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Working Paper no.46

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June 2004

Crisis States Programme
Working papers series no.1

ISSN 1740-5807 (print)
ISSN 1740-5815 (on-line)

Development Studies Institute
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Crisis States Programme

The Political Economy of Economic Liberalisation in Venezuela

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This article examines the political impact of economic liberalisation programmes in Venezuela from 1989 to 1998. Venezuela, a long-standing democracy, has experienced a virtual political implosion. The rapid downward spiral has seen an increasing crisis in governability that has been manifested by the collapse of the two main political parties, an increase in political polarization, more frequent coup attempts, alarming increases in voter absenteeism, the growing use of corruption scandals as instruments of political competition, the increasing frequency of mass and often violent street demonstrations, dramatic increases in crime, growing labour unrest including a two-month national workers strike, and the return of radical populist rhetoric and policy accompanied by a more authoritarian presidentialism that has been absent in Venezuela since the late 1940s.[1] Accompanying the increase in ungovernability has been a severe economic crisis. In the period 1988-2002, per capita income declines have been consistently among the worst in Latin America and percentage increases in income inequality, poverty and informal employment have been among the highest on the continent. Regulatory deficiencies were also at the heart of one of Latin America's worst banking collapses in the 1990s.

In many ways, Venezuela was an unlikely candidate for political and economic implosion. First of all, the Venezuelan state has not had to contend with ethnic, regional, caste or religious conflicts that make governance and the maintenance of social order particularly difficult in many parts of the developing world. Secondly, in the period 1958-1988, Venezuela maintained one of the most stable democratic systems in Latin America. In this period, political pacts among the leading political parties and corporatist structures were the main institutional innovations and mechanisms of financing state-led industrialisation and patronage to maintain political stability.[2] The system was aptly described by Rey as a "populist system of reconciliation".[3] Thus, crisis and breakdown in Venezuela have occurred in a polity that had accumulated substantially strong mechanisms to regulate and contain conflict. Finally, Venezuela was for six decades before 1980, the second fastest growing economy in Latin America and the economy with the lowest inflation rate, the latter a sign of a polity that contains and regulates conflict. Given its relatively favourable initial conditions the Venezuelan case may prove to be an instructive case as to the stresses liberalisation can

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[1] J. McCoy, 'Chavez and the End of "Partyarchy" in Venezuela', *Journal of Democracy*, 10:3 (1999); A. Stambouli, *La política extraviada*, Caracas: Fundacion para la Cultura Urbana, 2002; K. Roberts, 'Social Polarization and Populist Resurgence', in S. Ellner and D. Hellinger (eds), *Venezuelan Politics in the Chávez Era: Class, Polarization and Conflict*, Boulder: Lynne Rienner, 2003.

[2] D. Levine, *Conflict and Political Change in Venezuela*, Princeton: Princeton University Press, 1973; T. L. Karl, 'Petroleum and Political Pacts: The Transition to Democracy in Venezuela', in G. O'Donnell, P.C. Schmitter, and L. Whitehead (eds), *Transitions from Authoritarian Rule*. Baltimore: Johns Hopkins University Press, 1986; J. C. Rey, 'La Democracia Venezolana y La Crisis del Sistema Populista de Conciliación', *Estudios Políticos*, 74 (October – December 1991).

[3] Rey (1991).

unleash, not only in transition economies,[4] but in a late developing, capitalist, and long-standing democratic polity.

The causes for the breakdown of the Venezuelan polity are diverse with deep roots in history. It is not my intention to provide a theory of that breakdown. This is because large-scale social changes that occur in a brief space of time are often the result of a unique, and non-repeatable constellation of highly disparate events, and contingent actions.[5] Rather, my purpose here is to explore the extent to which the adoption of programmes of economic liberalisation and administrative decentralisation contributed to the process of breakdown in Venezuela.

General thinking has been that liberalisation and decentralisation are part of a tandem of reforms that would spur economic recovery and growth and lead to more accountable transparent and effective governance. Even after the World Bank backed away from promoting radical structural adjustment programmes, it reaffirmed these basic propositions about the role of liberalisation in its so-called “capability approach”, which posited that “poor governance” is the result of an over-extended state relative to its institutional capacity at a given moment in time.[6] While it is acknowledged that state-created rents and rent management systems, such as in industrial policy, may have worked in a handful of countries, especially in Northeast Asia, the advice for poorly performing Latin American economies would be “not to try this at home” since the administrative capacity to effectively administer subsidies, export ‘contests’ and investment co-ordination is generally lacking. Otherwise, the proponents of liberalisation would argue, there would not be so many infant industries that failed to ‘grow up’. In effect, the capability approach advocates that the state’s role in the economy should be matched to its capability – a decidedly static and apolitical view of capacity. The capability approach implies that if the state can focus its scarce administrative skill in the ‘fundamental’ areas and leave production to the private sector, the overall management and governance effectiveness in the economy will increase. Within Venezuela, liberal reformers in the second Pérez administration (1989-1993) also believed that the state did not, and importantly, could not, have the administrative capacity to construct a state-led developmental strategy.[7] This line of thinking is similar to what Hirschman referred to in Latin American policy circles as “fracasomania”, or the failure complex among Latin American leaders who insist that everything that has come before has been an utter failure.[8]

In academic and policy circles within Venezuela, the main diagnoses of how to improve state capacity and governance in Venezuela were also driven by the insights of rent-seeking theory and its related variant, the rentier state model. The main thrust of this literature claims that oil abundance induces an overly centralized, Soviet-style public authority and excessive state interventionism and discretion which, in turn causes growth-restricting and productivity-restricting corruption and rent-seeking.[9] The idea that corruption has been the main obstacle

[4] A. Przeworski, *Democracy and the Market*, Cambridge: Cambridge University Press, 1991; L. King, *Does Neoliberalism Work? Comparing Economic and Sociological Explanations for Postcommunist Performance*, mimeo, Departmemt of Sociology, Yale University, 2004.

[5] A. O. Hirschman, ‘The Search for Paradigms as a Hindrance to Understanding’, *World Politics*, 22:3 (1970).

[6] World Bank, *World Development Report: The State in a Changing World* , Oxford: Oxford University Press, 1997, pp.61-75.

[7] M. Naím, *Paper Tigers and Minotaurs: The Politics of Venezuela’s Economic Reforms*, Washington, D.C.: Carnegie Endowment Book, 1993.

[8] A. O. Hirschman, ‘Policymaking in Latin America’, in A. O. Hirschman, *Essays in Trespassing: Economics to politics and beyond*, Cambridge: Cambridge University Press, 1981.

[9] Naím (1993); G. Torres, *Quienes Ganan? Quienes Pierden?* Caracas: Banco Consolidado, 1993; T. L. Karl, *The Paradox of Plenty: Oil Booms and Petro States*, Berkeley: University of California Press, 1997.

to development and that state-created rents cause corruption became the intellectual pillar behind neo-liberal governance policies in general and the advocacy of economic liberalisation and political decentralisation in particular. From the lens of rent-seeking theory, the main aim of economic liberalisation is to reduce the discretionary centralised authority of state leaders to create rents. Governance reforms aim to promote transparency and accountability, which serve the same ends. At the same time, political reforms such as decentralisation and fiscal federalism aim to increase 'civil society' oversight and promote democracy, both of which have the dual function of reducing arbitrary rent allocation while also modernising and de-personalising political relationships.

In this article I suggest that economic liberalisation and political decentralisation has not strengthened the state as the capability approach predicted. The idea that weak states will govern the economy better by intervening less – the so-called capability approach – has not been borne out by the trajectory of the Venezuelan economy. What is missing in the capability approach is an analysis of how capacity is constructed and, in particular, the role that political strategies of conflict resolution and competition play in constructing legitimate alternatives to failed state-led development projects. The 'good governance paradigm' promoted within the international development community downplays the task of reconstructing and/or building political organisations. This is because of the influence of the rent-seeking and corruption literature in informing policy on state capacity building and the negative view of politics that flows from that analysis.[10] As a result, the governance agenda neglects the necessary role that political strategies play in state capacity building. In this article I demonstrate how political analysis allows us to develop a more adequate account of the risks that reforms generate and to discuss the political sustainability of reforms.

The rest of the paper is organised as follows. Section 1 describes the liberalisation reforms and examines the domestic political support based for such reforms. Section 2 examines the economic and distributional impact of the reforms. The evidence suggests that liberalisation not only failed to revive private investment and economic growth, but also contributed to a worsening of the factorial distribution of income, which contributed to growing polarisation of politics. The causes and consequences of the failure of the state to regulate the banking system are also discussed. Section 3 examines the political processes through which neoliberal reforms contributed to political instability and the increased use of the corruption scandal as a weapon of political and economic competition. Particular attention is paid to the role of policy switches and party-neglecting strategies among the reformers. Section 4 briefly suggests why neoliberalism generated greater political instability and decline in state capacity in Venezuela compared to some other Latin American reforming economies. The Conclusion explores the theoretical and policy implications of the Venezuelan experience.

The Economic Liberalisation Package of 1989

In 1989, Carlos Andres Pérez launched one of the most ambitious liberalization reforms in Latin America. The liberalization plan, known as the "Great Turnaround" ("*El Gran Viraje*"),

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[10] The mainstream view of politics has been greatly influenced by a negative view of the state. For instance, models of the welfare state pioneered by Pigou have been replaced by models, which view the state as either "predator" (D. North, *Structure and Change in Economic History*, New York: Norton, 1981), "bandit" (M. Olson, 'Dictatorship, Democracy and Development', *American Political Science Review*, 87 (1993)), "populist" (R. Dornbusch & S. Edwards (eds), *Economic Populism in Latin America*, Chicago: University of Chicago Press, 1990), or "grabbing hand" (A. Shleifer & R. Vishny, *The Grabbing Hand*, Cambridge, MA: Harvard University Press, 1998).

included the unification, and massive devaluation of the exchange rate, trade liberalization, privatisation and financial deregulation, including freeing of interest rates, elimination of nearly all restrictions on foreign investment, and the introduction of tax reforms, including the introduction of value-added taxes.[11] Indeed, the reforms represented a turnaround. Since the transition and consolidation of democracy in 1958, Venezuela had historically been legitimated by the state-led developmentalism, economic nationalism, a spirit of anti-imperialism,[12] with centralised rent deployment patterns controlled by the executive and brokered by two hegemonic and highly centralised and clientelist political parties.[13] The programme was intended to be an orthodox reform package along the lines of the Washington Consensus.[14] Its chief architect, Planning Minister Miguel Rodríguez, envisioned that Venezuela, in economic terms, would follow the post-1982 Chilean model of neoliberal reform.[15] While 'big push' industrial policies were discredited, there seemed to be little caution amongst the Venezuelan economic reform team that an equally ambitious 'big push' liberalisation programme could be carried out. This lack of caution was bold given that Venezuela had suffered in the previous decade from an increasingly ineffective state apparatus and party system, and had considerable fewer oil export revenues per capita to compensate the losers of the reform programme (see data on declines in oil exports below).

The impetus to these policies was a balance of payments crisis in 1988. The previous three years of the Lusinchi administration (1986-88) were characterised by populist macro management. The maintenance of several price controls and a multiple exchange rate regime were sources of corruption and distortions. In these years, the fiscal deficit averaged 7.6 percent of GDP. By 1988, inflation had reached 30 percent in an economy with historically very low inflation. The deficit on the current account had reached 9.9 percent of GDP and net international reserves were negative $US 6.2 billion.[16] As with many structural adjustment programmes, macroeconomic stabilisation was combined with economic liberalisation even though there is little evidence that it is either prudent or necessary to implement both simultaneously.[17] Restoring macroeconomic balances in the exchange rates or in fiscal accounts does not imply that trade liberalisation will improve export performance or productivity growth in a late developer.

Apart from balance of payments crisis in 1989, there were economic and political factors that contributed to a sea change in Perez's policy stance. Firstly, the long-run growth performance

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[11] For details, see R. Hausmann, 'Quitting Populism Cold Turkey', in L. Goodman, J. Forman, M. Naím, J. Tulchin and G. Bland. (eds), *Lessons from the Venezuelan Experience*, Baltimore: Johns Hopkins University Press, 1995; J. Corrales & I. Cisneros, 'Corporatism, Trade Liberalization and Sectoral Responses: The Case of Venezuela, 1989-1999', *World Development*, 27 (1999); M. A. Rodríguez, *El Impacto de la Política Económica en el Proceso de Desearollo Venezolano*, Caracas: Universidad Santa Maria, 2002.

[12] F. Coronil, *The Magical State*, Chicago: University of Chicago Press, 1998.

[13] Ironically, in the first Pérez administration (1974-1978), the government attempted one of the largest state-led 'big push' natural-resource-based industrialisation programmes in Latin America, a programme that was known as *La Gran Venezuela* (Karl, 1997, pp.143-160; J. Di John, *Mineral Resource Rents, Rent-Seeking and State Capacity in a Late Developer: The Political Economy of Industrial Policy in Venezuela 1920-1998*, PhD dissertation, University of Cambridge, Faculty of Economics and Politics, 2004, pp.137-147).

[14] J. Williamson, 'What Washington Means by Policy Reform', in Williamson, J. (ed.), *Latin American Adjustment: How Much Has Happened?* Washington: Institute for International Economics, 1990.

[15] Interview with Miguel Rodríguez, June 2003. Rodríguez failed to point out two important differences between 1989 Venezuela and post-1982 Chile. First, the latter was an authoritarian regime that had severely weakened the power of political parties and labour unions. Moreover, there was broad support for neoliberal reforms among the opposition parties in Chile, whereas there was little support in Venezuela for such reforms.

[16] Rodríguez (2002), p.39.

[17] D. Rodrik, 'Understanding Economic Policy Reform', *Journal of Economic Literature*, (March 1996).

of the Venezuelan economy and its state-led industrial strategy was becoming increasingly poor. In the period 1973-1988, gross domestic product per capita declined 15 percent. Secondly, declines in oil exports per capita further restricted the resources for patronage and induced many actors, such as labour unions and business chambers, to clamour for changes as well as reduce their loyalty to the party system, which was central to the distribution of oil rents.[18] In the period 1950-1980, real exports per capita averaged $1,550 (in 2000 dollars), but declined to $1,150 in the period 1980-1990. Within this trend decline in oil exports per capita, oil prices collapsed by 50 percent in 1986, which translated into oil exports per capita plummeting to an annual average of less than $600 per capita in the period 1986-1988. Sudden declines in commodity prices seemed to have added to the sense of 'fracasomania', as it underlined the vulnerabilities of export dependence on oil.

Politically, there was increasing domestic pressure from the mid-1980s onwards from influential business groups, who were advocating economic liberalisation as a way to increase economic efficiency and to reduce the dominance of the state and political parties over resource allocation.[19] One manifestation of this pressure was the Grupo Roraima (a group of influential business leaders, academics and consultants), which produced a series of influential documents, particularly the Proposal for the Country in 1984, critiquing state-led development policies and calling for radical change.[20] Secondly, Perez's policy conversion to neoliberalism may have been influenced by the large-scale campaign contributions and close relationships with economic groups who expected to benefit from the new rent opportunities that privatisation and liberalisation would bring.[21] Thirdly, Pérez was greatly influenced by the emergence of an elite group of academics (mostly economists and business administration experts trained in US universities) that had no party affiliation and generally were champions

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[18] M. Penfold-Becerra, 'El colapso del sistema de partidos en Venezuela: explicación de una muerte anunciada', in J.V. Carrasquero, T. Maingnon and F. Welsch (eds), *Venezuela en transición: elecciones y democracia 1998-2000*, Caracas: CDB publicaciones, 2001.

[19] While the neoclassical political economy, and in particular, rent-seeking theory links domestic pressure to the creation of state-led interventions, there is much less analysis of the role that interest groups play in inducing the state to withdraw from governing the economy (H. E. Schamis, 'Distributional Coalitions and the politics of economic reform in Latin America', *World Politics*, 51 (1999)).

[20] Grupo Roraima, *Proposición al país*, Caracas: Grupo Roraima, 1984. For a discussion of Grupo Roraima, see R. De la Cruz, *Venezuela en Busca de un Nuevo Pacto Social*, Caracas: Alfadil Ediciones, 1988, pp.71-80.

[21] Interview with Gumersindo Rodriguez, June 2003. See M. Coppedge, 'Venezuelan Parties and the Representation of Elite Interests', in K. J. Middlebrook (ed.), *Conservative Parties, the Right and Democracy in Latin America*, Baltimore: Johns Hopkins University Press, 2000, on the role of campaign contributions in influencing policy decisions. The economic groups close to the Pérez administration were popularly known as the "Twelve Apostles" (a term coined by P. Duno, *Los doce apósteles*, Valencia: Vadell Hermanos, 1975), many of who came, like Pérez from the Andean region. The ties between President Pérez and the Apostles were forged during his struggle to assume the Acción Democrática (AD) presidential candidacy in 1973, when Pérez's own isolation in AD and lack of control over the party hierarchy convinced him of the necessity of establishing a power and financial base outside the party machinery. The names of these businessmen appear in many of the financially most lucrative contracts awarded in the period 1974-1978 (T. L. Karl, *The Political Economy of Petrodollars: Oil and Democracy in Venezuela*, unpublished PhD dissertation, Department of Political Science, Stanford University. University Microfilms International, Ann Arbor Michigan, 1982, pp.463-512). To Pérez and his faction of AD, the Apostles represented an attempt to democratise capital by breaking the hegemony of traditional large family business groups. Pérez's reliance on the Apostles probably increased by 1989, since he was even less favoured by the central executive committee of his own party, AD, than in 1973. The two most influential figures were probably Pedro Tinoco, who owned one of the largest banks, Banco Latino and who became President of the Central Bank in 1989, and Diego Cisneros, head of the Cisneros Group, which became the most successful group by the 1990s, and was one of the few groups to develop extensive commercial holdings internationally.

of radical, neoliberal reform.[22] When elected many of the key positions in the cabinet were given to these academics, most of whom worked in the country's leading business school, the Instituto de Estudios Superiores de Administración (Institute of Higher Administration Studies, IESA). This group of ministers were called the 'IESA Boys' in Venezuela, analogous to the 'Chicago Boys' in Pinochet's Chile.[23] Finally, while international agencies like the World Bank, IMF, and Inter-American Development Bank, greatly supported neoliberal reforms throughout the region, there is little evidence that, in 1989, these organisations were putting pressure on the Venezuelan state to contemplate an ambitious liberalisation programme. Thus, the reform team had a high degree of 'ownership' over the programme,[24] though it is the case that once the state went to IMF and World Bank for structural adjustment loans, the programmes were orthodox in nature.

The most rapid liberalisation reforms took place in trade policy. It became well known that the protection system did not have clear performance criteria guidelines. The perpetual protection of infants that fail to grow up became the norm.[25] The trade liberalisation for industry was the most rapid in Latin America at the time, and profound. The maximum tariff was reduced from 135 percent, one the highest in the region, to 20 percent by 1992. By 1993, average tariffs declined further to 10 percent, one of the lowest levels of trade dispersion among Latin America's major liberalisers. Average tariffs were dropped from 37 percent overall and 61 percent for finished goods in 1988 to 16 percent and 26 percent respectively in the period 1991-1993.[26] The non-tariff barrier coverage declined from an average of 44 percent in the period 1985-1987 to less than 5 percent, one of the lowest rates among major Latin American trade liberalisers, in 1991-1992.[27] In terms of political reform, important institutional reforms in decentralisation were undertaken. These included elimination of political party slates and the installation of direct elections for governors and legislators at the state and municipal levels including the devolution of power in health and education sectors.[28] There were also significant changes in intergovernmental fiscal transfers. In 1989, transfers from the central government to regional governments were raised from 15 percent to 20 percent; in 1994, governors and mayors were to receive 10 percent of all value-added taxes, a percentage that was to rise to 30 percent over the subsequent five years.[29]

Indeed, the decision to implement the liberalisation programme was clearly based on the idea that the regulatory structure of the state had become the principal contributor to stagnation in

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[22] J. C. Navarro, 'Venezuela's New Political Actors', in L. Goodman, J. Forman, M. Naím, J. Tulchin and G. Bland (eds.), *Lessons from the Venezuelan Experience*, Baltimore: Johns Hopkins University Press, 1995, p.127.

[23] Coppedge (2000), p.128.

[24] This point was corroborated in both my interview with Miguel Rodriguez, and in an interview (Feb. 2004) with Anthony Elson, who worked for the IMF, during the structural adjustment loans of 1989. Of course, while the reform team may have 'owned' the programme, there was little evidence that the majority of the population would support the reforms.

[25] World Bank, *Venezuela: Industrial Sector Report*, Washington, D.C.: World Bank, 1990, p.19.

[26] Corrales & Cisneros (1999), p.2103.

[27] S. Edwards, 'Trade and Industrial Policy Reform in Latin America', in A.L. Resende (ed.), *Policies for Growth: The Latin American Experience*. Washington, D.C.: IMF, 1995, p.200. According to Cisneros & Corrales (1999), p.2102), the number of import licenses granted by the state declined from 2,204 (representing nearly 48 percent of manufacturing production) to less than 140 in 1992 (affecting approximately 2 percent of manufacturing production).

[28] R. De la Cruz (ed.), *Federalismo fiscal y decentralización*, Caracas: Edciones IESA, 1997; M. Grindle, *Audacious Reforms*, Baltimore: Johns Hopkins University Press, 2000, pp.37-93.

[29] M. Penfold-Becerra, 'Federalism and Institutional Change in Venezuela', paper presented at the American Political Science Association Annual Meeting, Boston, 2002, pp.19-20.

Venezuela.[30] The abundance of resources available and relatively high investment rates in Venezuela over long periods would strongly suggest that the problem of poor long-run growth has been, at least in part, a problem of inefficient resource management and hence incentive structures at all levels of Venezuelan society. The institutional collapse of the state apparatus was argued to be a sufficient reason for the state to "abdicate power" and let decentralized private agents assume control of coordinating economic activity.[31] This logic is broadly similar to the capability approach of the 'governance' paradigm.[32] What was not communicated to the public, however, was why a rich oil country with three years of rapid growth in the period 1986-88 needed such harsh structural adjustment.

Neo-Liberal Reforms and Economic Performance

The Venezuelan experience with economic liberalisation in the period 1989 until the emergence of Hugo Chávez as president in 1998 calls into question many of the predictions of the good governance paradigm, the capability approach and the models of rent-seeking and corruption upon which both are based.[33] It also calls into question the validity of rentier state predictions.[34] The period 1989-1998 was marked not only by the continued stagnation of output and productivity growth, but there was a growing perception that corruption had not only not declined, but was, in fact, increasing.[35]

Table 1 Growth Trends in the Venezuelan Economy, 1920-2002
(average annual growth rates*, %)

	Non-oil GDP	Manufacturing
1920-30	10.2	n.a
1930-40	2.7	n.a
1940-50	9.6	6.6
1950-57	9.1	15.0
1957-65	3.4	8.5
1965-80	5.7	5.8
1980-90	-0.1	4.3
1990-98	2.3	1.5
1998-2002	-1.9	-5.0

Notes: * all output series in 1984 bolivares
Source: Baptista (1997); Banco Central de Venezuela (BCV), *Annual Reports*, Caracas, various years

30 Naím (1993).
31 Cordiplan, *El Gran Viraje*, Caracas, 1990.
32 World Bank (1997).
33 See World Bank (1997), pp.61-77, on the capability approach; and Naím (1993) and M. Naím & A. Francés, 'The Venezuelan Private Sector: From Courting the State to Courting the Market', in L. Goodman, J. Forman, M. Naím, J. Tulchin and G. Bland (eds), *Lessons from the Venezuelan Experience*, Baltimore: Johns Hopkins University Press, 1995, for a mainstream discussion of the negative effects of rent-seeking in the Venezuelan context.
34 As developed, for example in Karl (1997).
35 Di John (2004), Table 3.2, p.87. Based on Transparency International subjective corruption indices (an index of 10 minimum corruption, an index of 0 indicates maximum corruption), Venezuela's corruption index worsened from 3.3 in the period 1980-85 to 2.5 in the period 1992-1995. See D. Treisman, 'The Causes of Corruption: A Cross National Study', *Journal of Public Economics*, 76 (2000) for a critical discussion the methodology underlying the construction of the Transparency International indices.

Per capita gross domestic product declined 2.7 percent in the liberalisation period, 1990-1998. In the non-oil economy, economic liberalisation did not reverse the long-run decline in either non-oil GDP or in manufacturing growth (see Table 1).

Manufacturing growth, which had been on a downward trend since the mid-1960s, declined from an annual average of 4.3 percent in the period 1980-1990 to 1.5 percent in the reform era of 1990-1998, and collapsed to minus 5 percent in the period 1998-2002.[36] Non-oil annual growth did increase from minus 0.1 percent in the period 1980-1990 to 2.3 percent in the period 1990-1998. However, this rate was still well below the growth rate in the previous three decades and collapsed again to minus 1.9 percent in the period 1998-2002.

Moreover, there was continued decline in total investment and particularly private sector investment as indicated in Table 2:

Table 2: Gross Fixed Investment Rates: Venezuela, 1950-1998

(annual average as percentage of GDP and non-oil GDP respectively in current prices, %)

	All investment (as % GDP)			**Non-oil investment** (as % non-oil GDP)		
	Total	**Public**	**Private**	**Total**	**Public**	**Private**
1950-60	27.7	10.5	17.2	34.8	16.9	17.8
1960-70	24.2	8.4	15.8	26.1	9.1	17.0
1970-80	34.4	10.8	23.6	36.8	9.6	27.2
1980-90	21.3	10.6	10.7	22.5	8.7	13.8
1990-98*	15.8	9.9	6.9	13.7	5.6	8.1

Note: * non-oil investment data for the period 1990-95 only

Source: Baptista (1997); (BCV), *Annual Reports*, various years; BCV (1982); Oficina Central de Estadísticas e Información (OCEI), various years.

Investment rates, particularly private investment rates, in the 1990s were significantly lower than in any period since 1950. The non-oil public investment rates in the 1990s were also lower than at any period since 1950, which also suggests that the effectiveness of the state in mobilizing resources did not increase as a result of economic reforms. The model of state abdication has not, in the Venezuelan case, led to a more secure environment in which to invest. Finally, the move toward decentralisation in the 1990s (through the creation of municipal and state elections and the transfer of service provision in health and education to state governments) has not led to significant to improvements in governance at the local and state level.[37]

[36] The socio-economic effects of long-run economic stagnation, which neoliberal reforms did not reverse, have been devastating. Firstly, there has been a dramatic decline in average real wages, which in 1995, had already fallen below the levels attained in 1950 (Baptista, *Bases cuantitativas de la economía venezolana 1830-1995*, Caracas: Fundación Polar, 1997, Table IV-1, p.145). In the period, 1995-1998, real wages declined by 4.01 percent per year. Prolonged stagnation has led to a significant increase in the incidence of poverty. The percentage of households below the poverty line was 20 percent in the 1980-81. The share of poor households increased to 36 percent in 1985-86; 42 percent in 1989-90; 51 percent in 1994-95; and 56.4 percent in 1998-2000 (G. Márquez & C. Alvarez, , *Poverty and the Labour Market in Venezuela 1982-1995*, Washington, D.C.: Social Programs Division, Inter-American Development Bank, 1996).

[37] Grindle (2000), pp.37-93.

While investment has stagnated, there has been a massive shift in the factor distribution of income in favour of profits and away from wages in the liberalization period, as indicated in Table 3:

Table 3: Net Factor Distribution of National Income in Venezuela 1950-1998

	Share of wages and salaries in national income (annual average, percent)	Share of corporate profits, dividends, rents and interest payments in national income (annual average percent)
1950-1960	47%	53%
1960-1970	46%	54%
1970-1980	49%	51%
1980-1988	46%	54%
1989-1998	36%	64%

Source: BCV, *Statistical Series*, various years

The share of corporate profits, rents and dividends oscillated between 51 percent and 54 percent in the period 1950-1988. However, in the liberalisation period of 1989-1998, capital owners appropriated an annual average of 64 percent of national income. Despite the fact that capitalist surplus appropriation and rents were increasing, private sector investment rates declined in the 1990s. In fact, much of the increased surplus appropriation went abroad as accumulated capital flight, which reached $14 billion in the period 1994-2000. Capital flight was nearly the same as the accumulated surplus in the current account of the balance-of-payments ($15 billion) in the same period.[38]

While liberalisation has been associated with a dramatic decline in labour's factorial share, it is not possible to conclude definitively that liberalisation caused this decline. There are, as Rodríguez points out, important feedback effects to consider.[39] On the one hand, labour unions had weakened prior to the liberalisation period. In 1975, the rate of unionisation was 33 percent, but fell to 26.4 percent by 1988 owing to economic stagnation and decline. Moreover, the ties between the main labour-based party, AD, and the main labour federation (the Confederación de Trabajadores de Venezuela, CTV) weakened throughout the 1980s.[40] Labour's weakened political power contributed to the decline in its bargaining power over factorial shares. One the other hand, the liberalisation policies clearly exacerbated this trend as lower factor shares along with weak demand for labour owing to stagnant investment further weakened labour's power. In the period 1988-1995, the rate of unionisation fell by

[38] Rodríguez (2002), p.67. Massive capital flight became a feature of the Venezuelan economy from 1979 onwards. In the period 1979-1983, capital flight amounted to $29.2 billion, which was larger than the public sector debt of $27 billion accumulated by 1983! See M. A. Rodriguez, 'Pubic Sector Behaviour in Venezuela', in F. Larraín and M. Selowsky (eds), *The Public Sector and the Latin American Crisis*, San Francisco: International Center for Economic Growth, 1991, and Di John (2004), pp.178-184, for a discussion of the policy failures and distributive conflicts underlying the growth in capital flight-cum debt crisis.
[39] F. Rodríguez, 'Factor Shares and Resource Booms: Accounting for the Evolution of Venezuelan Inequality', *WIDER Working Paper*, 205 (2000), pp.35-36.
[40] Roberts (2003), pp.60-61.

nearly 50 percent, declining from 26.4 percent of the workforce in 1988 to 13.5 percent in 1995.[41]

The worsening of distribution contributed to the growing polarization of politics. Such divisiveness was manifested in increasing factionalism within and between the political parties and declining support among the poor for economic reforms.[42] The severity of the growing polarisation was manifested in the widespread support among the poor for two military coup attempts in 1992, the first of which was the military rebellion of Hugo Chávez, whose popularity was based on the stressing injustices of the neo-liberal model.[43] Growing inequality was also the focal point of Rafael Caldera's famous speech in Congress in 1992, where he condemned the actions of the coup plotters, but emphasized that the discontent of the military officers was a fair reflection of the injustices of the neo-liberal programme. This speech revived Caldera's political image (he was president in the period 1968-1973).

While some analysts have hailed the full implementation of trade liberalisation as a remarkable political achievement,[44] the liberalisation period, as indicated in Table 1, failed to revive economic growth. The decline in manufacturing growth was particularly disappointing. In 1989, the first year of the 'Great Turnaround' plan, there was a dramatic decline in manufacturing output of 14.5 percent. In the period 1988-1998, manufacturing growth declined and was widespread across sectors (see Table 4). Only seven out of twenty-five sectors registered positive growth rates over the period, and most of the sectors that did register growth were in low-technology or limited growth technology sectors (i.e. food products, non-ferrous metals) natural-resource processing or were in turn-key assembly-line sectors with little technology transfer (i.e. autos).

[41] Roberts (2002), p. 61, using data from International Labour Organisation (ILO), *World Labour Report 1997-98*. Geneva: ILO, 1997, p.235. Accompanying the decline in labour union membership was an increase in informal employment in the liberalisation period. In the period 1980-90, the rate of informal employment of the non-agricultural labour force averaged 39.5 percent. However, the level of informal employment increased to an average of 44.5 percent in the period 1991-1995, with a tendency toward continued increases as the sub-period 1994-1995 saw informality rates reach an average of 48.5 percent (based on data from Central Office of Statistics and Information (OCEI), *Household Surveys* and *Employment Surveys*, various years). The consequence of growing fragmentation and informalisation of the labour and production process negatively affected the social bases of support for political parties, and hence contributed to the de-institutionalisation of conflict mediation capacities in the Venezuelan polity. It also meant that populist/outsider strategies become more likely to be effective political strategies. It is perhaps no accident that the two subsequent political leaders - Caldera and Chávez - relied on *anti-politico*/outsider discourses and less on corporatist modes of intermediation that characterised Venezuela's pacted democracy in the past.

[42] Roberts (2003). Naím (1993) explains political instability in terms of the failure in the communication strategy of the Pérez administration to inform the poor and middle class the benefits of reform. This line of reasoning underestimates the distributional impact the liberalisation model itself. Polling evidence from the period 1989-1991 suggests that the poor strata were much less likely to support the reforms than upper income groups (Roberts, 2003, p.63).

[43] See D. Canache, *Venezuela: Public Opinion and Protest in a Fragile Democracy*, Coral Gables, FL.: North-South Center, 2002, for evidence on the poor's support for the military coup as well as their continued support for Chávez in the period 1992-2000.

[44] Corrales & Cisneros (1999), p.2099.

Table 4. Growth Rates in Venezuelan Manufacturing 1988-1998
(average annual growth in gross output, %)

All manufacturing	**-1.8%**
362 glass products	6.4%
361 pottery, ceramics	5.7%
351 industrial chemicals	3.2%
311 food products	2.8%
384 transport equipment	2.4%
372 non-ferrous products	1.8%
356 plastic products	1.5%
324 footwear	0.3%
321 textiles	-0.4%
313 beverages	-1.2%
342 printing & publishing	-2.5%
354 petroleum derivatives	-3.2%
369 non-metallic minerals	-3.7%
382 non-electric machinery	-4.1%
371 iron and steel	-4.6%
383 electrical machinery	-5.4%
332 wood furniture	-6.0%
341 Pulp, paper	-6.1%
355 rubber products	-6.5%
352 Other chemical products	-6.6%
381 fabricated metal products	-7.6%
323 leather products	-7.7%
322 Apparel	-8.4%
390 other manufacturing	-9.0%
314 tobacco	-9.3%

Source: OCEI, various years; BCV, *Statistic Series*, various years

Economic liberalisation has also induced changes in manufacturing product specialisation that are unlikely to enhance long-run productivity growth and technological development. Table 5 illustrates the extent to which the relative shares of manufacturing sectors with different technological characteristics have changed in the period 1970-1998.

Table 5. Structure of Manufacturing Value-Added in Venezuela, 1970, 1990, 1996, 1998*

Sectors	1970	1990	1996	1998
I	5.3	12.4	11.2	11.0
II	5.1	1.7	2.3	3.0
III+IV	52.8	55.4	61.3	60.3
V	33.2	30.4	25.3	25.8

* Notes: Following Katz (2000), pp.1591-1592, the groups used here are as follows: I. metalworking and engineering-intensive industries; except motor vehicles (ISIC 381, 382, 383, 385); II. Motor vehicles (ISIC 384); III. Food, beverages and tobacco (ISIC 311, 312, 313); IV. Natural-resource processing industries (ISIC 341, 351, 354, 355, 356,371, 372); V. labour-intensive industries (ISIC 321, 322, 323, 324, 331, 332, 342, 352, 361, 362, 361, 390).
Source: OCEI, various years

Following the classification by Katz, Group I are technology-intensive sectors where productivity growth is likely to be greatest. Group II is the motor-vehicle sector where growth is generally dependent on the extent to which foreign direct investment is active. Groups III and IV are the capital-intensive sectors of food processing and natural-resource production. Group V are generally low-technology, labour-intensive sectors such as footwear.[45]

There are several important trends to consider. First, the technology-intensive sectors (I) increased from a low base before economic liberalization. Thereafter, their share in total manufacturing value-added (MVA) decreases slightly from 12.4 percent in 1990 to 11.0 in 1998. Thus, all of the increase in technology-intensive sectors occurs in the era of protectionism. The share of group I sectors in Venezuela by 1996 is similar to other medium-sized Latin American countries such as Chile and Colombia.[46] Second, liberalisation has induced a further specialisation in the capital-intensive sectors of foodstuffs and natural-resource processing. The share in MVA of groups III and IV increased from 55.4 in 1990 to 60.3 percent. The centrality of these sectors in product specialisation limits employment creation, increases the investment requirements of production and is only modestly dynamic in terms of technological development. Once again, Venezuela's focus on foodstuffs and natural-resource production is similar to the Latin American pattern in the 1990s.[47] Third, a somewhat surprising outcome of liberalisation is a decline in the share of the labour-intensive sectors. The group V share in MVA declines from 30.4 percent to 25.8 percent in 1998. One of the main ideas in the Washington Consensus was that devaluation, by reducing wage costs, would induce more labour-intensive production. This has clearly not happened in Venezuela; nor has it happened more generally in Latin America in the 1990s.

In sum, the liberalisation period has not generally promoted shifts in production that are either productivity-enhancing or favourable for employment creation in Venezuela. The high levels of service sector production, which tends to be more informal and less unionisable, also affected the social bases of support for political parties. As indicated in Table 6, the economic liberalisation period has seen slight increases in already high levels of 'premature tertiarisation':

Table 6: Structural Change in Composition of Non-Oil National Product: Venezuela 1950-1998

(at 1984 prices and expressed as % of non-oil GDP)

	Agriculture	Manufacturing	Rest of Industry*	Services
1950	8	8	22	52
1960	6	15	24	55
1973	7	16	17	60
1981	6	18	17	59
1990	6	20	10	64
1995	6	19	14	61
1998	6	20	10	64

Note: * refers to construction, mining and electricity and water sectors

Source: BCV, *Statistical Series*, various years

[45] J. Katz, 'Structural Change and Labour Productivity Growth in Latin American Manufacturing Industries 1970-1996', *World Development*, 28:2 (2000), p.1591.

[46] Katz (2000), p.1592.

[47] Katz (2000), p.1592.

The consequence of growing fragmentation and informalisation of the labour and production process means that populist/outsider strategies become more likely to be effective political strategies. It is thus no accident that the two subsequent political leaders – Caldera and Chávez – relied on anti-political discourses and less on corporatist modes of intermediation that characterised Venezuela's pacted democracy in the past.

While economic liberalisation policies may have provided increased discipline over producers compared with the previous era of protectionism, it did not provide the incentives for firms to engage in re-structuring. There are several reasons for this. First, the rapid trade liberalisation left many firms with little time to compete with lower priced imports. Second, financial deregulation led to a drastic increase in interest rates. Bank loan rates, which were fixed at often-negative real rates, averaged 12 percent in the 1980s. In 1989, with financial deregulation, the loan rate jumped dramatically to 34 percent and averaged 45 percent in the period 1990-1998.[48] The average ratio of bank credits to GDP in the period 1989-1993 declined to 31.3 percent, nearly one-half the ratio of 52.6 percent in 1988.[49] Third, credit to manufacturing firms, particularly small and medium declined dramatically and was instrumental in weakening political support from parts of the business community for the neo-liberal reform. In the context of trade liberalisation and economic stagnation, many of the family conglomerate groups engaged in manufacturing were dismantled,[50] and many smaller operations were forced into bankruptcy. There is little evidence that competitive pressures were providing growth-enhancing and productivity-enhancing producer incentives.

In addition to lagging growth and investment in the liberalisation period, the inability of the state to effectively regulate the banking system was a powerful indication that a smaller state does not necessarily produce a state capable of managing 'fundamental' regulatory functions effectively. Venezuela experienced a major collapse of the banking sector as severe as the worst in recent economic times, including financial crises in East Asia. The lack of supervisory and regulatory mechanisms and blatant theft of government bailout funds by bankers (estimated at nearly $US 7 billion) in the form of capital flight led to large-scale bank closings and government takeover of many of the economy's largest commercial banks in 1994 and 1995. The bailout cost the government the equivalent of 18 percent of GDP, the fifth most severe banking crisis in the world during the period 1975-1995.[51] The main cause of this crisis was the weakness of the state vis-à-vis financial groups and its inability to impose effective banking supervision, regulation and enforcement of fraudulent practices in the financial liberalisation period.[52] Some of the leverage that large financial groups had derived from the large campaign contributions many made to the Pérez presidential campaign.[53] Moreover, the financial groups were able to resist opening the banking system to

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[48] R. De Krivoy, *Colaspo del Sistema Bancaria Venezolana de 1994*, Caracas: Ediciones IESA, 2002, p.308.

[49] De Krivoy (2002), pp.55-56.

[50] A. Francés, 'Qué le paso a la empresa venezolana en los noventa?', *Debates IESA*, 3 (2001).

[51] World Bank (1997), p.68.

[52] De Krivoy (2002).

[53] Coppedge (2000). The appointment of Pedro Tinoco (one of Pérez's Twelve Apostles) as Central Bank President was indicative of the power of the financial community and the degree of cronyism between the executive and some big financial groups. Tinoco owned Banco Latino, which went from the fifth largest to second largest bank in the period 1989-1993. Banco Latino became the largest holder of government treasury bonds, one of the more lucrative enterprises in the banking sector. The lack of banking regulation permitted Latino and other banks to engage in self-loans, and transfer large amounts of deposits offshore. By 1993, 70 percent of all bank's assets were self-loans (De Krivoy, 2002, p.165).

foreign competition and takeover until 1995.[54] In the period 1989-1992, the annual budget of the banking regulation board amounted to a paltry $8,000 per private financial institution. This amount was equivalent to the annual salary of a middle level manager.[55] Weak state capacity in this case was not simply 'inherited', as the capability approach would have it, but was the result of the political power of financial groups able to resist changes in the regulatory system and to resist implementation of already existing laws.

Neo-Liberal Reforms, Corruption and Political Instability

The liberalisation period also produced uncertainty and political tension, and increased in the perception that corruption had worsened. The sudden deregulation led to a frenzy of what Naím refers to as "oligopolistic wars" among business groups vying for control over raw material supplies, financing, and distribution channels.[56] The rapid dismantling of trade protection and a decline in state-business cooperation had no counterpart in trust and 'social capital' of inter-conglomerate networks. The particularistic nature of the 'politics of privilege' between the state and business groups meant that business and industrial chamber associations lacked effective collective institutions. In the context of weak judicial and regulatory mechanisms, these wars turned into nasty battles undertaken in the media as business groups aggressively invested in newspapers, magazines, and radio and television stations. According to Naím and Francés, there reached a point where no major media enterprise was independent from a major private conglomerate group.[57] The limited social capital of business groups clearly intensified a 'war of positions' within the private sector that added greatly to the atmosphere of political and social instability that marked the liberalisation era of the 1990s. Neo-liberalism, if anything, created the setting for increases in mafia-like activity to appropriate the large rents that suddenly emerged with deregulation.

The manner in which economic liberalisation was introduced also de-stabilised the polity. Pérez, elected in a landslide, had been president in the period 1974-1979, and many voters associated him with a period of prosperity and state largesse. Neither Pérez nor his party, Acción Democrática, stressed during the campaign that rapid and profound reforms were planned, though there were policy documents that indicated that some market reforms would be initiated.[58] By 'hiding' his policy intentions, Perez was one among many 'first generation' reformers in Latin America such as Salinas in Mexico, Fujimori in Peru and Menem in Argentina, that introduced economic reforms in the early 1990s despite running a campaign that 'hid' policy reform intentions. This misrepresentation of policy intention during the campaign – essentially deceiving the electorate – was to prove damaging to the long-standing consultation process in the Venezuelan polity.[59]

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[54] The banking crisis of 1994 left Venezuelan banks' book values at historic lows. In the period 1995-1998, a wave of foreign investment followed in the banking sector led by two leading Spanish banks, Banco Santander Central Hispano (BSCH) and Banco Bilbao Vizcaya Argentaria (BBVA). The increase in market share of foreign-owned banks went from less than 2 percent in 1994 to over 40 percent by 1999 (World Bank, *World Development Report: Building Institutions for Markets*, Oxford: Oxford University Press, 2002, p.89).

[55] De Krivoy (2002), p.30.

[56] Naím (1993), pp.95-100.

[57] Naím & Francés (1995).

[58] Stambouli (2002), pp.175-176.

[59] The second major policy switch in the period under study occurred in 1996 when Rafael Caldera, who won the Presidency in 1993 running on an anti-corruption, anti-neoliberal campaign, abandoned two years of price and capital controls and endorsed the Agenda Venezuela, a structural adjustment package with IMF support. The policy switch did only not reverse economic stagnation, it led to a further disillusionment with the party

Hiding reform intentions exacerbated the 'shock' to the public when economic liberalisation therapy was actually introduced. A few weeks after the announcement of reforms, Venezuela experienced its bloodiest urban riots since urban guerrilla warfare in the 1960s. The riots, known as the Caracazo, occurred in late February 1989. A doubling of gasoline prices, which were passed on by private bus companies, induced the outbursts. The government had actually announced that bus fares were allowed to rise by 30 percent, but did not monitor the increases bus companies were charging. Moreover, bus drivers ignored discounts to student prices.[60] The riots that ensued were contained by a relatively undisciplined military response that left more than 350 dead in two days. Although never documented, there are many informal accounts that point to left-wing organisations that mobilised groups to incite riots when gas prices were increased.[61]

The way in which liberalisation reforms were decided was also divisive. Pérez decided to completely abandon consultations with large rival factions within his party, AD, and introduced reforms by relying on insulated technocratic decision-making. Since 1958, Venezuela's democracy had been consolidated around a series of political pacts that relied on consensus building among the main political parties, labour unions and business associations. Two-thirds of cabinet ministers were from outside the governing political party, a move that created resentment and opposition in the legislative assemblies, including within AD.[62] Moreover, Pérez and his ministers' discourse were confrontational and insulting to anti-Pérez factions within AD. Miguel Rodriguez, the planning minister labelled reform critics as "dinosaurs", "unadapted", "cowards", and "unschooled", and Pérez did little to dissociate himself from such remarks.[63] Such a discourse contributed to the 'activation of boundaries' between the self-proclaimed 'modern' reformers and the 'backward' old guard of the political parties. The creation and activation of boundaries contribute to the escalation of political conflict and violence.[64] The break with pact-making and consultation exacerbated the emerging factionalism between and within political parties, and was largely responsible for the adversarial executive-party relations in the first three years of reform, and the massive increase in corruption scandals and accusations in the period.[65] As a result, political instability and investment risks increased.

One way to gauge the increase in conflict is to examine inflation levels, which reflect increases in the intensity of distributive struggles,[66] and the increasing inability of the state to manage such conflicts. While Venezuela's inflation rates have been relatively low by Latin American standards throughout, as indicated in Table 7, the rises in the 1980s and 1990s have been significant in terms of the country's own record of low inflation:

system and a deterioration of state institutions and public services (M. López Maya, 'Hugo Chávez Frías: His Movement and His Presidency', in S. Ellner and D. Hellinger (eds), *Venezuelan Politics in the Chávez Era: Class, Polarization and Conflict*, Boulder: Lynne Rienner, 2003, p.83).

60 J. Corrales, *Presidents without Parties*, University Park: Penn State Press, 2002, p.51.

61 Interviews with military officers and leaders of the Bolivarian Circles (June 2003).

62 Stambouli (2002) pp.179-180.

63 Corrales (2002), p.122.

64 C. Tilly, *The Politics of Collective Violence*, Cambridge: Cambridge University Press, 2003, p.96.

65 The rebellion of Pérez's own party, along with the 1989 riots, contributed to the isolation of the Executive. Such isolation 'signalled' a legitimacy crisis for the government, which, in turn, emboldened further attacks against the state (Corrales, 2002, p.167). The most notable examples were the two coup attempts in 1992 and the support among all political parties for the impeachment of Pérez, (who was forced to resign in May 1993).

66 B. Rowthorn, *Capitalism, Conflict and Inflation*, London: Lawrence and Wishart, 1971.

Table 7: Inflation Rates in Latin America, 1960-2002
(average, annual change, %)

	1960-70	1970-80	1980-90	1990-98	1998-2002
Average	**14.4**	**72.0**	**223.0**	**253.0**	**9.6**
Venezuela	**1.0**	**6.6**	**23.0**	**50.1**	**23.4**
Argentina	22.4	132.9	565.7	281.1	7.1
Peru	9.9	26.5	481.3	897.3	3.3
Chile	26.6	174.6	21.4	12.7	3.5
Colombia	12.0	19.3	23.5	23.7	10.6

Source: World Bank, various years

Clearly, economic liberalisation did not generate a constellation of political constituents capable of imposing stable macroeconomic management within the state.[67]

The increase in executive-party tensions, along with two coup attempts, heightened the resistance to reforms. Indeed, the Pérez government was forced to abandon many reforms. The programmes abandoned included banking reform, the creation of a Macroeconomic Stabilisation Fund, and increases in petroleum product prices.[68] Abandoning some reforms contributed to further political destabilisation. For example, the failure of the state to implement a meaningful and progressive tax reform signalled that the wealthier groups were able to effectively resist shouldering the burdens of reforms. When tax reform was finally implemented in 1995, the main increases were in value-added taxes, which increased from 0.5 percent of GDP in 1990-1994 to 3.9 percent of GDP in 1995-1998.[69] Income and property taxes remained negligible,[70] and were among the lowest on the continent. The regressiveness of value-added taxes and the generally low tax effort on the rich further exacerbated the growing problem of income inequality and the polarisation of politics. Regardless of the desirability of these reforms, the capability approach does not explain where the power and legitimacy of the state to implement reforms will come from to maintain the reform process.

The perception that corruption increased in the context of liberalisation also refutes the predictions of the 'capability approach'. The reasons for this increase are complex though several factors have contributed. First, the insulated manner in which policy reforms were introduced ran contrary to the consultative processes that had characterized the political pacts upon which Venezuelan democracy was built since 1958. Such insulation exacerbated factionalism within the governing party and between the government and opposition parties.

[67] A further indication failed macroeconomic policy can be seen in increasing exchange rate crises, particularly after 1983. From 1942-1961, the exchange rate remained fixed at 3.30 bolivares/dollar. Following a balance of payments crisis in the late 1950's, the exchange rate was devalued to 4.20 in 1961 and remained fixed between 4.20 and 4.40 from 1961-1982. In the period 1983-1999, the country experienced four different currency regimes and six currency crises. By 1988, the free market rate had fallen to 28.2/dollar during the multiple exchange rate regime in the period 1985-1988. Unification of the exchange rate as part of the economic liberalisation package brought a further devaluation to 50.5/dollar by the end of 1990. The long-run trend decline has continued as the exchange rate fell to below 600/dollar by the end of 1999.

[68] Corrales (2002), p.61.

[69] V. Tanzi, 'Taxation in Latin America in the Last Decade', paper prepared for conference on 'Fsical and Financial Reforms in Latin America', Stanford Univeristy, November 9-10, 2000, p.22.

[70] C. Obregón & F. Rodríguez, 'La Politica Fiscal Venezolana 1943-2001', *Reporte de Coyuntura Annual 2001*, Caracas: Oficina de Asesoría Económica y Financiera, 2001, p.25.

This increase in factionalism increased the degree of ‘whistle-blowing’, as those left out of decision-making used the corruption scandal as a weapon of political contestation. Moreover, the high levels of campaign financing by some of the prominent business groups for the Perez presidency created animosities among rival contenders within AD, and fuelled allegations that Pérez supporters would benefit from reforms. Rafael Caldera emerged as the leading political opponent of neo-liberal reforms in the early 1990s on an anti-corruption platform. He won the presidency in 1994. Second, the media increased and magnified the coverage of scandals, including the growing anti-corruption discourse among politicians and rival economic groups, which increased public perception that corruption was increasing.[71] The fact that few scandals ever resulted in arrests or penalties further fuelled public outrage. Third, the failure of the state to effectively regulate the banking system allowed bank owners and managers to engage in the illegal diversion of funds to off-shore accounts and to illegally fund their related business interests in non-banking ventures.[72] Finally, the decline real wages in combination with growing inequality quite likely reduced the tolerance the majority of people had for corruption and thus corruption scandals became politically more explosive and de-stabilising.

Finally, the liberalisation period coincided with a decided disintegration in the legitimacy of the political party system and growing crisis of governability, which was manifested in the ensuing social unrest and political violence. The magnitude of the crisis in governability was evident with the decline in the legitimacy of the dominant governing political parties, as evidenced in dramatic increases in voter abstentionism.[73] Apart from growing abstentionism, there are several other clear indicators of the decline in the legitimacy of the two dominant political parties since the consolidation of democracy in 1958. While one of the two parties has won the presidency from 1958 onwards; since 1993, neither party has held the presidency. There were also two abortive military coups in 1992, and the impeachment of Carlos Andrés Pérez’s presidential term in 1994 on corruption charges.

In 1998, the landslide presidential victory of a popular political outsider and former coup-plotter, Hugo Chávez and his Fifth Republic Movement, based on a radical (‘Bolivarian’) nationalist doctrine, and the virtual disappearance of the once dominant political parties, AD and COPEI, manifests a rupture in a dramatic period of evolving crisis. The nature of Venezuelan democracy has, like many of its Andean neighbours experiencing economic crises, moved toward a stronger presidential system with a declining role for political parties, along with the rise of political outsiders/*anti-políticos*. The Chávez administration, taking advantage of high levels of electoral support, changed the Constitution in 1999. These changes have curtailed the funding of political parties significantly. Moreover, Chávez increased the political role of the military and greatly increased patronage appointing military officers loyal to him to high public offices in the state. This, along with a strong anti-oligarchic discourse, polarised politics significantly in the period 2000-2003.

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[71] Pérez Perdomo, ‘Corruption and Political Crisis’, in L. Goodman, J. Forman, M. Naím, J. Tulchin & G. Bland (eds.), *Lessons from the Venezuelan Experience*, Baltimore: Johns Hopkins University Press, 1995.
[72] De Krivoy (2002).
[73] Since the consolidation of democratic elections in 1958, voter abstention rates averaged 7.6% in the five presidential elections in the period 1958-1983. From 1983, these rates increased dramatically: 18.1% in 1988, 39.8% in 1993 and 32.3% in 1998. At the regional and local levels, the average level of abstention in state and local elections since the institution of decentralized elections in 1979 has been dramatically increasing as well. The aggregate figures for state/local abstention rates are as follows: 1979 (27.1%), 1984 (40.7%), 1989 (55.0%), 1992 (52.8%), 1995 (53.9%). The data on all abstention rates from 1958-1995 are taken from Grindle (2000), p.83. The figures for 1998 are taken from the Venezuelan National Commission of Elections (www. Elecciones.eud.com/absten.ntm).

The Venezuelan Experience in Comparative Perspective

In comparative perspective, the breakdown and crisis of the Venezuelan state to govern the economy was among the most severe in Latin America in the 1990s. While it is beyond the scope of this paper to explore detailed comparisons, there are several factors that may have contributed to the more de-stabilising effects of neoliberalism in Venezuela.

First, politically, neoliberalism became associated in Venezuela with a worsening of income distribution. In the period 1970-1990, Venezuela had among the least unequal distributions of income in Latin America: only Uruguay, Costa Rica, Peru and Cuba were less unequal.[74] However, in the period 1990-1997, the growth in income inequality in Venezuela was the fastest in the region.[75] In comparative terms, the growth in inequality was perhaps more destabilizing politically in Venezuela than in other reformers, where the initiation of reforms began with among the highest levels of income inequality such as in Brazil, Chile or Mexico. In the latter countries, there was little scope for income distribution to worsen further. This suggests that rapid *increases* in income inequality matter more for instability than initial *levels* of inequality (Brazil and Chile have had much higher levels of income inequality yet have proven much more stable politically).

Secondly, hiding reform intentions and then attempting policy switches can be particularly de-stabilising in a long-standing democracy where economic programmes were generally predictable and known. Given the comparatively inclusive and consultative tradition in Venezuelan politics, such a "policy switch"[76] may have proved more de-stabilising than in many other Latin American reformers where either democratic politics was less salient (i.e. Chile, Mexico, Argentina) or where more chaotic macroeconomic management resulting in hyper-inflation and policy switches were a common feature of recent pre-reform history (i.e. Argentina, Peru, Bolivia, Brazil).

Third, the absence of immediate threats to the economy and polity also made a radical policy switch less justifiable, and thus less legitimate to many interest groups. Venezuela was experiencing a crisis of long-run economic stagnation but its effects were gradual. First, the economy was not experiencing hyper-inflation, which damages the incomes of the poor and middle-classes and which requires immediate and draconian measures as were implemented in Argentina and Peru. Second, there was no threat of guerrilla insurgency as in Peru or Colombia. Such threats can give the executive greater legitimacy and leverage to act without legislative consent. Finally, many people still believed Venezuela was a rich oil economy and did not need reforms.[77]

Finally, the failure of the Pérez government to forge an effective alliance with all tiers of the military, especially in the context of its party-neglecting strategy, proved disastrous. Many of the middle-ranking military officers had been disgruntled with the control political parties had

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[74] Inter-American Development Bank (IADB), *Development Beyond Economics*, Washington D.C.: IABD, 2000; Carmelo Mesa-Lago, *Market, Socialist, and Mixed Economies: Comparative Policy and Performance, Chile, Cuba and Costa Rica*, Baltimore & London: The Johns Hopkins University Press, 2000, Table V.14, p.639.

[75] M. Szekely M. Hilgert, 'The 1990's in Latin America: Another Decade of Persistent Inequality', Working Paper, Inter-American Development Bank, Research Department, 1999.

[76] S. Stokes, 'What do policy switches tell us about democracy?' in A. Przeworski, S. Stokes and B. Manin (eds), *Democracy, Accountability and Representation*, Cambridge: Cambridge University Press, 1999.

[77] M. Naím, 'The Real Story Behind Venezuela's Woes', *Journal of Democracy*, 12:2 (2001), p.20.

over promotions – a problem Pérez ignored.[78] In comparative perspective, Fujimori in Peru, while also antagonistic to parties, was more successful in maintaining stability and the reform process precisely because his government made an effective alliance with the military, and even increased its role in the government. Given the shifts in power balances and assets that liberalisation can bring, it is perhaps no accident that the relatively successful reconstruction of public authority and state capacity in Chile and Mexico, two countries undertaking neoliberal reforms, was achieved in the context of non-democratic continuity.[79]

Lessons from Neo-liberal Reforms in Venezuela

The logic of the state abdication model is to reduce the discretionary control by the state over rent creation through economic liberalisation and advocate greater democracy, which is supposed to make state action more accountable, transparent and predictable. Firstly, there is no evidence that state abdication, by reducing some type of state-created rents, reduces rent-seeking and corruption. The regulatory structure of the state is still open to influencing under any type of economic regime. Secondly, democratic reforms, and in particular, decentralisation, have not made the regulatory environment more secure. If anything, the institutional environment has become more uncertain with the decline in the legitimacy of political parties and government ministries in this period.

The Venezuelan experience also calls into question many other implicit assumptions with respect to the capability approach. First, 'building up' state capacities are marginalised in favour of 'levelling down' the state's role in the economy. Second, it is suggested that the net benefits of living with market failures outweigh the net benefits of actual state interventions in most developing countries. Neither of the first two assumptions is valid for the Venezuelan experience. Downsizing the state has, far from improving state capacity led to a collapse in the Venezuelan state regulatory capacity. There is little sensitivity in the capability approach to the historical factors behind the size of the state, and how a state's size may serve important functions of, for example, maintaining political stability and social cohesion. Third, there is little distinction made between low and middle-income countries. This is an important lacuna since, for poor economies, resource constraints may limit effective state capacity, whereas the relevant question for middle-income countries is *why* capacity is missing. Fourth, the capability approach endorses the idea that there are prerequisite capacity requirements to economic development. This is ahistorical. As Gerschenkron argued, the very process of embarking on late industrialization occurred despite the lack of any obvious prerequisite capacities in late developers.[80] As such, late development involves the development of capacity and endowment in the very course of industrialisation. In any case, there is little evidence that long-run growth paths were initiated in any late developing country by liberalising trade and reducing corruption. Finally, the capacity of the state to effectively regulate market activity (i.e. competition policy, financial regulation) is judged to be unproblematic in a more liberalised market economy. One of the reasons for this may be that there is little discussion of the large-scale rents that neo-liberal reforms create. The reality is

[78] F. Aguero, 'Debilitating Democracy: Political Elites and Military Rebels', in L. Goodman, J. Forman, M. Naím, J. Tulchin and G. Bland. (eds), *Lessons from the Venezuelan Experience*, Baltimore: Johns Hopkins University Press, 1995.
[79] M. Cavarozzi, 'Politics: A Key for the Long-Term in South America', in W.C. Smith, C.H. Acuña and E.A. Gamarra (eds), *Latin American Political Economy in the Age of Neoliberal Reform*, Miami: North-South Center, 1994, p.138.
[80] A. Gerschenkron, *Economic Backwardness in Historical Perspective*, Cambridge: Harvard University Press, 1962.

that financial deregulation, large-scale privatisations, and private monopolies create large rents, and thus rent-seeking/corruption opportunities. Moreover, the fact that much of these rents are new implies that the state will need to immediately develop regulatory capacities; otherwise monopoly power can be exercised relatively easily. The inability of the Venezuelan state to effectively implement financial reforms and regulations is a case in point. 'Getting institutions right' is not simply a technical exercise but requires an understanding of politics, and in particular, where and how the power and legitimacy of the state to enforce rules and defend property rights will arise.

While decline in state capacity and economic decline have been a main factor behind the collapse of the old pacted democracy, it is important to incorporate the role specific strategies played in the systems demise. This downfall was not an inevitable result of economic decline as some have argued.[81] The inevitability of decline also prevails more generally in new institutional theories of path dependency that view degenerate development paths and stagnation as historically inevitable given the set of institutions a country inherits.[82] Path dependency allows no room for politics or agency and would thus seem ill suited as a framework for understanding the contemporary trajectory of the Venezuelan polity. The timing of the breakdown requires explanation, and the contingent political strategies to implement reform and their political and economic impacts need, at least, to be included in the multifaceted process that constitutes the collapse of the party system and the capacity of the state to govern the economy. Finally, the brief comparison with other Latin American economies suggests that policy switches and political party-neglecting strategies are potentially more de-stabilising in long-standing democracies where consultation is an inherited feature of the polity.

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[81] Penfold-Becerra (2001); R. Hausmann, 'Venezuela's Growth Implosion: A Neoclassical Story?' in D. Rodrik (ed.), *In Search of Prosperity*, Princeton: Princeton University Press, 2003.

[82] D. North, *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press, 1990.

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- We will assess how constellations of power at local, national and global levels drive processes of institutional change, collapse and reconstruction and in doing so will challenge simplistic paradigms about the beneficial effects of economic and political liberalisation.
- We will examine the effects of international interventions promoting democratic reform, human rights and market competition on the 'conflict management capacity' and production and distributional systems of existing polities.
- We will analyse how communities have responded to crisis, and the incentives and moral frameworks that have led either toward violent or non-violent outcomes.
- We will examine what kinds of formal and informal institutional arrangements poor communities have constructed to deal with economic survival and local order.

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