Venezuela's sinking financial system requires a Hamiltonian overhaul

by David Ramonet

With the state takeover of two banks of the Latinoamericana-Progreso financial group last Dec. 15, the "third wave" of the insolvency crisis into which International Monetary Fund dictates have plunged the Venezuelan financial system has come to an end. The Latinoamericana-Progreso Group included the most important network of insurance companies in the country, which, together with the banks, are now in the hands of the Venezuelan state. The head of the group, a Cuban-Venezuelan named Orlando Castro Llánez, also has interests in Panama, Colombia, Puerto Rico, and the Dominican Republic, and was the most conspicuous of the "emergent" financiers behind former President Carlos Andrés Pérez, currently under indictment for corruption. Castro Llánez has been accused of links to Colombia's Medellín Cartel, although nothing has ever been proven against him.

With the takeover of these last two banks, there are now 13 banks which have been intervened against by the Venezuelan state since the collapse of the Banco Latino triggered the financial crisis on Jan. 16, 1994. Apart from the corrupt practices of financial speculation, these banks all share the fact that their owners in one way or another were all part of the "financial mafia" of former President Pérez.

Of the intervened banks, five now operate under state administration (Latino, de Venezuela, Consolidado, and now Progreso and República); together with the network of six state banks (the other five plus Banco Industrial de Venezuela), they represent more than half of Venezuela's commercial banks. However, as Oscar García Mendoza, president of the Banco Venezolano de Crédito, has insisted, the nature of the problem is that there is a systemic crisis of insolvency related to a poorly performing and reduced loan portfolio—the result of economic stagnation brought about by the neo-liberal, free-market economic policies of the past five years.

Of the banks still in private hands, four-fifths are controlled by two economic groups, the Polar Group and the Vollmer Group, along with three banks, the Provincial, the Mercantil, and de Lara. The rest are small family or regional banks. But the fact that more than 60% of all deposits now end up in the Central Bank has virtually eliminated the role of the private bank in Venezuela.

The fourth wave

In order to recapitalize the Banco Progreso, the state will have to assume losses of some $635 million. Until now, the state has poured some $5.8 billion into rescuing the other banks: That is, determined to keep the financial system afloat, Venezuela has spent the equivalent of nearly 70% of the 1994 public budget. All this liquidity came directly from the Central Bank's printing press, which "lent" the money to the government for rescuing the banks—or, put another way, for rescuing the banks' furious account holders. Part of that sum was used by the banks and their depositors to buy dollars and pull them out of the country. Through June 27, when exchange controls were imposed, the Central Bank's international reserves plunged by $5 billion. The result was a brutal devaluation that drove up the inflation rate.

This situation led President Rafael Caldera to take an urgent series of measures beginning June 27, such as exchange and price controls. He also issued Decree 283, through which the Emergency Financial Council (JEF) was brought into being. The JEF, headed by Finance Minister Julio Sosa Rodríguez, subjected the Central Bank and other agencies of financial control such as Fogade (the Deposit Guarantee Fund) and the Superintendency of Banks, to its oversight. It was precisely the "autonomy" of those entities which helped to accelerate the state's financial prostration. That "autonomy" continues to be the principal obstacle to solving the crisis.

The part of state-injected liquidity which was not converted to dollars, was deposited in the other private banks, the so-called healthy ones, driving them into crisis as well. In December 1993, these banks had combined deposits of 721.8 billion bolivars; in August, this had nearly doubled, to reach 1.35 trillion bolivars. Currently, the entire banking system holds deposits of 2.19 trillion bolivars, an amount equivalent to the entire national public budget.

Throughout this period, the Caldera government has been subjected to intense pressure, both domestically and from abroad. Both the Castroite left—represented by members of the São Paulo Forum such as the Radical Cause party and Lt. Col. Hugo Chávez, (ret.)—and the "conservative" economic groups have fed a process of political destabilization designed to prevent the government from effectively implementing its emergency Decree 283, such that the Congress (dominated by the conservative Copei and the Radical Cause) have refused to approve legislation that would give the Executive the authority sought by President Caldera to address the crisis. In particular, the congressional opposition has pushed the bankers' line that the Central Bank's "independence" from the Executive must be maintained at all costs.

Drawing on its "autonomy," the Central Bank has aggravated the crisis by issuing zero coupon bonds to allegedly "sterilize" useless liquidity. The effect has been rather to hide the insolvency of the Venezuelan banking system, giving a subsidy which has increased the inflationary potential by one order of magnitude. The bonds are actually generating more liquidity than they are supposedly retiring, since they pay a quarterly average of 12% for these deposits which are "borrowed" from the banks, to be invested in nothing. That is, on top of the 1 trillion bolivars issued for the financial bailout, the Central Bank has issued a similar amount in zero coupon bonds to "sterilize" the first 1 trillion!

No private bank is currently capable of handling this enormous surplus in liquidity. Of the total 2.19 trillion bolivars on deposit, 44% is "invested" in bonds, primarily the Central Bank's zero coupon bonds. Only 39% is actually invested in loans, due to the economic depression and continued exorbitant interest rates. In comparison, note that in December 1993, fifty-five percent was lent out, which was still a low figure in historical terms. Given that the rest of the deposits form part of the legal bank reserve, more than 60% of the deposits end up in Central Bank coffers, which multiplies the hyperinflationary potential.

The fact that the banks no longer function as traditional intermediaries of credit, and instead serve only to absorb liquidity which has no outlet in productive investment, makes all the more evident the need for a thorough reorganization of the country's financial system, perhaps even a generalized state takeover. Even more so, in view of the fact that the cost of maintaining the artificial solvency of the banks is only aggravating the hyperinflationary potential. But there are those who oppose this alternative and instead pressure the government to dismantle all the protective measures it has imposed, leaving inflation and the "invisible hand" of the financial speculators to "resolve" the crisis they have themselves created.

The alternative: development and credit

In the wake of the election victory of the Republican "neo-conservatives" in the United States, Venezuela's "conservatives" feel encouraged to intensify their pressure against the Caldera government. For example, banker García Mendoza has demanded that the government leave the banks to their own fate, eliminate exchange and price controls, and impose an International Monetary Fund program. He has been seconded by the president of the Chamber of Deputies, social democratic banker Carmelo Lauría. But the real standard-bearer for this line is liberal writer Arturo Uslar Pietri, a partner of La Seguridad insurance company, which was just rescued from falling into bankruptcy by its creditors.

Some conservatives have reached the point of considering backing a military coup, on the assumption that U.S. public opinion would be in their favor. Ironically, this is the option that Castroite Hugo Chávez is hoping for, in expectation that widespread rejection of such a coup among Venezuelans would turn into a revolution in the streets and would bring down Caldera.

The importance of List

In stark contrast, banker Luis Vallenilla, president of the Cavendes group, wrote an article in the daily *El Globo* of Dec. 5, entitled "The Importance of Friedrich List." The article details the historic truth about the economic development of the United States and of Germany in the last century. But Vallenilla goes further and explains how the Venezuelan government's debt with the Central Bank (the money "sterilized" by zero coupon bonds) can be converted into credit for carrying out the great infrastructure projects that the Caldera government has proposed: that is, how to kill two birds with one stone, by attacking the insolvency of the banking system *through* a development program.

Vallenilla offers as an example the way in which the first U.S. treasury secretary, Alexander Hamilton, converted the U.S. government's financial obligations into instruments of internal credit, in order to finance infrastructure and transportation projects which rapidly generated jobs, goods, and services. "In the end, the credit was not inorganic, given that the monetary mass generated was then backed by tangible produced goods. Hamilton also imposed protectionist tariffs, to protect the incipient U.S. industries from the powerful European ones," said Vallenilla.

The private banking system must similarly be put through bankruptcy reorganization, and reconstituted around participation in such government-led infrastructure projects.

It is only through such an orientation that the integration agreement pact between Caldera and Brazil's President Itamar Franco can be put into effect. On Dec. 8, while in Caracas, Brazilian President-elect Henrique Cardoso confirmed, "Relations between Brazil and Venezuela have improved significantly in recent years, and I have every intention of deepening the process of integration promoted by Presidents Itamar Franco and Rafael Caldera."

According to Cardoso, the possibilities of Venezuela's becoming a major partner with Brazil are enormous: "The basis for such a close relationship has already been established. The time has now come to make those projects a reality." He emphasized that their countries' shared Amazon border is not an obstacle: "The hydroelectric project in Venezuela's south and the supply of electricity to Brazil's north constitutes one example of this."