Oil-price drop and capital outflows threaten the Venezuelan economy

by Dennis Small, Latin America Editor

Venezuela, one of the world's principal oil producers and a leader of the Organization of Petroleum Exporting Countries (OPEC), was thrown into turmoil in early April when the continuing softness in the world oil markets induced the OPEC nations to decide to cut back on their volume of exports. Venezuela has agreed to drop exports from about 1.8 million barrels per day to 1.15 million bpd, which translates into a reduction in annual oil earnings of some $6-$7 billion.

The talk of the day in Caracas is how to adjust to this sharp drop in income. How much should the budget be cut? How many government employees should be laid off? Who should get the axe first? The ruling Copei and opposition Acción Democrática parties are tripping over each other proposing various economic formulas for austerity.

Venezuela is simultaneously being subjected to growing pressure by the international financial community to devalue its currency, the bolívar, after *20* years of stability. Last month the head of the central bank, Leopoldo Díaz Bruzual, managed to stare down a rumor campaign that the bolívar was about to be devalued. But in March a new speculative assault surfaced, which Díaz Bruzual told the press was a consequence of the recent devaluation of the Mexican peso. International speculators, he reported, were pressuring Venezuela, Brazil, and other Third World nations to devalue their currencies, in the hopes of making a profit from such a move.

But what makes the current conjuncture particularly worrisome for Venezuela is the fact that today's problems come on top of three years of consistent reductions in the economy's rate of growth, at the hands of the administration of President Herrera Campins.

Pérez versus Herrera

Up until 1979, the year Herrera took office, Venezuela was one of the Third World's most dynamically growing economies, with yearly GNP growth rates of a

Figure 1
Venezuela: basic economic statistics*

	1975	1976	1977	1978	1979	1980	1981**
Population (in millions)	12.2	12.6	12.9	13.3	13.6	16.5	18.0
Consumer Price Index	5.7	7.7	7.7	7.2	12.3	21.6	16.2
GDP	15.8	16.9	17.0	17.9	18.0	17.8	17.8
Total public debt (long-and short-term)				17.9	18.4	15.4	28.1
Total exports	8.8	9.3	9.6	9.2	14.2	19.2	20.2
Total imports	5.3	6.8	9.8	10.6	10.3	11.3	13.3
Trade balance	3.5	2.5	−0.2	11.4	−3.9	7.9	6.9

* Billions of current U.S. dollars
** Projected

Figure 2

Percentage growth in Venezuelan Gross National Product

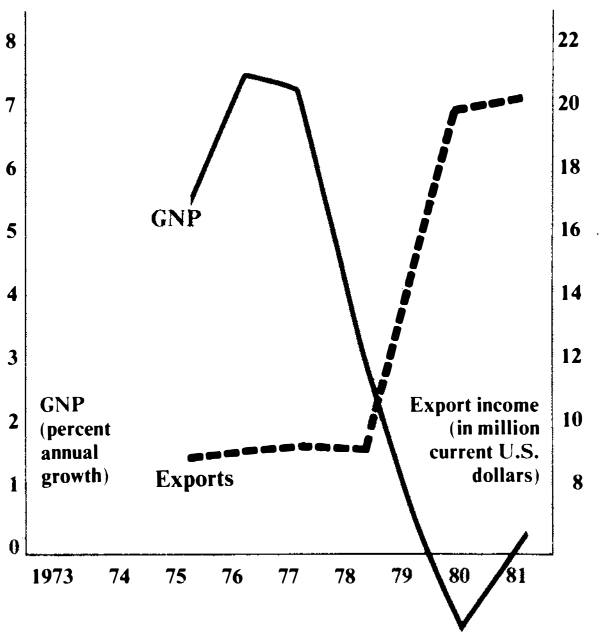
	1968-73	1973-77	1978	1979	1980	1981 (estimated)
Total GNP	5.1	6.8	3.2	0.7	−1.2	0.3
Manufacturing	6.7	9.5	4.9	3.8	3.8	0.8
Agriculture	3.6	4.2	6.3	3.7	2.9	−2.8
Construction	11.6	15.0	11.0	−9.7	−15.5	−2.8
Commerce	4.4	9.9	0.2	−6.6	NA	NA
Services	7.1	8.7	2.9	4.1	NA	0.8

solid 6-7 percent. President Carlos Andrés Pérez (1974-79) nationalizated the oil and iron industries, adopted a dirigist "V Plan" for the country's economy, deliberately shifted the use of oil revenues into industrialization efforts, and kicked off sizeable projects in steel, aluminum, hydroelectric, and so forth. This led to a leap in gross capital formation to an average of 29 percent per year between 1975 and 1977, and to an import boom averaging up to 30 percent per year. There was also a shift in the internal composition of imports in favor of capital goods for the industrialization effort.

From his first day in office, Herrera explicitly shifted in favor of a more services-oriented economy, and more strict adherence to monetarist guidelines as a national priority. The large industrial projects—Sidor, Venalum, and Corpozulia—have by and large been left to languish by Herrera. And the earlier period's high GNP growth rates have been replaced with rates of 0.7 percent, −1.2 percent, and 0.3 percent in each of the last three years. In this an across-the-board decline, the sectors hit hardest have been construction and agriculture (see Figure 1).

Figure 3

Gross National Product and export income



The irony of this situation is that Venezuela slumped into sharp recession at exactly the point (1979) that there was a significant increase in world oil prices. Since petroleum constitutes fully 95 percent of Venezuela's export earnings (the remaining 5 percent is made up mainly of iron ore and other raw materials, shipped primarily to Andean Pact nations within Latin America), the world rise in oil prices meant a leap in Venezuela's overall export earnings by over 100 percent in two to three years (see Figure 2). The question that immediately crosses one's mind is how President Herrera managed to shatter what was a booming industrial economy at precisely the moment that the oil revenues, which were the motor of development, were rising so sharply. It is almost as if the economy had been driven into recession deliberately.

That is precisely what happened. Admittedly, Herrera's term has coincided with the recessionary world economic environment caused by the high interest rates of U.S. Federal Reserve Board Chairman Paul Volcker. But Herrera himself has advocated and encouraged Volckerite policies for Venezuela. He came into office openly proclaiming his administration to be an experiment in the anti-growth policies of the Club of Rome—a think tank famous for its "Limits to Growth" thesis. Each of the economic policies subsequently implemented by Herrera were elaborated in a conference of 100 top international figures, including many Club of Rome members, in Caracas, Venezuela in February 1979, immediately prior to the change in administration.

As recently as his 1981 year-end review of the Venezuelan economy, central bank director Leopoldo

Díaz Burzual confirmed that the government had adopted the monetarist policy of "combating inflation" at the expense of economic growth—despite the objections of some other members of the cabinet. As a recent cable from the U.S. Embassy in Caracas to the Department of Commerce put it: "Terming the fight against inflation not completely compatible with growth, Díaz Bruzual said the BCV [central bank—ed.] had chosen to fight inflation and had met with success."

The success Díaz Bruzual is claiming is that the 1980 inflation rate of nearly 22 percent (foodstuffs rose at the dangerous rate of 39 percent) had been cut in 1981 to 16 percent. But the fact of the matter is that inflation had been steady at 6-7 percent up through 1978, and then shot upwards as a result of Herrera's anti-growth economic policies. One of the causes of the skyrocketing inflation rate—aside from international factors such as the run-up in world interest rates caused by Volcker's policies—is that Herrera shifted the direction of government spending away from productive investment projects, and into unproductive areas like services and debt repayment. Thus, we have the following comparative table:

Percent of government spending by area

	1974-78	1979-81
Investment	42.7	26.0
Services	52.7	63.5
Debt service	4.6	10.0

The rise in debt service payments shown in the last row of the above table, translated into the following performance of Venezuela's debt service ratio (the interest and amortization on foreign debt as a percentage of foreign exchange earnings from the export of goods and services):

Venezuela's debt service ratio

Year	Percent
1975	5.8
1976	4.2
1977	8.1
1978	7.6
1979	10.4
1980	12.0
1981	28.7

Throughout this period, the Herrera administration also adopted monetary and fiscal policies which facilitated a tremendous flight of capital out of Venezuela and into (especially) the Florida real-estate market. Some sources estimate that as much as $6 billion in Venezuelan resources are today tied up in speculative activities in Florida.

Sectoral forecasts

Oil: Venezuela's petroleum output has for the past years fluctuated in the range of 2.0-2.2 million bpd, with the vast majority of this being exported: only 250,000 bpd or so are consumed internally. In 1980, crude-oil output dropped from 2.356 million bpd to 2.168 million bpd (−8 percent), and for 1981, the Central Bank announced there had been another reduction of 3.9 percent. Now production has dropped to 1.7 million bpd.

Short- to medium-term prospects on this line are grim for Venezuela, as for other oil exporters, due to the marketing problems created by the world reduction in energy consumption. Venezuela may benefit relative to other oil exporters, due to its geographical and political proximity to the United States, but this will in no way solve Venezuela's problem. In fact, already the United States is refusing to purchase the quantities of crude Venezuela would like to sell.

Over the longer term, Venezuela will experience aggravated difficulties in the oil sector, due to minimal investment in further oil exploration. At present, most

Venezuelan economist calls for exchange controls

One of the most outspoken voices on behalf of high-technology industrial development in Venezuela has been that of Dr. Gumersindo Rodríguez, Planning Minister from 1974 to 1977 under Carlos Andrés Pérez. Rodríguez was the intellectual author of Pérez's ambitious "V Plan" development strategy, and today remains an influential policy voice in the Acción Democrática (AD) party. In a mid-January interview with one of Venezuela's regional newspapers, *El Informador* of Barquisimeto, Rodríguez stated:

"I believe that the next government of Venezuela . . . faces the responsibility of ensuring a rate of growth of the economy that increases employment and real income in the population, without at the same time weakening the Venezuelan currency. . . .

"I believe that that policy must be based on a re-expansion of the economy to bring it to a higher rate of growth. . . .

"To avoid the flight of capital abroad and the excessive spending of foreign currency, we must inevitably impose exchange controls. One measure I would suggest within those controls is the adoption of a strong tax on foreign travel. It is necessary to make the tourist dollar more expensive. Currently, we Venezuelans are spending $1.5 billion [per year] on foreign travel."

efforts are going into developing the vast deposits of very heavy oil in the Orinoco Basin, but most observers agree that extraction of this low-quality oil will not become profitable at a world oil price any lower than $30 per barrel. The current Herrera administration seems to be banking on such an eventuality.

Heavy industry and infrastructure: There are serious problems in this sector, which under the Pérez administration had become the motor driving the rest of the economy.

All of these major industrial projects are substantially behind schedule, principally due to reductions in government financing by the Herrera administration. As the London-based *Latin America Weekly Report* summarized the situation: "A major question mark hangs over the Guayana projects and their financing, which could make a nightmare out of Pérez's dream of *la Gran Venezuela.*"

Downstream manufacturing activities have also dropped in 1981, as seen in the meagre overall growth rate of 0.8 percent. Particular problem areas were automobiles, textiles, and capital goods. Steel was off 4.9 percent for the year. But it is probably the construction industry in Venezuela that has been hardest hit of all as a result of the cutbacks in the big projects. After experiencing an average growth rate of 15 percent per annum from 1973-77, and 11 percent in 1978, construction activities contracted sharply over the next three years: −9.7 percent in 1979, −15.5 percent in 1980, and a projected −2.8 percent in 1981.

Agriculture: After two poor years in 1979 and 1980, last year was close to a disaster for Venezuelan agriculture. Production dropped by nearly 3 percent, leading to a situation in which the country must now import over 50 percent of its food consumption needs.

We forecast that this sector will *worsen* over the next two to three years, as a direct result of government policy. The 1982 government budget for agriculture has been cut by 32 percent over 1981 levels; virtually all price subsidies have been eliminated; government directives requiring private bank lending to farmers have been repealed; and no serious effort to modernize agricultural technology is being maintained.

A program to launch industrial recovery

Despite the damage done to the Venezuelan economy over the past three years, it is possible—both politically and economically—to put that country back on the course of rapid industrial development. There is still an underlying psychology of optimism among leading political strata in the country which translates into a continuing commitment to turn Venezuela into a modern industrial nation-state.

In the last half of 1981, the country was being drained of capital at the rate of over $120 million per day, as capital fled Venezuela (where interest rates were being held at 12 percent) to Miami and New York banks (at 18-20 percent interest rates). The fixed parity of the bolívar (4.3 to the dollar), and its free convertibility, facilitated this wave of flight capital. A battle exploded over whether or not to raise Venezuelan interest rates to international levels. Over the objections of central bank director Leopoldo Díaz Bruzual, rates were finally allowed to rise to an average 16-18 percent in late 1981. This move had the expected result of contracting credit available to domestic industry—but it failed to stop the flight of capital. Most recent reports are that over $140 million is leaving Venezuela daily, despite the rise in interest rates.

Under these circumstances, serious talk has begun to emerge in Venezuela of imposing exchange controls and other emergency financial measures. *EIR* proposes an overall strategy of economic recovery that would be based on the following steps:

1) **Impose strict foreign-exchange controls.** In an international environment determined by Volcker's stratospheric interest rates, this is a necessary defensive monetary financial measure for any developing nation that seeks to control its own money supply and credit system. In this way, the Venezuelan government could put a halt to the billions of dollars that have fled the country for the Florida real-estate market (see article above). The inordinate luxury tourism engaged in by Venezuelans—largely in Miami—should be sharply curtailed (see box).

2) **Lower domestic interest rates to the 4-6 percent range.** Using the buffer created by exchange controls, preferential domestic interest rates in this range should be made available in industrial areas which are national priorities. The current Friedmanite credit strangulation of local businessmen can in this way be ended.

3) **Develop high-technology areas of heavy industry.** Venezuela should reinstate the emphasis made under Carlos Andrés Perez's "V Plan" on steel, aluminum, hydroelectric projects, and other infrastructure. In addition to these already identified projects, it is urgent that Venezuela immediately initiate a serious nuclear-energy endeavor, in order to develop the energy technology of the 21st century.

4) **Establish bilateral treaty agreements for transfer of technology with advanced-sector nations.** The proposal by *EIR* founder Lyndon H. LaRouche, Jr. for gold-reserve monetary backing for international trade and investment is the framework required to achieve the above goals.