21st-century socialism in Venezuela is broken. Ways out of the current economic crisis

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Regardless of who prevails the political crisis the country is undergoing, Venezuela is in urgent need of crisis-management policy-making. Policies need to be sensible enough so that the country can recover from what is its worst crisis since *el bloqueo*.

The question now is to see whether there is an alternative to non-adjustment "Madurism" or the classical Washington Consensus recipe in its nth reloaded version, which by the way would not look that different from Unasur's stabilization plan.

Of course, there are, despite what Margaret Thatcher or even Rafael Caldera might have us want to believe. The policy implications of a recent Latin American economic theory and China's early liberalization experience seem appropriate to at least make a reference to when thinking about policies to take the country out of its current crisis.

Learning from old developmentalism and neoliberalism

The economic development theory that I refer to is new developmentalism (ND). It considers the exchange rate to be the most important macroeconomic variable affecting a developing country's development path. Luiz Carlos Bresser-Pereira, one of Brazil's current top economists is the most prominent author of this literature.

ND was born in Brazil during the early years of the Lula administration. It emerged as a critique to his continuation of Fernando Henrique Cardoso's set of macroeconomic institutions, which are derived from what is known in the literature as the Augmented Washington Consensus or the Washington Consensus Plus agenda.

These institutions are referred to as the macroeconomic tripod in Brazil. They include mandatory primary fiscal surpluses, a floating exchange rate and an inflation targeting central bank. They are so anchored in this country that messing with the first one is what led to Dilma's removal.

But wait, aren't exactly these policies the state of the art in macroeconomic policy making and thus what Venezuela needs? Not quite. ND's critique to these set of institutions is that they are too focused on inflation fighting. New developmentalist argue in favor of institutions with a broader goal of macroeconomic stability, i.e. not only a low and stable inflation rate, but also a stable exchange rate, interest rate, profit and wage rates.

New developmentalist authors argue that actually focusing on inflation has been the driving force behind the real's appreciation trend in the 2000s, which co-existed with a "reprimarization" of the country's export basket.

ND explains the problem with the macroeconomic tripod as follows. To keep inflation at bay, the Brazilian *Banco Central* has kept for a long time a high policy interest rate, the *selic*. At the current level of 13.75%, Brazil is far away from the low-rate world German savers complain about.

When you combine high rates with free capital mobility and a floating exchange rate, you create incentives for carry trade that fuel currency appreciation during times of high liquidity in developed economies. Such a high interest rate, combined with an appreciated exchange rate, dampens investment in the manufacturing tradable sector, which according to many strands of the literature is the driver of productivity growth, i.e. economic development.

Perhaps many are not aware of this, but export "reprimarization" is a shocking trend for Brazilian development economists, given that the country managed to diversify its export basket away from commodities between the 1960s and early 2000s. Such a reversal is a problem because, as we know in Venezuela, dependence on primary exports tends to increase the volatility of your growth trajectory, especially if you are a developing country.

The main policy implication of ND is to strive for an undervalued exchange rate, such as in China. Needless to say, this was never followed by the Lula and Dilma administrations. Instead, what these governments followed was labeled "social developmentalism", given its focus on stimulating the economy by internal demand increases fueled by continuous minimum wage hikes and social spending.

Venezuelan observers might be tempted to call this strategy *Chavismo* light, i.e. a strong focus on social spending and minimum wage increases, within the straightjacket of neoliberal macroeconomic institutions. Funny enough such a constellation never existed in Chavez's Venezuela. He either followed neoliberal macro policies between 1999–2002 with no relevant social policies expending boost or increased them afterward abandoning the neoliberal dogma.

ND focus on the exchange rate as a key policy target is in no small measure influenced by the Chinese experience. Let's now then discuss which features of the Chinese liberalization experiment could be relevant for a blueprint of a Venezuelan anti-crisis plan.

The relevance of China's liberalization experience for Venezuela

China's liberalization experience seems worthwhile to consider given that a non-democratic government undertook it. Moreover, until the reforms were set in place, the previous development strategy brought the country to African levels of poverty.

Here the parallel with the Venezuelan government is not exaggerated. Maduro has governed the country without any type of counterbalance by the national assembly, be it dominated by *Chavistas* (2013–2015) or the opposition (since 2016). Given this precedent, it is hard to see how an opposition president will want to reduce her powers once in office.

Moreover, despite the World Bank classifying Venezuela as an upper-middle -income country, the country's GDP per capita, when calculated in current dollars at the black market rate (link not easily available within Venezuela because of given government censorship), is less than USD 100. This is an income level that should make the country soon join the club of least developed countries.

For those of you interested in the economics of transition, Justin Yifu Lin's work is a good place to start. He was the World Bank's chief economist (the first from a non-Western country) and is nowadays a professor at Peking University. He has compared transition experiences in Eastern Europe with that of China and concludes that shock therapy is costly.

Most European transition economies more or less halved their GDP per capita and took over a decade to recover their pre-transition income levels. These countries followed the shock therapies designed by Jeffrey Sachs. He was also the mastermind behind the shock therapies applied before in Latin America.

Yet, China, a country that did not apply a shock therapy, never experienced these so-called transition recessions and actually managed to almost double its GDP per capita ten years after liberalizing.

That shock therapy is painful is hardly news for Venezuelans old enough to remember the string of events that started with Carlos Andrés Pérez's IMF-backed structural adjustment program "El Paquetazo" in the late 1980s, the *Caracazo* riots that followed, the failed coup d'Etats that mainstreamed Chavez, the worst banking crisis the country has faced, the "Agenda Venezuela" another IMF-backed austerity program and finally the election of Chavez as president in 1998. Please think about these string of events whenever you think that Venezuela's solution to the crisis is a shock therapy.

Lin argues that the negative impact of a shock therapy depends on the importance of output and employment of non-viable enterprises. In today's Venezuela, this negative impact should thus be large given the omnipresence of loss-making state-owned enterprises (SOEs) and private enterprises that can only survive thanks to subsidized dollars for importing inputs and machinery.

The three most relevant differences between your typical shock therapy and China's liberalization have to do with how the Chinese government dealt with its system of government set prices, the exchange rate, and SOEs.

Privatization was not high in the Chinese liberalization agenda, contrary to what happened in most countries applying shock therapies. Even nowadays Chinese SOEs represent about a quarter of the country's GDP, a similar proportion exhibited in some Nordic countries.

In the case of Venezuela, one single SOE represents about a third of the country's GDP, namely PDVSA. Given its strategic role, the company should definitely remain in public hands. Yet, the case is considerably weaker for most of the other SOEs, especially the ones renationalized in the peak of the 2000s oil boom. However, following the Chinese gradualist approach, privatization of these SOEs should be gradually done.

Moreover, China applied the dual-track pricing system, which was designed as a smooth transition from government to market set prices. So instead of liberalizing all prices overnight, between the conception of the idea in the mid-1980s and the early 1990s the share of goods with prices regulated by the state gradually diminished to almost nothing.

Following this logic, the Venezuelan government should maybe start by reviewing the need to regulate the price of staples in private supermarkets in middle and high-class neighborhoods. The economies of scale of these chains will most surely allow them to underprice *bachaqueros*, the infamous black-market middle-men.

On the exchange rate front, by the early 1980s China had a two-tier exchange rate system, including the official rate and the so-called swap rate where regional public foreign trade companies were allowed to freely exchange part of their export proceeds against RMB.

Given that the swap rate was more or less guided by market forces, it tended to be more depreciated than the official rate. Moreover, in China in the 1980s and early 1990s, as in Venezuela nowadays, the difference between the two exchange rates, which oscillated between 30 and 100%, stimulated rent-seeking behavior. This problem was eliminating by unifying the exchange rate to the more depreciated "market" rate and instituting ever since a managed float.

Given that in Venezuela the difference between the most appreciated parity, nowadays called Dipro at BsF. 10 to the dollar, and the black market, at about BsF. 4,100, is almost 41,000%, to follow the Chinese example the Dipro should be set at about 50% of the black market rate and exporting firms (e.g. PDVSA) should be allowed to exchange if they want, part of their export proceeds at a market price. Such an exporters' forex market could replace the so-called recently sent Dicom/SIMADI rate (about BsF. 660 to the dollar), which appears to only exists in paper.

Such a reform could set the stage for a medium term unification of the exchange rate to the exporters' market level so that the Venezuelan Central Bank could oversee a managed float of a competitive exchange rate.

The competitiveness of the parity is the key issue here. It should competitive enough so that agents will have appreciation expectations, which are easily countered by keeping interest rates low, as has been done in China since the early 1990s.

Even though at first sight it might seem odd to compare China's political system in the early 1980s with Venezuela's current system, the dominance that Maduro has shown by governing by decree since he came into power, makes the comparison not so exaggerated. Also in the case that the current political crisis is solved in favor of the opposition, it is difficult to imagine that the new president will happily relinquish all her powers once in office. Last but not least, the similarities with China go beyond politics. Arguably Venezuela is nowadays as poor as the East Asian giant in the 1980s.

In sum, Venezuela could attempt to restore the market price system in the medium-term by developing its own dual-track price system, think about gradually privatizing its recent renationalized companies and seek to set a managed float at a competitive rate.

The other reform alternative that I proposed to have a look on, i.e. the policy implications of ND, sets the focus on a developing country's exchange rate for improving its development perspectives.

In this sense, most new developmentalist authors would agree that instead of striving for a floating exchange system, Venezuela's reform efforts should strive for a managed float at a competitive parity. This means one that would allow alternative exporting sectors to be profitable.

Criticizing the macroeconomic institutional setting left by Cardoso and followed by Lula and Dilma, new developmentalists have shown, that despite successfully addressing Brazil's inflation problem, such a setting actually increases the volatility of the country's growth path by increasing its dependency on the commodities' price cycle. It is not by chance that apart from heavily oil-dependent Venezuela, Brazil's economy is the worst hit in the current region's downturn.