ability to formulate a vision that conveys a sense of the purpose of the reform process—to the population as a whole, or to major groups within the population—so that an adequate public perception of the links between reform and national goals and values can be formed. Attention will also be given to the idiosyncratic characteristics of the Venezuelan polity that may have influenced the results of the process. This paper will not, however, give a detailed factual account of the complex political and economic situation in Venezuela between 1989 and 1993. The level of historic and institutional detail has been kept to the minimum required for an adequate understanding of the general argument by a reader unfamiliar with the country.

1.2 The adjustment program in Venezuela was known for its comprehensive and orthodox nature. It was launched as a response to an acute crisis in both the balance of payments and fiscal accounts, but from the beginning it was designed to address not only the short-term goal of restoring macroeconomic equilibriums, but also to significantly affect the root causes of the distortions. To accomplish this, it was designed to restructure key governmental agencies, privatize state enterprises, liberalize trade, and eliminate subsidies and price controls to all kinds of inputs and products, drastically changing the inward-looking, import-substitution model that had been dominant for three decades and replacing it with an export-oriented economic strategy (see the excellent account in Moisés Naim 1993 for details concerning this and many other aspects of the Venezuelan case).

1.3 The program earned early praise for its fast and thorough implementation. It is perhaps one the clearest examples of shock therapy in adjustment that can be found in the catalogue of recent experiences with adjustment processes in developing countries (World Bank 1993). No allegations of lukewarm commitment or uneven application of policies across sectors
have been raised against those responsible for the design and implementation of the program. The specialized literature has questioned the fast pace of adjustment rather than to complain, as is the case for many programs, about slow and half-hearted advancement of reforms (Hausmann 1995).

1.4 The adjustment process in Venezuela was also unique in several other respects that augment the interest of the Venezuelan experience. It took place in a country with a solid democratic tradition that had proven resilient, even as other countries in the region fell under the rule of authoritarian regimes. It also had a substantial resource base made possible by the oil industry and received significant support from the multilateral banks and other international institutions.

1.5 At some point, however, things started to go wrong. Opposition mounted; key reforms stalled; support for the reform program, never strong, weakened even more. After five years of reform, a massive urban riot, two failed coups d’etat, a president impeached, and an electoral victory by the most conspicuous opponent of economic reforms indicated that something had indeed gone awry with economic reforms, and cast doubt on the continuation of reforms in Venezuela. There is even a risk of a vicious circle of macroeconomic instability and repeated adjustment efforts in ever more adverse conditions.

1.6 One of the striking features of this outcome—and a fundamental contention of this paper—is that it can hardly be attributed to the economic effects of the adjustment program, at least as these are usually assessed by the international community. Positive results came very soon—sooner than expected by the policymakers themselves—in several important areas, including the balance of payments; exchange rate; foreign exchange reserves; export performance; and, above all, growth. Even inflation was being brought under control. In structural reform, trade liberalization; elimination of price and exchange controls and input subsidies; and the termination of financial repression, as well as the restructuring of pivotal public agencies, such as the one in charge of port administration, were well advanced if not completed eighteen months after the program was launched. The privatization program, the reform in the agricultural sector, and the implementation of the social safety net lagged somewhat behind, but they were in progress, and a series of bills had been sent to the Congress to move forward in the field of tax reform and other sensitive areas that required legislative approval.

1.7 Thus, the argument that follows constitutes not an attempt to question the design or technical details of the economic measures taken by the Venezuelan government, but instead places emphasis on an analysis of the conduct of the political process that accompanied the technical side of economic reform. It is argued that the determinants of the political failure and eventual economic reversal of the reform process, in spite of its early success, can be found in the dynamics and institutional aspect of governance capacity; that is, in the institutional weaknesses and symbolic and leadership shortcomings of the Venezuelan state. By the late 1980s, both had reached a critical level, just at the time when they would be most needed, given the necessity of structural adjustment. On the institutional side, bureaucratic capacities to design and implement policies had become severely impaired in the public sector; in symbolic and leadership matters,
the Venezuelan political system was navigating through a major crisis, which made it difficult to build and sustain coalitions that could act as effective supporters of the reform program.

1.8 This paper is organized into six sections. The first provides background information about the development of political and economic conditions in Venezuela prior to the launching of structural reforms. The second depicts the critical economic conditions of 1988 and the circumstances that shaped the campaign message and early policy signals of the Pérez administration. The third, and most extensive, portion describes both the stabilization package and the structural reform program and considers their adequacy and shortcomings in presenting an effective vision, as well as the governance capabilities of the Venezuelan state during the first half of the presidential term; particular attention is paid to the political economy of tax reform. The fourth section goes beyond failures in the effective vision that informed the adjustment response to deal with the organization of opposition to reforms. The fifth part includes a brief review of the fate of reforms under the administration of R. J. Velázquez and the first months of the tenure of Rafael Caldera, with particular reference to whether the economic reforms were as irreversible as originally planned by reformers. The last section is reserved for some general conclusions.

1.9 The essence of the argument is that in the Venezuelan case, an effective vision was not a requirement of short-term restoration of macroeconomic equilibriums, or even of the vigorous implementation of an ambitious structural reform package, but it was indeed needed if the reforms were going to be sustainable in the long run. Even if the failure in sustaining reform can be attributed partially to events not directly related to the nature of the adjustment program, the weak governance capacity exhibited by the Venezuelan state rendered the reform-minded administration defenseless when serious political challenges arose.

1.10 This paper is based on technical reports and recent political and economic analyses of different aspects of the Venezuelan reform process, as well as interviews with privileged witnesses.
Venezuela Before 1989

2.1 By the end of 1988 the Venezuelan economy was in the midst of deep fiscal and external imbalances, which led to the implementation of a drastic stabilization program by the incoming administration of Carlos Andrés Pérez in early 1989. The description and analysis of the political economy of such a program is at the core of this paper. Before detailing both the dimensions of the economic crisis at the time and the adjustment response, however, it is worth considering a set of contextual elements and previous developments that allow for a more adequate perspective on the events of end of the decade.

The 1980s: Oil Booms and Economic Mismanagement

2.2 The Venezuelan economy has been dominated by the oil industry since the beginning of the century. No other economic activity has been comparable in profitability, size, or importance for the financing of governmental activities. Yet one of the paradoxes of the Venezuelan case, as Rodríguez (1991) has emphasized, is that the 1980s were years of economic decline for the country, as they were for the rest of Latin America, although the oil shocks that were such an important factor in the negative performance of the Latin American economies of the time were positive shocks for Venezuela.¹

2.3 The explanation of this paradox can be found in economic mismanagement. The use of extraordinarily high oil revenues to finance a large expansion of state-owned enterprises during the 1970s contributed to create a structural public sector deficit that was not sustainable once the price of oil went down.² Of course, the oil booms could not last forever; this would have been anticipated by more competent or less short-sighted decisionmakers than those in charge at the time. Instead, the Herrera administration decided in 1982 to sustain the overvaluation of the Bolívar, while at the same time keeping interest rates well below the high rates in the United States as the preferred instrument to fight inflation. That this policy was announced and sustained in spite of early and widespread warnings about its consequences

¹ Between 1980 and 1985 the accumulated variation in gross domestic product (GDP) for all Latin American economies was negative. In this context, Venezuela represented a particularly acute case of economic decline, with a -20.8 percent growth over that period, the worst economic performance in the area, with the exception of Bolivia and El Salvador (Haussmann 1992).

² Central government transfers to nonfinancial, state-owned enterprises averaged 3 percent of GDP between 1984 and 1990.
suggests that it is plausible to interpret the behavior of economic policymakers as simple ignorance of the critical technical aspects of their decisions, at least in the short term.\footnote{The most benign interpretation of this key episode in contemporary Venezuelan economic history is that the government had what could be described as difficulties in the timely adaptation of economic policy to changing external circumstances, which in turn could be explained by the good results that “traditional” economic policies had produced for the country over the previous three decades, making it ill-prepared to face sudden changes in the international environment. Hausmann (1992) has argued that by the early 1980s the performance of the Venezuelan economy started to deteriorate as the consequence of a failure to adapt to changing external circumstances that made the exchange rate, public spending, and interest rate rules that had prevailed since the early 1960s obsolete. However, an adequate consideration of the political economy of policy responses in the early 1980s goes beyond the scope of this paper.}

2.4 The consequence was that the Venezuelan economy experienced acute overindebtedness and massive capital flight shortly after receiving extraordinary external transfers from the surge in oil prices that followed the military and political conflict in the Middle East. In 1983 the Venezuelan government found itself unable to sustain the considerably overvalued exchange rate that had prevailed throughout the oil boom of the 1970s and decided to implement gradual devaluation and a multiple exchange rate regime that allocated dollars following a complex administrative procedure ruled by a set of priorities established by the government (Rodríguez 1991; Pacheco 1992).

2.5 These events are still, after more than a decade, the symbols of the beginning of economic hardship and reductions in the standard of living for the Venezuelan population. The multiple exchange rate regime turned into a device well-suited to postponing structural adjustment, as well as a hub of corruption, massive rent-seeking, and huge price distortions. Quite clearly, the traumatic economic events of 1983 would end up costing the party in power, the Christian Democrats (COPEI), the election. The Lusinchi administration (Acción Democrática, or AD), inaugurated in February 1984, took office. The actions of the new administration implied that it either defined its economic policies under the assumption that the country was suffering only a transitory lack of foreign currency, or it was completely unwilling to face the political costs of a structural adjustment process. Adjustment proceeded, of course, but reluctantly and without structural reform. In 1985, after several years of very slow or negative growth, the government launched a public investment stimulus package to be financed by a devaluation—a measure that in Venezuela leads automatically to an improvement in government accounts, because the government, through its ownership of the oil sector, is by far the largest supplier of foreign currency—and a set of marginal adjustments to consumption and corporate income taxes. Thus, public investment went from 7.7 percent to 12 percent of GDP in one year (Pacheco 1992). At the same time, in an attempt to shield the population from the hardships of devaluation-induced inflation, the minimum wage was raised, a compensatory bonus was paid to salaried workers, and price controls were imposed on more than 100 categories of goods.

2.6 In the election year of 1988 the economy grew 5.8 percent, following a year of 3.7 percent growth; unemployment was at 7.3 percent, compared with more than 10 percent only two years before, indicating the success of the stimulus package. The costs, however, were extremely high: the balance of payments exhibited a deficit of 7.8 billion dollars, the fiscal deficit reached
9.4 percent of the GDP, and the Central Bank had lost 4 billion dollars in only one year, leaving the availability or foreign exchange reserves at a critical level (World Bank 1993). In addition, the economy had accumulated acute price distortions. By the end of 1988 and the beginning of 1989 these distortions became apparent with the appearance of generalized shortages of staple foods, while at the same time the governmental agencies in charge of monitoring price controls were borrowing staff from other ministries to cope with the complexity and costliness of controls. The coincidence of the economic and the political cycles in 1988, an election year, created the incentive to stimulate the economy at any cost to maintain the government’s popularity up to the last minute. That goal was achieved, and there was ample incentive to disregard the costs or the negative consequences—they would be the problem of the newly elected administration.

2.7 During the decade-long economic decline there was no shortage of warnings and dissident voices. Roraima, a group of private sector managers and academics, produced a "Proposition to the Country," calling for a reorientation of the economy toward export-oriented activities other than oil and a redefinition of the role of the state to make it less dirigiste, more efficient, and focused on activities other than those already covered by private initiative. The document was formally presented to President Lusinchi, but it was dismissed immediately, without debate or attempt at justification. The Presidential Commission for State Reform (COPRE), a public agency charged with both research and advocacy, produced a comprehensive blueprint for the reform of the economy and public administration during the Lusinchi term in office. COPRE successfully promoted several major political reforms, such as the enactment in 1989 of direct elections for governors and mayors, but never achieved success in influencing economic policies or the role of the public sector in the economy. It is a matter of record (Pacheco 1992) that the Central Bank repeatedly warned the executive about the economic unfeasibility and social costs of the implementation of the stimulus package between 1986 and 1988, but such warnings were systematically ignored by the president and the finance minister. In contrast to the Herrera administration’s behavior, which has been described succinctly as mismanagement, economic policymaking under Lusinchi seems closer to what Drazen (1994) has called "benign neglect": the failure to adjust either because of a sincere belief that "the problem will solve itself," making adjustment unnecessary, even counterproductive (in Venezuela, this translates into the expectation of a sharp new increase in world oil prices, as actually happened in 1973 and 1979), or the use of this same expectation as an excuse for an unwillingness to act.4

4 Several comments attributed to the president at the time by privileged witnesses seem to provide support for the first alternative. The actual behavior of the Lusinchi administration, however, and in particular its willingness to sustain clearly damaging and irresponsible macroeconomic policies to the very end of its term as an instrument for maintaining presidential popularity—a goal that was achieved—seems to suggest a certain dose of political manipulation of the economy more compatible with the second interpretation.
The Politics of Economic Mismanagement in an Oil Economy

2.8 All these economic processes were accompanied by political developments that are worth mentioning to reach a fuller understanding of the conditions surrounding the initiation of stabilization and structural adjustment in 1989. Particularly important is the legitimacy crisis that engulfed the main political institutions of the country: the political parties, central pieces of the whole decisionmaking and implementation structure of the Venezuelan state, were deeply factionalized and in disrepute, primarily because of the widespread perception of corruption that constitutes the common sense explanation of the paradox presented at the beginning of this section.5

2.9 The importance of political parties in Venezuela can hardly be overestimated. They have represented the main instrument of political mobilization and representation during the past thirty-five years, as well as privileged channels for consensus building and interest aggregation. The parties, particularly AD and COPEI, which have alternated in power since the beginning of the democratic regime in 1958, can be considered the architects of the constitutional setting in Venezuela and its main source of support. It is important to take into account that seven orderly presidential elections, including four episodes of clear and legitimate triumph of the main opposition party, is no small achievement in a country plagued by political anarchy and authoritarian governments since it achieved independence.

2.10 The origin of contemporary political stability can be found in a political pact made by the main political parties and endorsed by the private sector, unions, the church, and other major interest groups. All these groups formally signed—and lived by—a commitment to accept election results as legitimate, whatever the results; to make major decisions only with widespread consultation and unanimity; and not to interfere with issues or policies considered vital by any of the parties. The pact granted a de facto veto power over a whole set of possible policies to all those included in the pact (Levine 1973; Karl 1987).

2.11 As universally accepted and formally enshrined in the Constitution of 1961, Venezuela became a democratic nation, with presidential and parliamentary elections every five years. The Constitution granted extensive powers to the executive and little autonomy to state and municipal authorities. Electoral rules allowed for extremely strong influence by party leadership in the determination of who would get elected to the Congress, because citizens could only vote for closed lists of candidates, which in turn led to strict party discipline in parliamentary voting, given that members of the Senate or the lower chamber knew that to be reelected they needed to please the party leaders rather than be responsive to a regional constituency.

2.12 Single majority was the rule for presidential elections—and has remained so, in contrast to several of the original features just described—making possible the victory of the

5 Regardless of how much corruption there actually is in Venezuela, corruption looms large in the public mind, probably as a result of the need to find a plausible explanation for what is perceived as the coexistence of substantial national wealth—in the form of oil—and continued economic decline.
largest of a set of minorities. This actually occurred several times, particularly in the elections of 1963 and 1968. After a highly fractionalized beginning, however, AD and COPEI eventually became the dominant forces in the political system (Kornblith and Levine 1994), systematically winning elections and capturing a large majority of congressional votes, as table 1 illustrates.

Table 1: National Electoral Results, 1958-88

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<td>Presidency</td>
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<tr>
<td>AD</td>
<td>49.18</td>
<td>32.81</td>
<td>28.24</td>
<td>48.70</td>
<td>43.71</td>
<td>56.72</td>
<td>52.91</td>
</tr>
<tr>
<td>COPEI</td>
<td>16.21</td>
<td>20.18</td>
<td>29.13</td>
<td>36.70</td>
<td>46.64</td>
<td>34.54</td>
<td>40.42</td>
</tr>
<tr>
<td>Other</td>
<td>34.61</td>
<td>43.02</td>
<td>42.63</td>
<td>12.40</td>
<td>7.99</td>
<td>7.51</td>
<td>4.43</td>
</tr>
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<td>Congress</td>
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<tr>
<td>AD</td>
<td>49.45</td>
<td>32.77</td>
<td>25.55</td>
<td>44.44</td>
<td>39.68</td>
<td>49.95</td>
<td>43.26</td>
</tr>
<tr>
<td>COPEI</td>
<td>15.20</td>
<td>20.86</td>
<td>24.03</td>
<td>30.24</td>
<td>39.81</td>
<td>28.71</td>
<td>31.12</td>
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<tr>
<td>Other</td>
<td>35.35</td>
<td>46.37</td>
<td>50.42</td>
<td>25.32</td>
<td>20.51</td>
<td>21.34</td>
<td>25.62</td>
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Notes:
Figures in bold indicate winner of the election.

2.13 For all its stability, in time serious problems arose in the structure and functioning of the political system. Several observers and scholars had warned from the beginning of the 1980s that the pact at the root of Venezuelan democracy had become exhausted (Naim and Piñango 1984; Romero 1986; Rey 1988). Both AD and COPEI shared responsibility for the economic mismanagement that has been reported above, and in the process lost ever-growing groups of voters and became rigid and somewhat dated political organizations. At the same time, neither these nor any other significant political party openly advocated a significant reorientation of public policy, away from the traditional, import-substituting, inward-looking model and in favor of a more open, export-oriented economy led by the private sector. The most exciting leadership offering to the Venezuelan citizen in 1988 was a former president, Carlos Andrés Pérez, firmly linked in the public memory to the years of prosperity brought by the oil boom of 1974.

2.14 In the meantime, the state bureaucracy, the public institutions that are the core of the ability of any government to effectively regulate public activities and provide social services and infrastructure, became captured and extremely inefficient. In a well-known pattern of institutional capture in developing countries (Paul 1991), the education, health, transportation, social security, communications, water, and even tax administration bureaucracies turned into

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6 Strong criticism and detachment with respect to political parties is one of the outstanding characteristics of contemporary politics in Venezuela. According to a recent study by the Consejo Supremo Electoral, the top-level authority in Venezuelan elections, adding up militants and sympathizers of political parties, they reached only 25.3 percent of the adult population in 1990, down from 38.4 percent in 1983 and 48.7 percent in 1973. In March 1992, 48 percent of the urban voting population answered “none” to the question: "Which is the party whose ideas concerning how this country should be governed do you agree the most with?" The same figure in 1984 was 24 percent. For a detailed commentary of these and related facts see Navarro 1995.
ineffective organizations. They lost their ability to respond to problems and challenges, and sometimes even to deliver the services they were routinely used to produce, all at a time when they demanded significant resources and evolved into union-controlled operations at the service of their workers rather than the public. The unusual financial strength of the Venezuelan public sector made possible the development of these distortions to a degree uncommon in other countries, where the citizens enjoy less of a fiscal illusion than they do in Venezuela. The traditional financing of the public sector by taxes on the oil industry has meant that decisions to increase public expenditures have no direct relationship with tax increases, which are clearly perceived by the average citizen, thus decreasing the incentives to demand accountability from political representatives and public sector managers.

2.15 Such distortions were not unrelated to party dominance and the resulting generalized alienation from the main political institutions. On the contrary, they must be understood as a coherent pattern of political arrangements in which the strong party dominance built into the working of the political system was the main foundation of its stability, as well as the origin of generalized clientelism, public sector overextension, and interest group capture, all of which led, by the mid-1980s, to a major legitimacy crisis.\footnote{The expression "legitimacy crisis" is intended to imply that distrust in government and the major political institutions particularly political parties, the presidency, the Congress, and the judicial system had reached acute levels and was widespread among citizens by the late 1980s. It is assumed in this paper that in such an environment, the search for political support and the very foundation of the capacity of any government to earn support and build coalitions face particularly difficult challenges. In the language of the recent developments of the economics of organization, we could trace a parallel between this kind of generalized lack of confidence in the workings of government by citizens and the inefficiencies that arise in an organization in which a minimum degree of trust in the sound exercise of authority ceases to exist (Kreps 1992).}
Initial Conditions and Adjustment Response: How Adjustment and Economic Reform Came to be Both Unavoidable and Embraced by the Pérez Administration

Early Surprises and Expectations Management

3.1 The macroeconomic imbalances created in the last years of the Lusinchi administration were large enough to become apparent by early 1989. On February 27, less than a month after the new administration had taken office—and before it actually implemented the stabilization package—large urban riots and widespread vandalism erupted in Caracas and other major cities. Triggered by a sharp rise in public transportation fees in a Caracas suburb, and magnified by early reports broadcast by all major TV and radio stations, the population in many poor neighborhoods and even some middle-class areas went on a violent rampage, looting shops, disregarding ineffective police responses, and arguably reacting to months of high uncertainty, food shortages, and anticipation of hard austerity measures. Order was restored only after army deployment and violent repression. In what time would prove to be a very influential event, the honeymoon with an administration elected with over 50 percent of the voting population had come to an unexpectedly early and violent end.

3.2 To the credit of the administration, the riots did not prevent the launching of the adjustment program and the initiation of comprehensive structural reforms. Before briefly reviewing these, however, it should be noted that the population was hardly prepared for the austerity measures that are the essence of a stabilization package. The previous administration had concealed the sharp deterioration of macroeconomic conditions, even to the presidential candidate of its own party, who would eventually win the election. It has already been said that food shortages had become widespread in the early days of 1989, and that price repression was becoming unsustainable. It can be argued that the economy was on the verge of very high inflation if not hyperinflation: during late 1988 and the first two months of 1989 inflation reached 4 percent monthly, in spite of severe and generalized price controls. The new administration took office just in time to intervene, making what was one of the largest social benefits of the stabilization package—avoiding a significant inflationary episode—a counterfactual
that the new government would not be able to translate into political support for reforms in the years to come.

3.3 In addition, neither the public persona of Carlos Andrés Pérez nor, for the most part, his explicit campaign message indicated that his administration would adopt structural reforms in line with the so-called "Washington consensus." His first tenure had been marked by the oil boom of the early 1970s, and the consequent huge increase of state involvement in the economy. For most Venezuelans, Pérez was the father of the entrepreneurial state, of the steel and oil nationalizations, a leader implicitly or explicitly associated with high public spending and a unique rise in standards of living for all Venezuelans. During his presidential campaign, he reinforced this reputation, giving scarcely any clue of a change in either his economic orientation or intentions: he called the IMF the "neutron bomb" for developing countries, and openly praised the populist economic program of his close friend Alan García in Perú. In addition, Pérez belonged to Acción Democrática, a political party well-known for its advocacy of strong state interventionism, firmly linked to union power and other pro-dirigisme lobbies, and the party of Jaime Lusinchi, whose government had been anything but sympathetic to the functioning of market forces.

3.4 All this is relevant because it suggests that, whatever the benefits of the liberalization policies to be undertaken by the Pérez administration, the Venezuelans did not vote for them. They elected a charismatic leader associated with abundance, paternalism, and state interventionism who belonged to a social-democratic political party that had been the main force behind the development of the Venezuelan entrepreneurial and overextended state. When the Venezuelan citizens faced an adjustment program and liberalization policies, they had to be surprised. Very little in either their political culture or in the electoral process had prepared them for what was happening.

Early Signs of New Directions: From Unavoidable Circumstances to an Economic Reform Program

3.5 Perhaps the first signal of the kind of policies to be adopted by the new administration was the composition of the newly appointed cabinet of Carlos Andrés Pérez. Pivotal positions in economic policymaking—the planning and the development ministries in particular—were now in hands of people with predominantly academic or private sector

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8 Several economists who had the opportunity to talk to Carlos Andrés Pérez just a few months before the elections have reported the authenticity of such populist views about the economy. It is a matter of pending historical research to determine exactly when and how Pérez would change his mind and become firmly committed to liberalization and pro-market reforms. For the purposes of this paper, however, it is enough to take into account both the role of his previous economic reputation as a populist in the evolution of public expectations concerning the eventual orientation of his administration and the fact that he actually, and from the very first day in office, launched comprehensive pro-market reforms that went far beyond the minimum adjustment required to reduce external and fiscal imbalances. For more on this issue, see Naim 1993.
backgrounds and little or no party affiliation. Even this signal, however, was not entirely clear, because the crucial position in the Ministry of Public Finance and other important appointments were put in the hands of people affiliated with the party and with a much more interventionist and mainstream Venezuelan economic stance—doubtless an attempt by the president to secure AD’s support.

3.6 Another early signal was the willingness exhibited by the economic team to look for cooperation and support from international organizations. Depletion of foreign exchange reserves required IMF support, and an ambitious structural reform program could obviously benefit from World Bank and Inter-American Development Bank (IDB) support. At the time, however, Venezuela had been isolated from multilateral cooperation since the early 1970s, a result of the oil bonanza, so this kind of support, in the context of an emerging "Washington consensus," was quite a novelty in the management of economic policy in Venezuela.

3.7 The growing influence of the economic team on presidential decisionmaking, the pressure of economic imbalances, and the influence of international organizations would quickly combine to produce a structural reform program that would go beyond short-term stabilization goals to constitute a whole new reform program to be proposed to the country.

9 The separation of party officials and technically oriented ministers with no party affiliation constitutes a characteristic of adjustment response in Venezuela that contrasts with several other cases, notably the Mexican experience, where the PRI structure somehow incubated a highly qualified new leadership that was eventually charged with the design and implementation of structural reforms. It is difficult to ascertain whether this factor is decisive for the political feasibility of reforms, but in Venezuela it certainly undermined the reform process by weakening the stance of the economic team and making difficult the process of disseminating and explaining the new economic orientation to the population. For a recent review of the political economy of policy reform that deals extensively with the issue of the role of technocrats, see Williamson 1994.
Early Successes and Critical Shortcomings:  
The First Three Years

The Stabilization Measures of 1989

4.1 The acute macroeconomic imbalances faced by the new administration generated an adjustment response that can be properly labeled "shock therapy." Clearly the most important element of a plan would have to be a sharp devaluation, because the exchange rate applicable to most transactions—the multiple exchange rate created at the end of the Herrera administration remained in place with few changes—had been nominally fixed at Bs.14.50 per U.S. dollar since 1986. Indeed, in March of 1989 the exchange rate was unified and left free to float; all exchange controls were abolished.\(^\text{10}\) In addition, financial and price repression were simultaneously eliminated by lifting price controls and liberalizing interest rates, which jumped from 13 percent to around 35 percent. On the fiscal side, the central government brought its investment almost to a complete halt. It dropped from 3.2 percent of GDP in 1988 to 0.1 percent in 1989, and if current expenditures increased moderately, it was an effect of devaluation on external debt service rather than an increase in domestic expenditures, which remained unchanged (World Bank 1993).

4.2 An important part of fiscal policy during adjustment in Venezuela has to do with the translation of a devaluation into an increase in the PDVSA (the state-owned petroleum holding company) surplus in Bolívares, which flow directly through taxes into increased budgetary revenues for the government. Thus, between 1988 and 1989 the government revenue from the PDVSA surplus rose from 11.4 percent of GDP to 20.5 percent, mainly because of the sharp nominal devaluation. This increase in revenues generously compensated for the recession-induced reduction in tax receipts for 1989, substantially contributing to the almost equilibrated fiscal stance of that year after the large deficit of 1988.

4.3 Related stabilization measures included a renegotiation of the Central Bank exchange rate guarantees on private import letters of credit and payments of private external debt

\(^\text{10}\) The exchange rate reached Bs. 39 per U.S. dollar less than one month after the elimination of controls. By the end of 1989, it had reached 43 Bs. per U.S. dollar. Such a nominal devaluation brought a real devaluation of some significance, which was gradually compensated in the following four years.
that reduced their burden from 10 to 4 percent of GDP, and the beginning of negotiations with international creditors to restructure the external debt of the public sector under the Brady Plan umbrella. Substantial support for the stabilization program was obtained from the IMF, the World Bank, and the IDB.

**Short-Term Economic Impact of the Stabilization Program**

4.4 The success of a stabilization program is usually judged by its effectiveness in deficit reduction, restoration of external equilibrium, and inflation control. On all these counts, the Venezuelan program of 1989 was an almost unqualified success. The fiscal deficit went down from 9.4 percent of the GDP in 1988 to 1.1 percent in 1989, and then to a surplus in 1990. The balance of payments exhibited a positive and drastic turnaround, particularly the current account, and reserve accumulation started at a fast pace, reaching $12.5 billion in 1990. Price liberalization and a 140 percent devaluation created a price shock in the second quarter of 1989, contributing to an 80 percent rate of inflation for that year, but from October onward the monthly rate of inflation was about half the prevailing rate in January and February. Table 2 contains information concerning the evolution of the main macroeconomic indicators in the years directly relevant to evaluating the short-term impact of the stabilization program of 1989.

4.5 In 1989 the GDP registered negative growth of 8.6 percent overall, and even greater negative growth in several important sectors, such as manufacturing and construction. Unemployment jumped from 7.3 to 9.6 percent and real salaries fell by 9 percent. All this created an immediate increase in the poverty counts, which led the government to attempt to construct a social safety net to compensate for the social effects of adjustment. Nevertheless, given the low implementation capabilities of line ministries in the social area and the highly inefficient instruments that had been used to advance income redistribution, brand new, targeted antipoverty programs had to be designed and put in place, which delayed the beginning of compensation until at least seven months after the launching of the bulk of the stabilization program in March. Here, as we shall see repeated in other instances, the institutional and technical weaknesses of the Venezuelan state prevented the reformers from compensating the short-term losers of adjustment in a timely manner. After the initial delay, however, quite significant compensation would proceed.¹¹

4.6 In spite of the initial difficulties, the short-term negative impacts of adjustment were rapidly reversed. Vigorous growth would resume, reaching 6.4 percent in 1990 and 10.4 percent in 1991. Unemployment would fall slowly but consistently until 1992, and poverty indicators showed some improvement in 1991 (Márquez 1993). In addition, international reserves kept growing. Nevertheless, the most visible indication that potentially serious medium-

¹¹ The PEP (Programa de Enfrentamiento a la Pobreza), initiated by late 1989, soon reached a dimension comparable to the Mexican Programa Nacional de Solidaridad in spending per capita. The Mexican program was generally believed to be a model social welfare program, and one of the key components of the political feasibility of the structural reforms undertaken by the Mexican government. For details, see Márquez 1993 and Navarro 1994.
term stabilization problems remained was the persistent level of inflation, slightly above 30 percent. This, however, leads directly to the fiscal dynamics of the Venezuelan adjustment response that will receive a separate treatment below.

### Table 2: Evolution of the Main Macroeconomic Variables

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>GNP growth (percent)</td>
<td>3.7</td>
<td>5.8</td>
<td>-8.6</td>
<td>6.4</td>
<td>10.4</td>
<td>7.0</td>
<td>-1.0</td>
</tr>
<tr>
<td>Government deficit (percent of GDP)</td>
<td>-4.4</td>
<td>-9.4</td>
<td>-1.1</td>
<td>0.2</td>
<td>1.1</td>
<td>-2.7</td>
<td>-3.5</td>
</tr>
<tr>
<td>Current account (US$ million)</td>
<td>-1,391</td>
<td>-5,809</td>
<td>2,161</td>
<td>7,961</td>
<td>1,055</td>
<td>-2,000</td>
<td>-1,815</td>
</tr>
<tr>
<td>Capital account (US$ million)</td>
<td>707</td>
<td>-2,011</td>
<td>-5,266</td>
<td>-2,883</td>
<td>3,019</td>
<td>2,822</td>
<td>1,329</td>
</tr>
<tr>
<td>Exchange reserves (US$ billion)</td>
<td>10.9</td>
<td>7.1</td>
<td>8.1</td>
<td>12.5</td>
<td>14.4</td>
<td>13.0</td>
<td>12.3</td>
</tr>
<tr>
<td>Inflation (percent)</td>
<td>40.3</td>
<td>35.5</td>
<td>81.0</td>
<td>36.5</td>
<td>31.0</td>
<td>31.9</td>
<td>45.9</td>
</tr>
<tr>
<td>Unemployment (percent)</td>
<td>9</td>
<td>7.3</td>
<td>9.6</td>
<td>9.9</td>
<td>8.8</td>
<td>7.5</td>
<td>8.7</td>
</tr>
</tbody>
</table>

Source: Banco Central de Venezuela.

### Launching Medium-Term Structural Reforms

Almost simultaneously with the implementation of the stabilization package, the Pérez administration decided to launch an ambitious structural reform program. It would take the opportunity created by the correction of the deep distortions caused by the mismanagement of the previous administrations and eliminate what the president and his closest economic advisers judged to be the root causes of such distortions: the inward-oriented import substitution model of development and its correspondent interventionist and overgrown state apparatus. The economy of the country was so thoroughly organized along interventionist lines that almost every aspect of governmental activities required profound changes. Not surprisingly, the VIII National Plan, written by representatives of the highly technical economic team, was named "The Big Turnaround." A partial list of the reforms undertaken during the Pérez administration between February 1989 and May 1993, when the president was demoted by Congress after a Supreme Court ruling that there was sufficient evidence to indict Pérez for corruption, includes the following (Naim 1993; Torres 1993; World Bank 1993).

- **Foreign trade regime.** Called by experts "one of the most distorted commercial policies in the world," the foreign trade regime was drastically reformed, eliminating all quantitative restrictions. The administration immediately eliminated licenses and prohibitions on 1,900 items accounting for 77 percent of manufactured imports and significantly lowering tariffs between mid-1989, when the maximum tariff reached 135 percent, and 1992, when 20 percent was the highest operating tariff. In spite of widespread fears that this would have devastating effects on local industry, the compensating effect of devaluation

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12 This is generally believed to be an extremely fast trade liberalization process, which in three years accomplished what international standards normally assume would take seven years.
generally offset the effect of liberalization and the large majority of industrial sectors either improved or maintained their previous performance and profitability, once the impact of the 1989 recession had faded (IDB 1992).

• **Foreign investment regime.** By January 1990 all restrictions to foreign investment were eliminated, with the exception of the oil, mining, and banking sectors.

• **Privatization.** After a slow start, privatization took a big leap forward with the privatization of the telephone company, CANTV, 40 percent of which was sold by the end of 1991 for US$1,880. A major airline and several minor state enterprises and assets, such as banks and miscellaneous factories, were also sold. A well-defined privatization schedule was assembled showing the time and conditions for the sale of hotels and electric companies.

• **Public sector restructuring.** Several public agencies were reformed, either to make them more efficient or to create the conditions for later privatization. The INP, in charge of managing the seaports, was restructured and privatized in 1991, the water holding company was decentralized, the institute in charge of building public housing was restructured, and so forth.

• **Social sector reform.** Although it never tackled the issue of reforming the agencies in charge of social policies, the administration developed a pattern of new project implementation units devoted to the management of entirely new compensatory programs: direct cash subsidies, safe motherhood and nutrition, school construction, microenterprise support, urban infrastructure for poor areas, and the like.

• **Financial sector reform.** Laws to improve the regulatory framework for banking and capital market activities were finally approved under the provisional government of R. J. Velázquez in 1993, but they were prepared and introduced in mid-1992.

• **Institutional reforms in fiscal and monetary policy.** A new Central Bank law aimed at substantially reinforcing its independence from the executive was passed by the end of 1992 at the initiative of the administration. A new Public Credit Law was also passed, setting strict limits on the power of Congress to authorize additional expenditures after approving the yearly Budget Law.

• **Institutional reforms in the price mechanism and competition.** New anti-trust and anti-dumping laws were enacted in 1992 and corresponding agencies were created and staffed, and were in operation by the end of that year. The existing Law for the Protection of Consumers was abolished, and the agency in charge of enforcing it was turned into an Institute or Consumer Education, which had no significant price-fixing authority.

• **Energy sector.** Apart from planned privatizations, CADAFE, the largest public electric company, started a restructuring process, and electricity rates were raised
to put them in line with long-term marginal costs. Gasoline prices were gradually raised in 1991 following a previously announced schedule.\textsuperscript{13}

- **Agriculture.** A sector that had experienced much intervention, agriculture was widely liberalized, with the elimination of trade restrictions, input subsidies, and price controls. There was strong public investment in infrastructure and the Agricultural Ministry was restructured.

- **Tax reform.** A comprehensive reform attempt was launched initially in 1991, without much success (the next section will provide details).

4.8 This impressive list of achievements can be in part be explained by the extensive powers of the presidency in Venezuela, which allow for substantial reforms to be implemented by the executive without much formal approval by either the Congress or other levels of government. Other factors, such as the relative absence of organized opposition and the generous compensation paid to unionized public sector workers are elaborated below.

**"The Great Turnaround" as a Vision**

4.9 The first thing that can be said of such a reform agenda is that it was highly coherent and comprehensive: almost every sector of governmental action was touched by reformist aims or actions, and this generally happened in a way that was consistent with the rest of the reforms. The common orientation of reforms was clearly to turn the economy into a competitive, export-oriented structure with much less intervention, with the public sector becoming much more of a liberal state concentrated in market failure correction and direct redistributive actions. It goes without saying that such an orientation entailed a drastic departure from the direction in which the economy and the public sector were traditionally headed in Venezuela.

4.10 Given these characteristics—coherence, comprehensiveness, and novelty—it can be argued that, beyond stabilization, the structural adjustment program of the Pérez administration looked at first like a whole new vision concerning the future of the country and the way in which state-society relations would be organized in that future. It can be deduced from observation of the reformist drive and the analysis of its official synthesis—the VIIIth National Plan, that Venezuela was to become a market-oriented economy, integrated with the world not only through oil exports, but also through a set of internationally competitive industries. A smaller and stronger state apparatus would be devoted to regulating private sector activity, but not to

\textsuperscript{13} Gasoline prices are a particularly sensitive issue in Venezuela given the existence of a strong and widespread belief that Venezuelan citizens are entitled to cheap gasoline because the country is abundantly endowed with oil. It has been found that the gasoline subsidy is an extremely regressive subsidy: for every Bolívar that goes to a person in the lowest quartile of the population, four Bolívars go to a person in the highest quartile (Rigobón 1992). Still, the matter has proved to be literally impossible to handle politically in recent years, and the Pérez administration achieved some success in reducing the subsidy only for a short period of time and by adopting a very gradual price increase schedule.
replacing it, and with public sector activity oriented to investment in public infrastructure and social services.

4.11 Yet, for the most part, this was the vision of the small group of highly qualified economists and managers that surrounded the president, and the vision of the president himself. Regardless of his radically different stance on economic policy during the campaign and his first term as president, Carlos Andrés Pérez would become a staunch supporter of reforms, and would remain so even under the most difficult political circumstances. Nevertheless, no organized political force supported the program: not a single party or political movement of significance in Venezuela has embraced a market-oriented economy openly as a guiding principle of its ideological platform. The closest case is COPEI, which does so rather mildly and, having lost the election in 1988, could hardly expose itself as the main supporter of the government.

4.12 Even AD, the president's party, did very little to provide congressional help when it was needed.14 Many of its leaders openly distanced themselves from what Pérez was trying to do, and the party members who were appointed as cabinet members were, generally speaking, the less enthusiastic advocates of reforms. In order to understand this, it is important to take into account that Pérez had won the nomination after a bitter internal battle that left AD far from united in its support of the party's official candidate to the presidency. Almost all positions of authority within the party at the time were in the hands of party officials who had been opposed to the Pérez nomination, and that would remain so even after the official announcement of his candidacy. Above all, however, it can be argued that the most powerful cause of AD's lack of support for the economic reform program was ideological: they saw the increasing room given to market forces by the Pérez policies as incompatible with the social democrat and interventionist ideological tradition of the party.15

4.13 Organized interest groups and influential social sectors also provided little support. At least as many businessmen were pleased by price deregulation as became alienated by the termination of protection and subsidies. Trade liberalization was begun with far less interest group opposition than expected, yet this does not necessarily mean that it received open support from the private sector or any other social group. Given the immediate unpopularity of the reforms, illustrated by the events of February 27, it could be observed that even managerial groups ideologically committed to pro-market reforms were silent. This may perhaps be understood as a prisoner dilemma paradigm: they may very well have hoped to benefit from policy reforms without suffering the political costs of openly supporting an unpopular program. A new potential constituency that could have supported the reforms were export-oriented

14 AD's behavior in Congress during the Pérez administration was formally supportive of the administration, in the sense that it never declared itself openly as an opposition force, but in practice it provided only lukewarm support or no support at all to several key initiatives, such as tax reform. It could have been a major factor in supporting reforms, because it had the largest minority in Congress, only a few votes from absolute majority.

15 The introduction of ideology as an explanatory variable at this point of the argument may look at first like an ad hoc device to fill a gap in the main line of reasoning. The author would prefer to interpret it as a fully integrated part of the argument, on the lines suggested by North: "Ideas and ideologies matter. . . . Ideas and ideologies shape the subjective mental constructs that individuals use to interpret the world around them and make choices" (1990, p. 111).
entrepreneurs, but this group did not emerge forcefully, probably because of a lack of time and the absence of direct actions by the administration to encourage them.

4.14 In any case, the weakness—a result of the legitimacy crisis—of the major and traditional channels of interest articulation, the political parties, made the whole process of exercising political influence extremely confusing and badly structured. Direct action by groups of the population, such as street demonstrations, and the direct and often unpredictable reactions of mass media to political and economic circumstances became the dominant forces in day-to-day politics. Surpassing the orderly and clearly identifiable interest groups, these would be the forces that would become dominant in the political dynamics that were about to engulf the Pérez administration and its reform program.

**Initial Constraints and Subsequent Failures in the Articulation of an Effective Vision**

4.15 "The Great Turnaround" represented a vision, yet it was probably so fragmented in many important respects that it can hardly be called an effective vision. As has just been illustrated, it could count in its favor ideological coherence, able design, a highly competent economic team, and strong presidential commitment. To this it might be added that, as the core of a new national project, it had a natural connection to contemporary developments in the international environment, such as the global tendency toward free trade and competitiveness, and it was consequently supported by multilateral organizations. Nevertheless, major constraints in the formulation and implementation of an effective vision were present.

4.16 Several of these constraints have already been mentioned: the complete unpreparedness of the population for the new policy orientation, given the contrasting nature of such orientation, and the legitimacy crisis that affected the political system, political parties in particular. There were other constraints: to the collective action problem that has been hypothesized to have affected even potential supporters of reforms, an information problem has to be added (Seabright 1994). The departure from traditional, long-standing, and well-known patterns of economic and governmental organization was surely going to generate uncertainty among individuals, firms, and organized interests concerning their role in the reform process and its end result.

4.17 Even if the administration's claim that the new vision would improve social welfare could be taken at face value—quite a leap in a country with a political culture filled with deep distrust of the potential of free markets to achieve socially valuable goals—the radical innovations of the reform programs were a source of uncertainty. This uncertainty included the new economic role, social identity, and the welfare of each individual, particularly once the new economic orientation was put in place. It created a situation in which an inefficient equilibrium prevails in spite of the realization of the potential gains of social cooperation (Mueller 1983).

4.18 In addition, it was at least reasonable for the public to think that the reform effort would become another short-term shift in public policy rather than a strategic turnaround. The
public sector had earned this lack of faith, given the erratic macroeconomic management that had occurred over the previous decade. The administration did the best it could to combat this attitude. It took all available steps to reassure the private sector that the new policies were here to stay and that few or no deviations would be attempted or tolerated. The case of trade reform is paradigmatic in this respect: the drastic reduction in trade barriers was carried out across the board and relatively quickly, on the assumption that granting exceptions to a particular sector or proceeding too gradually would unleash a wave of rent-seeking that the institutionally weak and captured Venezuelan state would not be able to resist.

4.19 This instance is also revealing of one of the initial conditions of the reform process that created restrictions to the advancement of the program: the weak technical capacities of the public bureaucracy. By the time a professional and capable public service was needed for the new and complex policies that were being designed and implemented, public agencies in Venezuela, with very few exceptions, were extremely rigid organizations that had lost relevant technical skills. They functioned for the most part as textbook examples of capture, paralyzed and distorted by excessive union power and the extended practice of patronage politics. Not much could be expected in the way of professional management from such agencies as the Development, Public Finance, Agriculture, Social Welfare, Education or Health ministries. This led the administration to adopt a managerial strategy based on what can be called "institutional bypassing" (Navarro 1994); that is, the attempt, not always successful, to ignore the line bureaucracy that was supposed to deal with a given problem or program, and to create of a new and parallel administration of highly qualified and well-paid personnel, able to effectively run the new policies.

4.20 In this connection, it must be observed that one of the reforms not attempted by the Pérez administration was civil service reform. Special ad hoc design and implementation units were set up in many sectors, often in close cooperation with multilateral organizations, but traditional bureaucracies were left untouched in the name of expediency, but also in what can easily be described as a deliberate attempt to avoid conflict with public sector unions. The reform program wanted to change the way the state functioned, yet it did not directly challenge the core of the economic organization and the politics of public bureaucracies. The balance between the need for fast results and substantial reforms was lost in favor of expediency and, it can be argued, political stability.\textsuperscript{16}

4.21 To this set of quite formidable initial constraints, the administration added its share of mistakes and limitations. As previously noted, the reputation and the outstanding campaign message of the president did little to counterbalance the unpreparedness of the population for a major turnaround of public policy. This failure would hobble the administration

\textsuperscript{16} Naím (1993) contends that the decision not to affect the interests of the education, public health, and social security unions was explicitly made by the administration to avoid any further weakening of the already reduced political base of the government. It is, of course, a matter of debate whether this decision actually enhanced the political feasibility of the reform process by avoiding confrontation with extremely powerful groups, or undermined the reform effort: first, creating easily perceived inconsistencies in the reform program and, second, by preventing the administration from using highly visible channels for the improvement of the social conditions of the population.
to its very end, and it has been widely recognized, even by top-level officials of the administration, that the failure to mount an effective communications policy, able to facilitate the acceptance of the reform program, was one of the major shortcomings of its implementation. Given the informational problems implicit in any reform attempt, poor handling of communications by the administration compounded the substantial transaction costs already attached to the implementation of the structural reforms.

4.22 It could be argued, however, that the problem goes even deeper than communication failure, at least as it is usually understood. In sharp contrast with the administration's high degree of intellectual sophistication and the coherence of the economic program, the political message never received a comparable degree of elaboration, which was needed to transform the mainstream orientation of the country through a political message that connected with the values, hopes, and language of Venezuelan citizens. The symbolic components of a vision are crucial to the conveyance of the acceptability of short-term losses as a necessary step to obtain corresponding gains at a later stage, and these components were extremely weak in the political discourse of the administration, if they were present at all.

4.23 This symbolic failure can be seen in a number of arenas. One that is particularly salient is the lack of perception of fairness in the sacrifices that the adjustment process required from different groups of the population, a crucial component of successful reform programs according to the literature (Nelson 1988). It has been mentioned that the development of a social safety net to compensate for the short-term social costs of adjustment was included in the reform package. With some delay, the administration would end up with the best organized and financed social welfare policy in the memory of the country, yet it is curious that the president and his cabinet were unable to extract political benefits from its creation. In contrast to the political support that emergency social programs have produced for reformist administrations in cases such as Salinas' Solidarity Program in Mexico or Paz Estensoro's Emergency Social Fund in Bolivia, the huge effort and talent invested and the overall good results obtained by the Venezuelan Plan de Enfrentamiento a la Pobreza were not able to prevent the perception that the administration was blind to equity issues. The problem was not that there was little concern for compensation for the poor, but rather that the administration proved itself unable to draw significant political support from its commitment to social policy. Other kinds of measures that have been powerful symbols to the population that even the privileged had been forced to make their share of the sacrifices—the perception in the stabilization program in Brazil that freezing bank deposits had been uniformly harmful for all social strata, the prosecution of powerful union leaders or businessmen in México—were absent or went unnoticed in the Venezuelan case.

The Political Economy of Fiscal Reform and the Problems of Medium-Term Stabilization

4.24 Beyond short-term successes, medium-term stabilization problems persisted; the control of inflation was the most important. After stopping the acceleration of inflation in 1989, and possibly preventing hyperinflation, the economy experienced rates of inflation a little above
30 percent in 1990, 1991, and 1992. Several factors contributed to this, but the most important was doubtless the persistence of the structural fiscal deficit caused by a chronically inadequate tax system. Venezuela is one of the countries of the world with the lowest fiscal revenues in relation to the size of the economy, about 5 percent of GDP, once one excludes taxes on the PDVSA surplus. Even though oil reserves and production potential have been on the rise over the last decade, the adequacy of taxes on oil to finance public expenditure has been gradually but significantly reduced by the fall in oil prices in the international market, as it can be appreciated in table 3. Coupled with the growing needs of the economy, this has led to a substantial gap between revenues and expenditure.

Table 3: Fiscal Revenues per Capita
(real 1991 U.S. dollars)

<table>
<thead>
<tr>
<th>Category</th>
<th>1981</th>
<th>1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-oil tax collection per capita</td>
<td>234.3</td>
<td>37.7</td>
</tr>
<tr>
<td>Oil tax collection per capita</td>
<td>1,693</td>
<td>485</td>
</tr>
</tbody>
</table>


4.25 Restrictive macroeconomic policies in 1989 led to a reduction in the fiscal deficit from 9 percent of GDP in 1988 to 1.1 percent. The budget surplus of 0.2 percent of GDP in 1990 that appears in table 2, however, hides the important fact that this figure includes the effect of a substantial rise in the dollar value of oil exports as a consequence of the rise in the price of oil that accompanied the Iraqi invasion of Kuwait. If this effect is taken out, a budget deficit of 3 percent of GDP emerges, which was the combined result of an increase in public investment on the order of 2 percent of GDP and a 10 percent appreciation of the exchange rate. Table 4 allows for a better appreciation of the main components of fiscal accounts in the years under consideration; it focuses on the structural fiscal deficit by excluding extraordinary revenues.

4.26 It was unreasonable to expect that the rise in oil prices would continue, but it is not difficult to understand the temptation that windfall revenues represented for an administration hard-pressed to accommodate political demands in the midst of an adjustment process. In any case, top-level decisionmakers contend that the public expenditure levels of 1990 and 1991 were thought to be sustainable once the comprehensive tax reform initiated by the administration in 1990 passed Congress. In the short term, however, the decision to increase public expenditures in 1990 at the very least seems to imply that reducing inflation below the 30 percent annual threshold was not considered a top priority. Throughout the administration’s term, the combination of exchange liberalization and inflationary pressures on the fiscal side would increasingly be contained by monetary policy.17

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17 This, in turn, would reveal itself as a major source of fragility for the financial sector as soon as political turmoil made it increasingly costly to sustain interest rate and exchange rate liberalization in 1993, and particularly in 1994, when a major financial crisis took place.
Indeed, aware of the structural fiscal deficit, the Pérez administration attempted a reform of the tax regime, which included a reform of the income tax, a new valued added tax, and later a tax on assets, as well as substantial improvements in tax administration that were supposed to improve the efficiency of tax collection. For all practical purposes, these reforms remained to be enacted at the abrupt end of the Pérez administration in May 1993 a contrast to the effectiveness that the reform program exhibited in almost all other sectors. The dynamics of fiscal policy and tax reform would eventually become one of the most interesting aspects of the political economy of adjustment in Venezuela.

Table 4: Principal Components of Public Sector Fiscal Accounts, 1988-92

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<tbody>
<tr>
<td>Ordinary revenues</td>
<td>24.4</td>
<td>30.4</td>
<td>34.0</td>
<td>34.0</td>
<td>26.5</td>
</tr>
<tr>
<td>PDVSA surplus</td>
<td>11.4</td>
<td>20.5</td>
<td>25.9</td>
<td>24.5</td>
<td>17.6</td>
</tr>
<tr>
<td>Other SOE surplus</td>
<td>2.5</td>
<td>3.0</td>
<td>1.9</td>
<td>2.3</td>
<td>1.1</td>
</tr>
<tr>
<td>Taxes</td>
<td>8.6</td>
<td>5.5</td>
<td>4.9</td>
<td>6.8</td>
<td>7.8</td>
</tr>
<tr>
<td>Ordinary expenditures</td>
<td>20.1</td>
<td>20.3</td>
<td>20.6</td>
<td>20.2</td>
<td>18.5</td>
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<td>Wages</td>
<td>5.1</td>
<td>4.6</td>
<td>4.4</td>
<td>4.8</td>
<td>5.0</td>
</tr>
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<td>Goods and services</td>
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<td>1.1</td>
<td>1.3</td>
<td>1.3</td>
<td>1.4</td>
</tr>
<tr>
<td>Interest of external debt</td>
<td>2.6</td>
<td>4.7</td>
<td>4.0</td>
<td>3.7</td>
<td>3.2</td>
</tr>
<tr>
<td>Transfers</td>
<td>6.2</td>
<td>6.7</td>
<td>7.4</td>
<td>7.0</td>
<td>6.9</td>
</tr>
<tr>
<td>Exchange losses</td>
<td>2.5</td>
<td>2.1</td>
<td>2.2</td>
<td>1.0</td>
<td>0</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>13.9</td>
<td>11.4</td>
<td>12.3</td>
<td>13.7</td>
<td>11.7</td>
</tr>
<tr>
<td>Deficit</td>
<td>-9.6</td>
<td>-1.4</td>
<td>1.0</td>
<td>-0.3</td>
<td>-4.53</td>
</tr>
</tbody>
</table>

Notes:
Figures on the fiscal deficit do not match exactly those shown in table 2 because several components, particularly extraordinary revenues, have been excluded here for the purpose of focusing the attention on the structural fiscal deficit.

Tax reform is generally believed to be one of the most difficult reforms in almost any polity, because it relates to the deepest layers of governance in a society. On the one hand, what are the members of a society willing to contribute to finance governmental activities and what do they consider the proper level of such activities; on the other hand, what is the distribution of the burden of taxation among significant social groups? Large socioeconomic conflicts are built and dividing lines develop in almost every society in keeping with the preferences and willingness to pay of the different groups. In addition to this, experience with the conduct of economic policy in many countries in Latin America clearly teaches that populist economic policies are intrinsically linked to lack of appreciation of the consequences of deficit financing (Dornbush and Edwards 1991). As a consequence, successful tax reform is believed to be one of the distinctive signals of the achievement of long-term stabilization, or of long-term success in the adjustment response.

In Venezuela, still another element has to be included in the analysis of the issue. Historically, oil taxes have relieved individuals and firms of significant contributions to the
financing of governmental activities, simultaneously creating a preference for high levels of public expenditure and a very low willingness to pay for publicly produced goods and services, either in the form of public sector prices and fees or in the form of general taxation. This adds to the difficulty of any major tax reform, because every rationalization of tax structure or administration runs against beliefs deeply ingrained in the political and economic culture. This difficulty was reinforced in 1990 and 1991, when both Congress and the executive were unable to avoid the impression that tax reform was not a priority—or not necessary at all—given the favorable developments in the international oil market.

Taking all these unfavorable factors into account, it is easy to understand why, by the time Pérez was forced from power, not a single tax reform had been approved by the Congress. It is instructive to take a closer look at some of the specifics of such a failure to reform the tax system. In the case of the income tax, in 1990 the administration sent Congress a bill that proposed a reduction in marginal tax rates, but compensated for this with the elimination or reduction of a series of loopholes that benefited the highest income groups. With this kind of proposal, the executive sought to both increase collections and to make tax administration easier and less demanding in personnel and red tape. Interestingly enough, Congress passed the reform of the income tax law, keeping the lower rates but increasing instead of reducing loopholes, with the net result that tax collections were bound to be lower and more difficult to administer. One of the most interesting aspects of this reform failure is that it cannot be attributed to the regressive redistributional consequences of the initiative; the passage of the original plan would have caused an increase only in taxes paid by the highest income groups. The upper-middle-class lobby proved powerful enough to block the provisions in the law that would have made Venezuela less of a tax heaven for them.

The VAT, in turn, never passed the earlier stage of debate in the Congress, and the tax on capital assets was introduced with delay.

Throughout this process, organized labor opposed tax reform—in spite of the progressive changes in income taxation and the creation of the tax on assets—for equity reasons, because the VAT was considered too regressive to be acceptable. Business associations opposed the VAT and the tax on assets because they thought they would discourage private economic activity. COPEI and AD considered the elimination of loopholes in the income tax to be unacceptable for the middle class and viewed the whole reform package as regressive. Behind all these arguments, however, it was clear that every group and party distrusted the ability of government to spend the newly increased fiscal revenues efficiently, and even distrusted the government’s need to improve its fiscal stance through a comprehensive overhaul of the tax

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18 For a very similar outcome of a tax reform process in a very different context that suggests the existence of a generalized problem of asymmetry of information among voters, organized interest groups, and political representatives, see Hafiz A. Pasha’s chapter on Pakistan in this volume.

19 Strictly speaking, there is no organized middle-class lobby in Venezuela. However, from the tax reform case and from other similar episodes it can be argued that a good share of members of Congress behave as if they were defending middle-class, or rather upper-middle-class, interests. This revealed preference for public policies that benefit the upper-middle class at the expense of the majority of the population is what the text refers to, rather than to the existence of a clearly distinguishable interest group.
system. The mentality of an oil-rich country was alive and strong (Rodríguez 1993); it did not matter that this was totally contrary to the difficult economic realities the country was facing, as table 4 illustrates.

4.32 All these events emphasize that even though the administration was able to move forward very fast on many fronts, progress can be attributed at least in part to the extensive powers of the presidency and the executive. In the case of reforms that had to pass Congress, progress in reforming the public sector or the economy was either much slower or nonexistent. This, in turn, is an indication of the very weak organized political support that "The Great Turnaround" was able to count on, since no political party, including AD, actively shared or supported the reform agenda. At the same time, the failed tax reform provides still another instance of a missed opportunity to show the country that there was a principle of fairness and equity behind the reform process, because the progressive nature of several of the tax reform proposals was never made known to the public to a significant extent.
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Unraveling Political Stability: Antiadjustment’s Political Entrepreneurs and the Triggering Effect of a Coup d’Etat

5.1 Lack of organized political support for the structural reform program was coupled with widespread, but similarly unorganized, opposition from 1989 to 1991. Public sector unions represented a significant roadblock in the restructuring or privatization of several public agencies, and they had to be generously compensated to move forward with reform. The many businessmen who had lost privileges or preferential treatment by the state represented a less vocal and effective source of opposition than initially expected by reformers. The media were generally hostile, reflecting in part the widespread unpopularity of the adjustment measures. Prevention of further impoverishment and very high inflation never earned even minimal sympathy for the administration or its policies, probably because the Venezuelan population has never experienced very high or hyperinflation, which made it particularly difficult for the administration to argue in favor of policies that had prevented this unknown evil. The party in government, AD, took every opportunity to distance itself from policies they did not consider their own, having been conceived and implemented by a technocratic team alien to the party and incompatible with the party’s natural inclinations in economic policy. All this produced congressional support that was, at best, reluctant. Nevertheless, opposition to reforms remained diffuse for three years, and there was no other economic program that could be offered to the public as an alternative to the administration’s. This lack diminished the public appeal of the opposition for some time.

5.2 The president did not seem to have many places to go for support. The vision of an open and competitive economy resting on a vigorous and export-oriented private sector with a government concentrated in regulatory and distributive activities was not actively supported by any organized political force. It is hardly surprising that the president compromised with AD

20 The economic team spent considerable time and effort trying to build communication channels and understanding between the party leadership and the cabinet. Thus, they would often attend party meetings, where they would present the new policies and their justification. According to their testimony and the actual outcome of such efforts, it seems that they were not particularly successful.

21 COPEI, the largest opposition party, had included some of the elements of reform in its presidential platform, and its support was important to the passage of several reforms that required congressional action, such as the reform in the consumer protection...
by reserving several important positions in the administration for party loyalists in exchange for what little support the party was willing to provide.\footnote{22} This, in turn, would create severe difficulties for those pushing reforms ahead; for many it became hard to believe that the new policies were really that new and different, given that the highest levels of government were filled with people who not only did not share the president’s commitment to reform, but also were tainted by past allegations of corruption or clumsiness in the exercise of public responsibilities.

5.3 The relative weakness of the administration’s political position is stressed by the episode of the congressional passage of the new Labor Law in 1989. Under the sponsorship of former President Rafael Caldera, a new labor law was making its way through Congress when the new administration took over. Shortly after inauguration, the time had come to vote for the final passage of the bill, but the new law was completely opposed in both letter and spirit to market liberalization. It imposed stiff conditions for the hiring, compensation, and dismissal of personnel in every firm and organization in the country. Significantly enough, all political parties voted for the passage of the bill and the president did not veto it, apparently anticipating that with overwhelming support for the initiative in Congress, his veto would easily be overridden, leaving behind a bitter political battle (Naím 1993).

5.4 Yet opposition to reforms could not coalesce for three years, enough time for substantial progress in structural reforms. On February 4, 1992, a failed coup d’etat would prove to be the signal for the many little and silent grievances against the administration and its policies to become one large and loud protest movement that would end up unseating Carlos Andrés Pérez before the end of the legally mandated five-year term. It goes beyond the scope of this paper to present a detailed account of the failed coup, but it is indispensable to understand its role in stopping the reform process, crippling governance capacity, and creating the conditions for the reversal of major reforms.

5.5 By late 1992 the opposition to the Pérez administration had become a movement in search of a leader. The payoff for a potential political entrepreneur willing and able to identify himself with widespread discontent—widespread not only among the poor, but also among the privileged business and political sectors that had lost state support and subsidies—was potentially very large. The coup attempt, under the leadership of four middle-range officers of the army, according to their own account, had been considered and planned for at least a decade, so it could hardly have had much to do with the specific policies undertaken of the previous three years. It was finally launched in February 1992, and was prompted by two factors: the favorable political

\footnote{22} Probably the most important case in this regard is the one of control over the CVG (Corporación Venezolana de Guayana). This public corporation runs the heavy industries (steel and aluminum) created in the 1970s and constitutes one of the most significant contributors to the structural fiscal deficit. This was an obvious area of reform privatization or restructuring that the administration never tackled in a significant manner, leaving it in the hands of well-known public sector managers linked to AD.
conditions and the achievement of positions of command important enough by those planning the attempt to make the coup possible.

5.6 Once the coup failed, its leader became a folk hero, thanks to the clumsy management of communications the day after the coup that allowed the chief rebel, Commander Chávez, to deliver a live televised speech to the nation. In addition, in what would prove to be even more damaging for the reform process, Rafael Caldera also delivered a nationally broadcast speech. After briefly condemning the violent actions of the rebels, he proceeded to a thorough justification of their motives and a frontal attack on privatization, liberalization, and the other economic reforms of the Pérez administration, blaming them for an economic crisis that did not exist at the time and for jeopardizing democratic stability. These incidents would identify for Venezuelans the two leaders of the opposition in the years to come, and would signal that it was time to make explicit the grievances that so far had been kept hidden. The media would constitute the major channel for the dissemination of aggressive anti-reform positions: suddenly all the fears and uncertainties faced by Venezuelans after the attempted coup were blamed on economic reforms, even though the reforms were delivering all that reasonably could be expected from them in many areas.

5.7 This episode is of particular interest because it demonstrates that—if the Venezuelan experience can be taken as a pattern—the generalized opposition generated by an adjustment program would create favorable conditions for the emergence of political entrepreneurs of anti-adjustment, and that the emergence of such entrepreneurs would depend upon the occurrence of an event that allows for the transformation of latent opposition into active and explicit opposition. The implication for the Venezuelan process is that, even if the actual occurrence of the coup d'état can be considered an event exogenous to the implementation of the adjustment program, this program no doubt created favorable conditions for the magnification of the impact of such a political event. On balance, the event almost totally impaired governance capacity and was the beginning of the reversal of economic reform.

5.8 After the coup attempt and the ensuing speeches, the administration became even weaker politically. Important policies were put on hold—the gradual increase in gasoline prices, for instance—and those that continued, such as privatization, did so at a much slower pace. Several crucial economic ministers were removed from the cabinet and replaced, sometimes with people of the same orientation but less subject to recrimination for the design of the reform package. Nevertheless, a second coup attempt would follow in November amid generalized calls

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23 It is worth noting that at no single moment of the bitter public opinion campaign against economic reform that followed the coup attempt was any alternative economic program explicitly proposed or even sketched by any of the anti-adjustment political entrepreneurs.

24 It is reasonable to think that the coup attempt initiated a "revolutionary crisis" in the sense suggested by Kuran (1989, p. 53): a sudden and unanticipated enlargement of the opposition to a regime caused by an individual event that creates the incentives and opportunities for the abandonment by citizens of "falsified political preferences" and the explicit adoption of "hidden preferences." A crisis of this kind does not necessarily end in a government or regime change, but it makes that a very likely outcome, as the Venezuelan experience confirms.
for the president's resignation. Finally, in the first part of 1993, a much stronger and coherent opposition to reforms succeeded in targeting Carlos Andrés Pérez as the main and almost exclusive force responsible for the ills of the nation, and indicted him on charges of corruption, unseating the president and creating the need for a provisional administration that would hold office until February 1994, when a newly elected administration would be inaugurated following the elections in December.
The Reform Program Derailed: Is Reform Irreversible?

Ramón J. Velázquez: Reluctant Reform and the End of Coherence

6.1 One of the clearest indications of the strength of the economy under the Pérez administration is that in 1992, the year of the two coup attempts, GDP grew 7 percent and, apart from a $1 billion loss in foreign exchange reserves and the structural problems with the fiscal deficit, the bulk of stabilization achievements was preserved. Ramón J. Velázquez, the provisional president appointed by Congress after the indictment of Pérez, selected a new cabinet that looked very much like a compromise between those in favor of continuing economic reforms and those absolutely committed to stopping them. Some tinkering with protectionism and preferential treatment for the agricultural sector would take place, but without any clear shift in policy. It was the end of coherence and strong commitment to reform, yet in no way was this the end of reform itself.

6.2 On the fiscal side, there was substantial progress. The tax reform that had been stalled for years in the Congress was enacted in a curious way: the imminence of a huge fiscal deficit for 1994 made it imperative to enact some sort of tax reform in 1993. The Congress, still unwilling to take the political burden of passing new tax laws, passed an "enabling law" that would allow the president to legally change the tax system without congressional intervention. After some hesitation, Velázquez enacted the VAT and the tax on firms' assets, completing the Pérez reform agenda in a quite unconventional way.

6.3 This was not, however, the last word in the story of tax reform. Enacted in the middle of the presidential campaign, the VAT became a major political issue. It was not only a new tax, unknown to Venezuelans, but it also presented serious implementation failures given the poor state of tax administration, where progress had been slow and difficult for reformers. The leading presidential candidate, Rafael Caldera, took a radical position against the VAT, promising to eliminate it as soon as elected, while the rest of candidates took a more nuanced position, criticizing the clumsy implementation but admitting the convenience of the tax. The highly charged political issue no doubt was influential in the final victory of Caldera on a radical
anti-reform platform. His administration thus far has been extremely coherent in signaling and maintaining a populist orientation, and in only nine months brought a substantial loss in the macroeconomic equilibriums restored by the adjustment response of 1989. The question is how far it would go down the path of reversing the structural reform program.

Irreversibility of Reform?

6.4 While the reform program was moving forward at full speed it was often said that many of the specific reforms had the characteristic of irreversibility. Once completed, it would be impossible for a future opponent to shift back to the interventionist and protectionist pattern typical of Venezuela before 1989. The issue of the eventual irreversibility of reform can be tackled by looking at the specific devices built into the reform program to grant irreversibility and the degree to which they have been effective in achieving that goal.

6.5 Trade liberalization is supposed to be irreversible because of the international commitments made by a country once the export-oriented and open economic model is defined. GATT and bilateral free trade agreements with different countries, particularly Colombia in the case of Venezuela, are good examples. In this respect, it is interesting to note how the political demand for protection rapidly increased in Venezuela as the new Caldera administration signaled in that direction. The Agricultural and Development ministries have both complained that they have faced obstacles to the raising of tariffs because of such international commitments. Actually, new policies are being designed to increase protection through the use of nontariff restrictive practices that are both legally acceptable and economically and politically equivalent.

6.6 Closely related to trade liberalization is price deregulation. The new administration has used the reenactment of the price freeze and price control as the instrument of choice to fight growing inflationary pressures. It has undertaken initiatives to offer trade protection as an incentive for industrial sectors that agree to comply voluntarily with price regulations. As previously mentioned in the listing of structural reforms, the Institute for Consumer Protection was transformed into an Institute for Consumer Education, without power to enact or enforce price controls. The Caldera administration has initiated a legislative proposal to restore these powers.

6.7 Central Bank independence was another cherished policy signaling irreversibility. During the first three months of the new administration, the Central Bank maintained the crawling peg and high interest rate policy that it had implemented at the start of political instability in an effort to keep the exchange market free, while at the same time preventing massive capital flight. The new administration identified high interest rates as the source of poor economic performance and announced its intention to lower rates following a fixed schedule.

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25 The results in the December of 1993 presidential election gave the victory to Rafael Caldera, as a leader of a diverse coalition of small parties, with a little over 30 percent of the vote, followed by the candidates of AD; COPEI; and an emerging party, Causa R, every one of them with a little over 20 percent of the vote. This is quite an unusual result in Venezuelan elections, since it meant the breakdown of the electoral duopoly of AD and COPEI.
This announcement triggered the resignation of the president of the Central Bank and an important flight to the dollar, which led to a devaluation of about 60 percent over a period of a few weeks and a massive loss of exchange reserves. The newly appointed directorate of the Central Bank is widely perceived as not having meaningful autonomy from the executive. In June of 1994, the administration decided to close the foreign exchange market in an attempt to stop the capital flight brought about by the loss of confidence in Central Bank autonomy and a series of government interventions in banking in the middle of a major financial crisis. After three weeks, the government decided to enact strict exchange controls at a fixed exchange rate, a policy presented as temporary, but still in place as this paper is being written.

6.8 Tax reform is another element to consider in examining the issue of irreversibility. As he promised during his campaign, Caldera eliminated the VAT. The fiscal deficit, however, made unavoidable the adoption of a whole new set of taxes, far less certain in their fiscal impact than the VAT, although clearly far more distorting. These included a tax on bank transactions, a sales tax on wholesale transactions, and a luxury tax. It is unclear at this point whether these tax reforms will produce a durable solution to the structural deficit in government revenues, although important steps have been taken in the reorganization of the agency in charge of tax collection. For the time being, the huge amounts spent to help ailing financial institutions have created a large source of monetary distortion in the economy and enlarged the dimensions of the fiscal deficit in a way that makes the management of fiscal policy increasingly difficult. Monthly inflation in the second half of 1994 was about 5 percent in spite of exchange and price controls, which suggests the possibility of very high inflation in the absence of a new stabilization program. If the international experience with adjustment is applicable here—given the high degree of political polarization in the country, at least since 1992, as measured by coup attempts, administration changes, drastic shifts in policy, and lack of legitimacy of major political institutions—the chance of an effective handling of fiscal policy in the short term seems slim at best (Edwards 1994).

6.9 Privatization was halted by a decision of the interim president, and so far the new administration has given extremely mixed signals concerning its willingness to push forward a privatization program, even if hard-pressed by a large fiscal deficit. The most important cases of privatizations completed under the Pérez administration have not been openly challenged, but the attitude toward the new private owners has been hostile. All in all, the economic and contractual characteristics of privatization seem to have made it the most—and probably one of the few—irreversible policies undertaken by the reformist administration.

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26 Seabright (1994) has pointed out that the most important argument for Central Bank independence may not be that it prevents the executive from intervening in monetary policy, but that it increases the visibility of the occasions when it does so. The argument fits perfectly to the recent Venezuelan experience: the resignation of the president of the Central Bank in May, a signal generally read as the end of Central Bank independence, triggered the largest decrease in the value of Venezuelan foreign debt bonds in a single day to date: the fall was twice the size of the one produced by the first coup attempt in February of 1992 (Pablo 1994).
6.10 So far, the Caldera administration has earned a reputation for a lack of coherence and noncompliance with former promises in economic policy. It has lost the confidence of the international investment community: Venezuelan bond ratings are around 20 percentage points less than they were in 1991; its rating by international country-risk-assessment agencies has worsened significantly; and the country risk has been estimated in the third quarter of 1994 at around 12 percent (Pablo 1994). At the same time, the Caldera government remained highly popular in public opinion polls during its first year; this great popularity can be viewed as its main source of strength. It is indeed a paradox of the politics of the adjustment process in Venezuela that an administration that had strong credibility with investors had no credibility with the Venezuelan citizens (the Pérez case), yet the administration that has achieved and maintained popular confidence has managed to lose the investors' confidence.

6.11 The balance, if any can be established in such a short period of time, is that reforms are indeed reversible. With the partial exception of privatization, reform will be reversed, resurrecting large distortions and inefficiencies throughout the economy and undermining its competitive potential.
Adjustment Without Vision? How an Adjustment Process Without Political Support Can Go Only So Far

7.1 In an international conference that took place at the beginning of the adjustment process in Venezuela, Ricardo Hausmann, later to become the planning minister of the last year of the Pérez administration, said that the success of the adjustment response and structural reform in Venezuela would depend upon its ability to deliver good results rapidly enough to gain the social and political support that, he recognized, was critically scarce at the time of the initiation of reforms (Williamson 1990). Unfortunately, in light of the many benefits that the reform program could have offered Venezuelan society, time would prove that statement to be wrong. The economic reform program did not fail to deliver. It can hardly be denied that the short-term adjustment response was a striking success, measured either in stabilization or in the design and launching of a comprehensive structural reform program. Yet it is easy to see, judging from the Venezuelan experience, that such a success was not enough to turn the economy and the country around in a more permanent way. Economic success did not translate into political support.

7.2 This point deserves some elaboration. It can be argued that the bad economic performance of 1989, a result of the devaluation and recession induced by the implementation of the adjustment program, was the original source of widespread opposition to the program. That might be the case. Several elements introduced in this paper, however, may lead one to question such a conclusion. It can be asserted that, whatever the misery of 1989, things would have been worse without adjustment. Even if this view is correct, as I think it is, prevention of greater difficulty had a very low potential to earn political support for the program, since counterfactuals rarely, if ever, earn political support. But there is more to it than this: simply put, the relationship between economic performance and political support is far from direct.

7.3 This is perhaps one of the most central issues of this paper: if we say that opposition to the program came from the undeniably bad economic performance of 1989, then why did the extraordinarily good performance of the in economy in 1990, 1991, and 1992 not garner generalized and strong support? To address this question, an ad hoc explanation of the asymmetry in the relationship between performance and support is needed: bad performance produces opposition, but good performance does not translate into support, at least in the short
run. Again this may very well be, but then the general point is confirmed: the relationship is far from simple and direct.

7.4 Still, some would say that the urban riots of February 1989 are proof that the effects of the adjustment package caused widespread resentment and active opposition to reform, but then we encounter a clear logical inconsistency. The riots took place before the package had been implemented, and it is generally believed that it is difficult for a consequence to take precedence over the cause. Once more, a plausible answer to this objection would be that it is not actual performance that causes a particular response to reform attempts, but the expectations and perceptions that accompany the adjustment process. Then again, the model that may eventually succeed in accounting for the relationship between economic performance and social and political response is likely to be complex, and it will by no means stipulate a direct and short-term relationship between good performance and strong or generalized support for reform attempts or for the administrations that implement them.

7.5 Thus, if the Venezuelan case is to provide any guidance, there seems to be no substitute for a well-articulated and clearly communicated vision that can be shared by substantial social and political groups, creating the basis for strong and coherent political support for pro-market reforms. The Pérez administration attempted a radical change in the basic orientation of the economy and the state that had scant organized political support. So meager was the support that one must admire how far the reform program went in the three years of its forceful application. The projected changes had coherence, were designed with a high degree of technical competence, and were attuned to international trends, yet lacked almost any other component of an effective vision. In contrast, the reform process had to take into account a number of severe initial political constraints, essentially those of the legitimacy crisis that political parties and all major political institutions were experiencing in the years immediately preceding the launching of adjustment, but also included the widespread decay in the capabilities of public bureaucracy and the lack of market-oriented economic culture in Venezuela after decades of protectionism and interventionism.

7.6 Given such constraints, governance capacity was critical in advancing reform, but it was reduced to presidential popularity and constitutional power, two sources that proved to be insufficient to sustain the reformist drive, and particularly to ensure its permanence. The very fact that allegations of presidential corruption were generally believed as credible—regardless of their authenticity, yet to be established by the courts—reveals a critical weakness in the leadership capabilities of an administration that could not possibly have succeeded without conveying a strong sense of authenticity and fairness in sacrifice to a population that had indeed contributed with substantial welfare losses to the advancement of adjustment and structural reform. Thus, there was no ability to convey fairness in the sacrifices needed or to alert the population to the efforts made to compensate the social costs of adjustment or to build an explicit connection between the reform program and wider national values and goals. Under these conditions, it was difficult to communicate the importance of the program or to energize the population in favor of
reforms, which would have solved at least partially the collective action problems attached to any large project of social change.

7.7 It has become common to think about the political economy of adjustment processes in terms of compensation: gaining support and offsetting opposition requires the identification of those in need of compensation and the decisions concerning when, how, and how much to compensate them (Seabright 1994). Yet another interesting aspect of the Venezuelan case is that there was no shortage of compensating initiatives: the program to fight poverty was well-financed and effectively implemented during most of the Pérez administration. It was directed at the poorest segments of the population, those presumably most seriously affected by adjustment, and its main failure was the delay in its start, rather than the amount of resources made available. But there was a set of other compensation mechanisms and initiatives put in place at different moments of the reform process: the middle class received the benefits of a law substantially subsidizing mortgage payments soon after interest rate liberalization in 1989; public sector workers affected by the restructuring of their agencies or enterprises were generously compensated, far beyond their legal claims in the cases of the agencies in charge of ports, water supply, and others. Businessmen received a large devaluation that seems to have been sufficient to compensate for the elimination or reduction of barriers to imports.

7.8 No substantial political benefits in acceptance or support for reform were realized from the significant investment of resources in these compensation initiatives, suggesting that uncertainty about the intent and ability to compensate may not be dissipated exclusively through the actual implementation of specific elements of compensation. This, in turn, leads to the conclusion that an active effort of coalition building and the elaboration of an appropriate political discourse are required components of compensation schemes that will actually earn support for reform programs, or at least reduce opposition to them. Once more, perceptions and expectations should play a key role in any explanatory model of similar processes.

7.9 It is usually argued that opposition to reform can be adequately explained by looking at interest groups dynamics. Because widespread rent-seeking and capture are the most common starting points of reform in developing countries, it is only natural to think about resistance to adjustment, and especially structural reform, through the strategies put in place by interest groups to undermine the reformist drive. There was much of this dynamic in the Venezuelan experience: several specific features of the very design of the reform strategy by the president can be explained as a clear attempt at avoiding head-on conflicts with powerful interest groups, as described above. Yet it is also clear in the Venezuelan experience that this is, at most, just a part of the story. To begin with, potentially powerful interest groups were not always a source of direct opposition to reform, the best example being the private sector after the rapid reduction in trade protection. But, more fundamentally, the history of the sudden consolidation of a strong anti-adjustment coalition after the attempted coup of February of 1992 can only be explained by looking at the active role played by political entrepreneurs and the incentives they face in an adjustment process. No single party, interest group, or faction was responsible for it, yet the political defeat of those advancing structural reforms took place under the leadership of political entrepreneurs able and willing to become the public expression of the many minor
resentments created by economic reforms, if that would prove to be an effective path to public office.\textsuperscript{27}

7.10 In the explanation of the end result of the Venezuelan reform process, it is very difficult to disentangle the role of initial constraints—generally speaking, the weak governance capacity and what has been referred to as the legitimacy crisis of democratic institutions in the country—from the weight of actual mistakes made by reformers, above all the failure in formulating an effective vision, and the active role played by anti-adjustment political entrepreneurs. All three played key roles in the way things turned out in Venezuela, and this uncompromising if somewhat disappointing statement should be enough for the purposes of a country study, such as the one presented here. Such a conclusion, of course, is blatantly insufficient from a more general point of view. When looking at other reform attempts in developing countries, and establishing comparisons, the goal should be to enhance our understanding of how these elements interact to produce given instances of success or failure in economic reform.

7.11 There is every indication that some of the achievements of the structural reform process can and will be reversed by the Caldera administration, stressing the short-lived nature of sudden shifts in governmental policy that are not accompanied by a solid political base and a well-articulated vision. Thus, the Venezuelan case seems to suggest that effective visions are not indispensable for short-term successful adjustment responses, but that they are indeed of great importance to the sustainability of reforms, and thus in determining the possibility of permanently enhancing governance capacity in developing countries.

\textsuperscript{27} The general point here is in line with the following comments by Bates (1990), when evaluating the contribution of interest group and collective choice theory to the understanding of the political economy of developing countries: "We must look to the political incentives that shape politicians' economic choices; for, by this analysis, politicians are not perfect agents of economic interests but rather have distinctive political incentives of their own. We must therefore understand the nature of the political problems politicians try to solve when making economic policy. We must also look at the ideologies that motivate their interventions. If politicians do take the initiative, we must turn our attention from the economic forces that demand political intervention to the political forces that supply it" (p. 44).
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