Andean Report by David Ramonet

Venezuela's Gordian knot

President Caldera's only viable option to control inflation is to issue low-interest credit for production.

Shortly after he became finance minister of Venezuela earlier this year, Luis Raúl Matos Azocar met with the executive committee of the Venezuelan Workers' Confederation (CTV). One of the labor leaders pointedly asked the minister: "The Central Bank has printed more than a trillion bolivars [roughly $6 billion] to bail out the banks which the financial mafia—the same one denounced by President Rafael Caldera—pushed into bankruptcy after having looted their funds and turned them into dollars to take them out of the country. Why can't the government at least issue a tenth of that amount and lend it at low interest rates for investment in industry, agriculture, wages, public services—in short, in creating new jobs? We don't want any more agreements that aren't kept, we just want to work."

After hesitating for a moment, the minister stated, "Interest rates can't be lowered any further because of inflation." He then repeated that the government's economic team is focusing all of its efforts on fighting inflation, and that this is why the government has called for creating an Anti-Inflationary Pact among government, business, labor, and the central bank.

But the so-called pact has become a Gordian knot for the government. Following the fallacious criteria offered by the likes of Milton Friedman and adopted officially by the International Monetary Fund (IMF), the agreement stems from the thesis that the government must restrict public expenditures until the fiscal deficit disappears; workers have to restrict their wage demands, businessmen must freeze prices, and the central bank must restrict monetary circulation.

This is bad policy, based on bad economic theory.

The pact will fail, because it is based exactly on what all governments in the world subject to IMF conditionalities have been doing, and failing as a result, to contain inflation. The irony is that the measures decreed by President Caldera on June 27, 1994, based on his own common sense as a nationalist statesman in opposition to IMF doctrine, are what have saved Venezuela so far from the avalanche triggered by the Mexican peso devaluation and the collapse of the dollar.

Last year, Caldera's government halted the disintegration of the Venezuelan banking system by intervening in eight banks and taking over another four while imposing exchange controls to stop capital flight. These measures reaffirmed the state's fundamental right to direct the economy. But Caldera didn't go further to kill the cancer of financial speculation. Nor did he replace this system with a new one based on the productive economy. Interest rates didn't drop, no new credit was generated, and, despite exchange controls, inflation continued because monetary and financial speculation continued to predominate over productive investment.

The money printed by the central bank, which the labor leader referred to, did not go to the millions of depositors robbed by the now-fugitive bankers, as the story goes. Rather, it went to the large "institutional investors," the large speculative funds which caused half the foreign reserves to flee the country in 1994. The owners of these funds are the same fugitive bankers.

The truth is that one year after the bank intervention, banks are only operating as a "petty cash fund." This is seen most clearly in the flow of funds from commercial banks during 1994. According to economist José Grasso Vecchio, last year, banks handled 1.2 trillion bolivars (approximately $7.3 billion). Of this, 61% was invested in central bank and government securities. Only 10% was channeled into loans.

Moreover, starting in the second half of 1994, real estate speculation zoomed. Currently, the price per square meter in residential areas of Caracas is above $1,000, which has caused rents to rise to unprecedented levels. At the same time, with the encouragement of business leaders, a black market has grown up in which the dollar is negotiated at 230 bolivars—35% more than the 170 bolivars to the dollar in the controlled market.

Without credit, production has been shrinking since 1994 at a constant rate of 3-4% annually. The informal economy, or hidden unemployment, now occupies 50% of the labor force. It is the fall in productive investment and employment which generate tangible goods rather than "services," that is the primary cause of inflation.

In his May Day message, President Caldera warned that the same people who insist on cutting public expenditures are the ones who yell the loudest in demanding public funds for themselves. The labor leader who questioned Matos Azocar is waiting for the President to respond with his good sense as a statesman: issue credit for production and kill the speculative cancer.

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