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Venezuelan Manufacturing, SME Decline and Failed Transition

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Abstract

Venezuela's economic system has been characterised by two attempts at "transition" to a modern economy: the first in 1958 at the start of its democratic system; the second in 1989 when it attempted to bring into being an open free market economy. These attempts have been unsuccessful in creating an open, participative and democratic economic society. One expression of this has been the relative decline in the manufacturing sector of Small and Medium Size Enterprises (SMEs) since 1960 and their absolute decline since the late 1970s. Statistical evidence is presented on this decline and it is placed in international context. Econometric testing of explanatory variables shows the significance of structural barriers in manufacturing and a lack of efficiency and innovation efforts by SMEs as key economic determinants of this process. This decline results from the deeply exclusionary nature of the economic structure, the roots of which lie in Venezuela's political history. A genuine transitional economy implies a participative economic democracy and access to the productive resources of the economy so new wealth can be created and new firms can come into existence. The decline of SMEs highlights not only an economic problem in Venezuela but also the wider political problem of lack of real democratic economic participation.

Keywords: Democracy; Venezuela; Transition; Manufacturing; Small Firms.

Introduction

There has been a growing awareness within recent decades of the importance of small firms and their revival within developed economies. Birch (1981) signalled this importance two decades ago when he pointed out that the majority of new jobs were being generated in the U.S. by small firms. Acs and Audretsch (1990) confirmed this by presenting evidence from 1976-86 showing that this increase in employment share of smaller firms was occurring not only in the general economy but in particular in manufacturing – thus confounding those who attributed this rise to a shift to a service economy. Storey (1994) confirmed the existence in the UK of what came to be seen as U shaped trend in SME manufacturing employment share. He located the change in trend in the late 1960 - a date often referred to in other studies of this phenomenon in developed economies. A famous study by Segenberger, Loveman and Piori (1990) concluded that from around the mid 1960s there had been a general revival of small firms in many industrial countries measured as a recent increase in their share of total employment. Evidence from other authors (Nugent 1994, Spilling 1996, Trau 1997) with respect to countries as far apart as Korea, Norway and Italy pointing to a similar reversal of trend has lent support for this claim. A subtext of this hypothesis is a belief in that such a revival constitutes a transitional state to a post-industrial economy. The postulated revival of SMEs is seen as vital to this re-assertion of economic democracy.

This paper will do the following: firstly, present the economic background of Venezuela over recent decades; secondly, present the evidence for the decline in manufacturing SMEs from 1962-1995; thirdly, summarise the results of recent economic modelling pf the Venezuelan manufacturing sector in order to highlight key economic explanatory variables of SME decline; fourthly, explain the institutional, political-economic factors that underlie the decline of the SMEs. In conclusion it will point to the deep structural changes needed in the Venezuelan economy and in government policy if there is to be any future for this stratum.

1. Economic Background

In 1970 Venezuela had a per-capita GDP higher than Spain, Hong Kong or Singapore. Only 18 years later and in spite of the oil boom that fuelled its economy the GDP of these three countries was approximately 2.5 times greater than that of Venezuela. Table 1 shows the GDP growth results of various countries from 1970-88 using Venezuela as a point of comparison with an index figure of 100 in 1970. It shows relatively poor rates of growth for five of the six Latin American economies listed. Singapore in 1970 had an index figure of 76 compared to Venezuela's 100. By 1988 Singapore had risen to 262 compared to Venezuela's fall to 92.

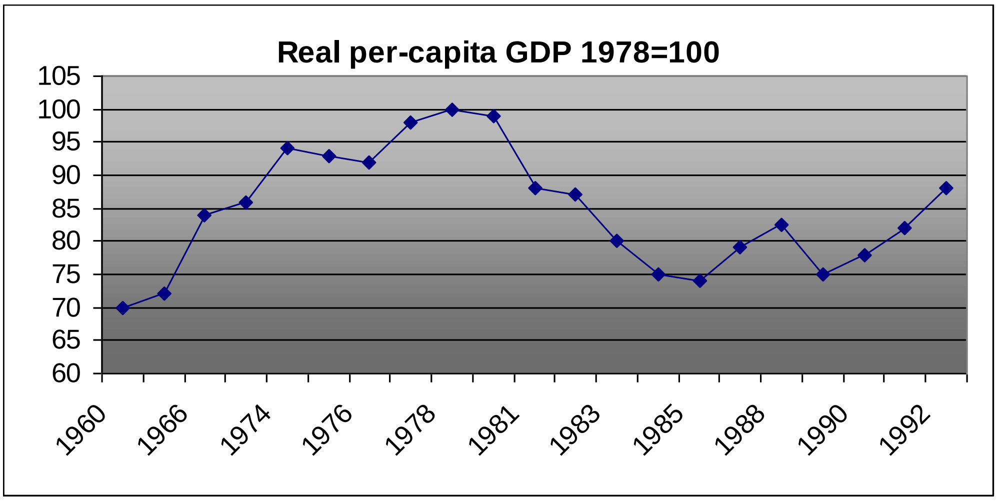
Venezuela was one of the few countries to experience an absolute decline in per capita GDP. The impact of different growth rates between economies over this short period is striking. The 1980s have been called the decade of lost growth in Latin America. This especially applies to Venezuela and was explicitly acknowledged in 1989 when new policies, embracing a different economic paradigm, were put in place.

Table

Per-Capita GDP, Selected Nations 1970 and 1988. Venezuela 1970 = 100			
			Growth rate annual
Country	1970	1988	1970-88(%)
Ireland	106.5	224.9	4.9
Venezuela	100	92.98	-0.4
Greece	94.35	143.41	2.4
Spain	90.08	237.05	5.5
Singapore	76.61	246.65	6.7
Hong Kong	72.58	262.89	7.4
Argentina	73.39	75.45	0.2
Brazil	36.29	67.03	3.5
Chile	68.55	47.37	-0.2
Colombia	27.42	35.99	1.5
Mexico	57.26	57.49	0

Source: Enright, Francés and Saavedra 1996

Figure 1 shows that there was a structural break in GDP growth per capita in the late 1970s. Prior to 1979 we have a long-term significant per capita growth averaging 1.7% per annum. Post 1979 this was reversed to an average negative figure of -1.9% p.a..



Figure

The strong growth of the first period reflected Venezuela's immensely rich natural resources and the fact that she was starting from a very low economic base. Population was very small and economic growth was rapid. Given these factors plus the world economic expansion during this period such growth was not surprising. However the development strategies guiding the economy were to lead the country into a blind alley. Venezuela, in common with many other Latin American countries, adopted inward looking policies of import substitution industrialisation, strong state control, and an extensive range of paterneralistic and clientilistic practices. Most economic resources were controlled by government.. The country relied mainly on its oil exports, which typically accounted for over 80% of total exports and over 50% of government revenue. This was its strategy to create the transition from a pre-modern to a modern economy.

However paradoxically high oil prices have often been followed by poor economic performance. For example the 1973-74 oil price rise produced a short term boom led by rising demand within the economy. The result was two years of negative per capita

GDP growth while the 1979 price rise was followed by negative per capita growth each year up to 1985 by which time per capita GDP had been reduced to the level of the mid 1960s. Oil revenues, controlled and distributed by government, became the main focus of state activity. Based on rising external debt there was growth from 1986-88 but the demand led expansionary policies that fueled this expansion led to shortages, inflation and the depletion of external reserves. The government's response of controls on prices, credit and foreign exchange further damaged manufacturing and the private sector and the economy remained even more dependent on the vicissitudes of oil prices and revenue. It became clear by the early 1980s that the crucial task of "sowing the oil revenues" and achieving the transition to a modern participative economy had not being achieved. Large amounts of the vast oil revenues supported government budget deficits, employed an expanding bureaucracy, provided funds to support and bail out nationalised industries, provided finances for elephantine projects and came to deals with unions giving concessions to workers that would have been otherwise impossible. Oil revenues therefore supported the status quo and those who were privileged by virtue of political power to be "insiders" to this system. Those who were "outsiders" were excluded from benefits. The growing informal sector which came to employ half the labour force were the most noticeable of these.

Inflationary policies, sustained by rising international debt, produced only short-term growth in the late 1980s and inevitably caused rising prices - despite price controls. The exchange rate deteriorated as external reserves diminished while shortages of key goods arose. The government's response of tightening controls on credit, prices and foreign exchange further distorted market structure exasperating competitive conditions of the non-oil economy. Serious productivity declines continued to characterise an economy chronically dependent on state-led industrialisation and the vicissitudes of international oil prices.

1989, the year that GDP fell 8% and public and private investement fell by 53%, marked a change in polcy that received the name of “el Gran Viraje” – the great turning point – so called because of the determination to turn away from the previous disastrous development strategies and embrace structural reforms with the adoption of free market reforms and attempts to dismantle parts of the government and bureaucratic apparatus. This was the second major attempt at “transition” – in this case to a free market economy. Reforms included:

- moving from an exchange rate and interest rates system - fixed by government with its highly discretionary rules determining who was to benefit - to a market-determined exchange rate system.
- moving from high and variable tariffs on imports to low and more uniform tariffs.
- deregulating investment; opening the public sector to competition; privatisation of some public enterprises.
- cutting generalised food subsidies.
- restructuring Venezuela's external commercial debt.

The economy responded positively and quickly to these reforms with strong GDP growth (e.g. 7.4%p.a. from 1990-92). while public and private investment leaped 80% in 1991 and a further 37% in 1992. The measures of economic growth such as private exports increases and fiscal deficit reduction showed dramatic improvement. However a notable feature of popular and democratic feeling in Venezuela is that moves to the free market have been resisted. Structural reforms inevitably exasperate short-term inequality. Riots, in which 300 died, occurred when fuel prices rose and in 1992 there were two unsuccessful military coups. They led to paralysis of the reforms and even the careful control of fiscal deficit was abandoned and it grew to 6.3 % of GDP in 1992. The privatisation program and other such measures were stopped. Eventually the president resigned. Venezuela abandoned the search for a liberalised economy and chose a former president associated with the early days of its democracy – i.e. it returned to the paternalistic style typifying the pre-1989 order. Venezuela, when faced with crisis has a political impulse towards the past. A political stalemate ensued with the authorities unwilling to enact unpopular measures. The economic situation deteriorated and inflation rose from 32% in 1992 to 46% in 1993 while GDP growth fell from 6.1% in 1992 and continued negative in 1993. Non-oil GDP fell by 1.5%. If by democracy we mean *popular will* then democracy and free market economic reform are uneasy bedfellows in Venezuela. A popular transition has not proved possible in this country.

The deteriorating economic situation provoked a collapse in 1994 of the second largest bank in Venezuela, Banco Latino, followed by further bank crises. Government support for the banking system in 1994 alone amounted to 13 % of GDP. This led to capital flight and pressure on the exchange rate and about $3 billion of foreign reserves was lost in the first half of 1994. The government in response imposed blanket foreign exchange and price controls. Inflation, often the barometer of crisis, rose to 71 % in 1994 and the fiscal deficit exploded to 14 % of GDP. Per capita GDP fell 5.3%. Venezuela's economic and political system, however, has always been propped up by oil, which is relatively immune to domestic difficulties. Oil GDP in 1994 for example rose by 4.6 % offsetting what would have otherwise been a catastrophic economic performance. The 1990s have proved to be as much a "lost decade" as the 1980s for Venezuela. Key performance data in the latter part of the decade is summarised below.

Venezuela's Economic Performance 1995-1999.

	1995	1996	1997	1998	1999
GDP % growth	4	-0.2	5.9	0.7	-3.7
inflation %	59.9	99.9	50	35.8	29.6
Unemployment %	10.2	11.8	11.3	11.1	12.5

Source: Data & Forecast Analysis 1999

Progress towards economic reform has been very slow and the economy, dependant upon oil, has been slow to open up to the international economy. The elections of 1998, as is the custom, paralysed the economy. The new administration under a radical new president has been unable to reactivate the economy despite extraordinarily high oil prices. The country has failed to establish a secure business environment within which business can flourish. The attempts to create a more open free market economy at the start of the decade have been reversed by the current government, which has embraced populist nationalist policies antithetical to the globalisation process. Despite the extremely high oil prices of 1999-2000 the country is in severe recession and incoming multinational investment, recognised to be so vital to the country's future at the start of the decade, has returned to its customary very cautious stance. Venezuela is in danger of becoming an economy with the transitional programme in reverse.

We have noted a structural break in Venezuelan economic performance in the late 1970s. The structural break in real per capita GDP growth occured around 1979. It was not that this year had a particular crisis to mark it. Rather the contrary, oil prices doubled. In addition public investment was running at very high levels of over 40% of GDP in 1979. Rather the crisis had been accumulating for many years throughout the whole economy. Real GDP per capita increased by an average of 1.7% p.a. from 1971 to1979. In the second period (1979-1990) it declined an average of –1.9% p.a. This trend was paralleled by other deeper yet similar trends in the economy. Gross fixed capital formation as a percentage of GDP for example grew by 7.7% from 1970-78 but subsequently declined by –9.8% from 1978-1990. Real oil income, underpinning the economy as a whole grew by 10.9% p.a. from 1970-80 but declined by –5.8% p.a. in the eighties. Individual indicators within the manufacturing sector begin to change around 1970. Trends in real MVA and employment numbers changed in 1979 and 1980 respectively from one of growth to volatile stagnation (cf. Figs 3 and 4).

It is quite clear that Venezuela has been in deep economic crisis for many decades and its oil wealth has allowed it to continue postponing the severe reforms that it inevitably faces. Its oil wealth has also propped up a peculiar type of democratic system - a unique symbiosis in which the people depended on the state rather than the other way around. Just as we observe failing political participation throughout the decades so also we have failing economic participation. This is also a failure in democracy. Complaints concerning the economic system are numerous in Venezuela and usually centre on corruption and also matters of distributive justice, for example, how the national wealth is shared. Not so well appreciated is that economic democracy also concerns access to the capital and productive resources of a nation.

These resources have been largely monopolised in the hands of the state and a small group of private interests in Venezuela. The majority of the population have been excluded therefore from productive participation. The wealth of any nation – even Venezuela with its tremendous natural resources - depends on the creation of new firms, which respond to new developing technologies, dynamic demand conditions and changing market opportunities in a complex global environment. This requires a business environment that allows this process to occur. This is exactly what Venezuela does not have. The Venezuelan state has been fundamentally concerned with the control and distribution of wealth rather than its creation. Oil money has been a dangerous luxury allowing the country to avoid the restructuring of state and economy

2. SMEs in Venezuelan Manufactruing

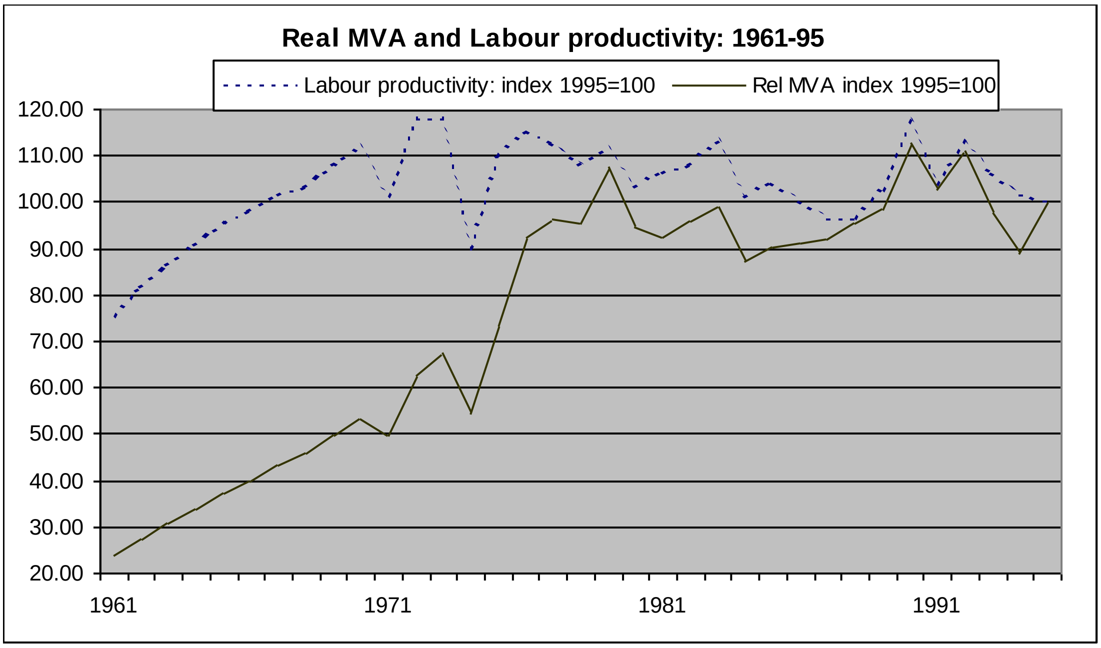
The term Pequeña y Mediana Industria – *PYMI* - refers to small and medium firms[i] within the industrial sector, principally manufacturing. A more general term is *PYME* - Pequeña y Mediana Empresas - which refers to the generality of small and medium enterprises (SMEs) within the economy as a whole. The vast majority of the PYME are in the service sector in Venezuela (as in other LDCs) and, of course, many are in the informal sector where approximately 50% of the labour force are now located. They represent the failure of economic democracy to integrate what is now the majority of the population in the economic system. Venezuela experienced growing unemployment and increased self-employment in the period from 1979 onwards which fed this growing sector rather than help create new micro firms integrated into the economic system. It is estimated that 84% of the 17 million new jobs created in Latin America from 1990-1995 were in the informal sector.[ii]

This informal sector includes a large quantity of small firms and individuals providing goods and services to the economy, typically consisting of sole proprietors and micro firms. They are found widely in commerce, electrical repair, auto repairs and transport, garment, metalworking, wood and furniture industries. However most of the informal sector lack proper skills and education and are in a trap of low income, low technology etc. They signify an economy in a low productivity trap.

From 1979 small firms declined as unemployment and the informal sector grew. However, surprisingly, there is evidence that even in times of GDP growth the informal sector still grew. In other words: be the economic situation good or bad the informal sector has increased its numbers (Rivero 1993). Its growth in recent decades therefore has been in times both of rising and falling unemployment. Rivero has suggested that informalisation has been a strategy by capital in reaction to the oil crisis. Industry externalised its costs in attempting to deal with the excessive levels of institutionalisation of the Venezuelan labour force. This is represented in the power of its unions, their integration with government parties and their ability to extract very favourable conditions in key state industries, which then become more generalised throughout the formal economy. The PYMI of course also suffers the imposition of legislation negotiated in the large firm and government sectors. Labour legislation raises the marginal cost of employing labour in the formal sector. Consequently, with the collapse of oil revenues, the informalisation of the labour force became inevitable. Many of the work force are obliged to be in the informal sector because firms do not wish to employ labour on the unfavourable terms of formal sector employment. In addition there are other powerful reasons for entering informal sector employment: for example to avoid high transaction costs associated with taxation, corruption, bribes and bureaucracy applicable to formal sector activity. The growth of the informal sector, the decline of the PYMI and the attempts by large firms to reduce their costs are all therefore part of the same story of an uncompetitive economy. The marginalisation of the majority of the population indicates a profoundly undemocratic system. In developing countries such as Venezuela we find a distortion of economic democracy expressed in the rise of the informal sector. This can be fruitfully viewed as form of social exclusion

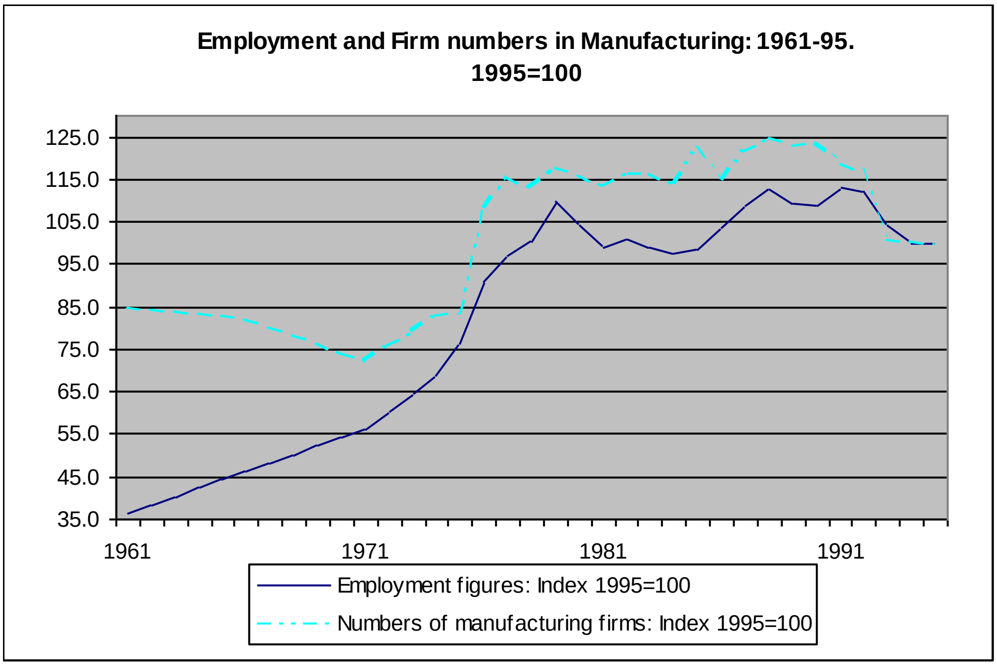
A transitional economy with an emphasis on economic democracy can have many forms. An important one of these is the right of individuals to establish small firms. Another is the right to a fair competitive structure so that these small firms can grow and prosper. These rights have to be established by the political authorities and enforced throughout the economic system. For example anti-competitive practices have to be discouraged, industrial relations should not militate against the interests of small firms…etc.

The Venezuelan manufacturing park is small and inefficient. Examining the period for which we have statistics, 1961 onwards, we can observe in Figure.2 that there was significant expansion of MVA up to 1979, greatly accounted for by the very low base from which the country was starting. However labour productivity in these years was very slow to increase. In fact it declined from 1971 to 1995. From 1979 to 1995 real MVA suffered a volatile stagnation.



Figure

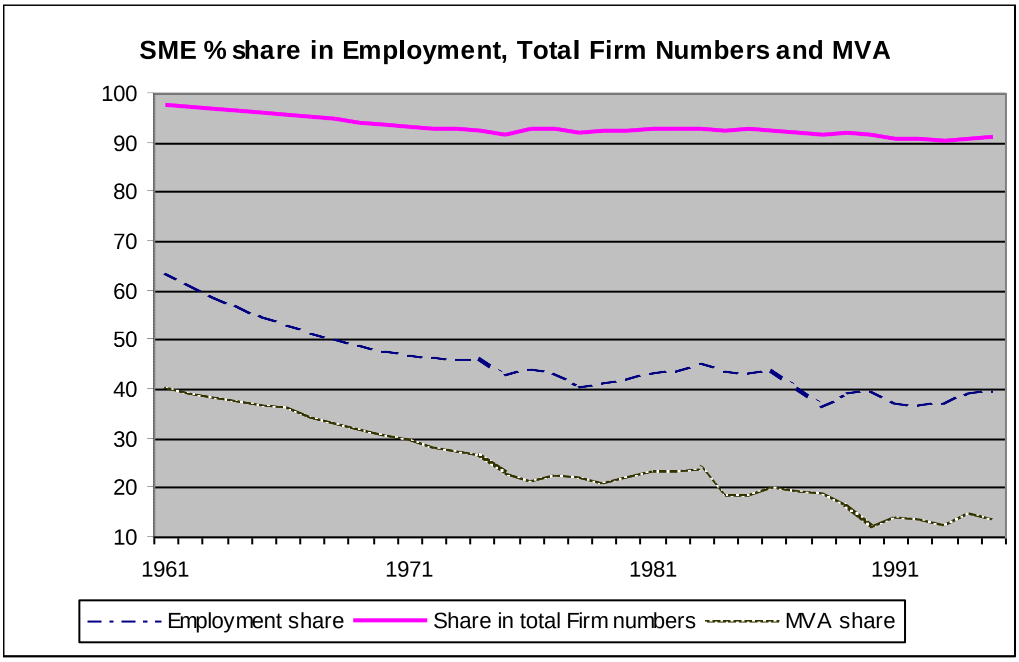
This picture is repeated if we look at employment in manufacturing and the number of firms in this sector (see Fig 3). Again we find the structural break around 1979 with significant growth before this period and decline after it.



Figure

As an indication of the lack of democratic inclusion and therefore from this point of view a failure of "transition" Figure 4 shows the participation of SMEs in manufacturing activity over this period. It shows the percentage share of SMEs in three indicators in the manufacturing sector: employment, number of firms and MVA. Here we observe something slightly different. Although there is a general and serious decline throughout the whole period, the loss of percentage share was greatest in the periods of expansion and less in contraction.

In Venezuela we have a severe decline of the SMEs in boom periods for two reasons. Firstly larger firms have greater economic and political advantages and take the lion's share of the gains. Secondly, because the business environment militates against smaller firms, new initiatives from below in the economy tend to be expressed as new start ups and increased employment in the informal sector. After 1979 stagnation and recession characterise the economy. SME share still declines from 1979 onwards but in general at a slower rate. The reason for this is the reverse of the above argument. Smaller firms contract relatively less in recession since they are operating at a low level and there are so few of them. They are providing essential services for the economy. This is explained further in the following section.



Figure

3. Modelling the Declining Venezuelan SME Manufacturing Share.

Mulhern and Stewart (1999) used time series data available for Venezuela (1961-1990) which allowed testing for explanatory variables of declining SME share using the Engle and Granger (1987) error correction methodology. The theoretical model was derived from Acs and Audretsch, who, using U.S. cross section data, found that industry wide structural variables (i.e. entry barriers such as industry capital intensity, market size, advertising and concentration ratios) have negative impacts on SME share while strategic responses by SMEs (innovation and efficiency efforts, especially of the larger of the SMEs) were found to compensate for these disadvantages and positively influence SME share. These empirical findings for SMEs in the US have a theoretical base. Structural variables are factors having a deterrent effect on SMEs formation and growth. They are more commonly referred to as barriers to entry. It is well known that economies of scale for example favour larger firms since the greater scale of the enterprise may offer significant reductions in average cost. Higher advertising rates in a particular industry are associated with large firm domination. Greater capital intensity in an industry will favour larger firms who can overcome this obstacle both to enter and grow within an industry. Structural barriers such as these can either be measured directly by various variables or suitable proxies can be used.

The dependent variable used in the model measured the change of SME share in manufacturing value added (SS). Independent variables and their expected signs were as follows.[iii] Capital intensity (KL), capturing barriers to entry, discourages small firm presence and therefore has an expected negative sign. Market size (LSZ) proxies for economies of scale and has an expected negative sign. Both KL and LSZ apply to manufacturing as a whole. It is assumed that the greater they are the more difficult it is to enter the manufacturing sector. Import penetration (IP) of the manufacturing sector is included and there was no expectation of sign.

While SMEs clearly can face structural barriers which affect negatively their share of the manufacturing market this is not the end of the story. SMEs can increase their share by improving by improving their relative performance vis-à-vis larger firms in efficiency and productivity variables. If SMEs for example improved their labour productivity relative to larger firms then we would expect, other things being equal, that they would increase their share of manufacturing output and employment.

Three stratum specific variables were used which measured such potential SME response. Two concerned relative SME efficiency. The first, labour productivity, measured the ratio of output to labour employed (RES). Two influences upon it were disentangled: the relative factor mix (capital/labour) of SMEs, RKLS, and pure efficiency, VS. VS measures the efficiency of labour alone after the capital/labour mix has been controlled for. VS is not observable and is the residual from the regression: $RES_t = \gamma_0 + \gamma_1 \, RKLS_t + VS_t$ where γ_0 and γ_1 are constant parameters calculated by ordinary least squares. Positive signs are expected on both variables since they constitute relative competitive advantage.

Relative investment intensity (INVS – an efficiency variable) of SMEs compared to industry as a whole - i.e. the relative ratio of value added to capital employed (capital productivity) - has an expected positive sign. Greater relative modernisation of the SME stratum, as indicated by a rising INVS, should lead to greater share in manufacturing production.

Total labour costs to the employer (RWS – a productivity variable) are measured as SME labour costs relative to manufacturing industry as a whole.[iv] The expected sign is negative since a rising RWS for SMEs constitutes competitive disadvantage.

GDP as an exogenous independent variable was added. This proxied for the general business environment. It was argued that, in the case of Venezuela during this period, the business environment was hostile to SME progress. The reasoning was as follows: in times of rising GDP Venezuelan SME share declines because large firms take greater advantage of favourable conditions. These include access to contracts, soft credit facilities,[v] political connections, preferential interest rates and greater access to many areas, such as, export markets, commercial information and new technologies.[vi] Quite simply, access to these advantages is determined by political influence rather than by genuine competition. SMEs are outsiders in the economic/political game.[vii] With falling GDP, SME share increases, not because SMEs are doing well but because large firms contract production, thus narrowing the gap between them. This was especially noticeable in the recession of the early 1980s. Large firm share decreased reflecting the larger reductions in production in the large firm strata compared to the SME strata. This greater volatility of the large firm strata can be observed across a range of important variables such as employment figures as well as numbers of firms in each strata. It is not that SMEs are more stable in any positive sense. Rather they are unable in periods of GDP growth to take as great an advantage of economic opportunities as large firms, while in recession they have less to lose than the larger firms. In this respect Venezuelan SME experience resembles that of certain industrial counties (Trau 1997, Spilling 1996). We therefore expect a significant and negative sign, i.e. that rising GDP is accompanied by declining SME share in Venezuelan manufacturing production.

With respect to Venezuelan manufacturing over a thirty-year period Mulhern and Stewart found that key structural barriers (the capital/labour ratio and the size of market) were found to be negatively correlated with SME share, while efficiency and modernisation measures had the expected positive signs and were significant.[viii] SME relative labour costs, as anticipated, were negatively related to SME share, while relative factor mix, relative efficiency and relative investment effort were positively and significantly correlated to SME share. Import penetration was found to be insignificant. The study found a very strong negative correlation between the proxy variable GDP and SME manufacturing share, indicating, in the author's opinion, evidence for a business environment hostile to SME interests.

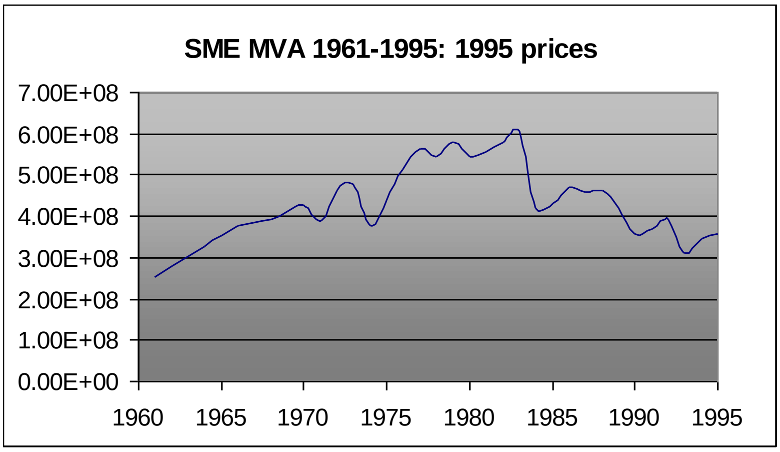
The study distinguished between long and short run determinants. The main determinants of long run shares were barriers to entry (KL), factor mix (RKLS), enterprise modernisation (INVS) and the exogenous GDP. RKLS and INVS positively influenced SME share while KL and GDP were negatively correlated with it. Changes in SME shares were adjusted by 87.8% of past deviations from this equilibrium. The primary variables which influenced short run changes in shares were the change in factor mix (ΔRKLS) and change in enterprise modernisation (ΔINVS). Both exerted the expected positive influence. This model explained 86.3% of the variation in changing SME share.

Overall the analysis of long run share confirmed the results of Acs and Audretsch's (1989) U.S. investigation, namely that SME share "is negatively related to the existence of structural barriers, positively related to the extent to which small firms rely on a strategy of innovation, and negatively related to the efficiency differential between small and large enterprises". Furthermore the results indicate the importance of investment and technology in the determination of short run dynamics.

The above modeling covers the period 1961 –1990. This closely corresponds to the first period of attempted transition to a modern economy from 1958 to 1989. The authors have not yet tested the period from 1989 up to the present because of the unavailability of firm data in the second half of the decade. However the data up to 1995, for example in Figure 4, showing SME share in the three key measures of share of firm numbers, share of total employment and share of MVA tell a mixed story. By and large SME share holds fairly constant in the first half of the 1990s. This probably reflects the economic reforms that were implemented in this period. However what is certain is that there has been no SME revival in this period. In the second half of the 190s SMEs have been under severe stress as interest rates have risen and the economy has continued to stagnate.

4. The Political Economy of Failed Transition.

The testing of the above model revealed the relevance of key economic variables in understanding SME share. However political economy variables are also very important. Unfortunately the paucity of reliable data sources in the Latin American environment make the testing of such variables or their potential proxies very difficult. Some results of the model also point to the political realm, especially the negative correlation between GDP and SME share. However besides the declining relative share there is there is very worrying fact of a declining trend in absolute SME MVA levels from around the 1979 structural break. Figure 5 tells the story. By 1995 SME production was at the level of the 1960s. Now relative decline of the SME sector may well be explained largely by arguments of relative efficiency and size levels. Venezuela, it could be argued, was in early stages of industrialisation where larger firms have distinct advantages over smaller ones. However the absolute decline of the sector over two decades cries out for explanations at many levels.



Figure

It should be noted that the absolute as well as relative decline of SMEs in manufacturing is not something, which can be understood by concentrating only on the manufacturing sector, which the above model largely does. The SME crisis is indicative the flawed nature of the political and economic system as a whole. This system from its inception in 1958 promised democracy and economic progress but it has failed to deliver them.

Venezuela's economic system and the political structure that lies behind it are flawed from two perspectives: firstly in orientation and secondly in structure. The first attempt at transition from 1958-1989 was characterized by a development strategy emphasizing state control, import substitution and large scale projects. The country relied on its oil revenues to fund its modernization programme. In a very short period of time Venezuela abandoned large parts of its agricultural system and the population became urbanized. Industry was protected by high tariffs and quota systems and the government concentrated on large scale projects such as oil, steel, aluminium, the Guri dam, and later petrochemicals. The failure in orientation of ISI strategies has been well documented and there is no need to repeat this story with respect to yet another country. The illusory success of the early years hid the underlying developing crisis. A protected highly subsidized non-market orientated economic system was destined to become highly unproductive. The state sectors in particular were highly protected and were suffering annual productivity declines of around 9% in the late 1970s. Even in the restructuring efforts of the 1980s annual productivity declines of 1.4% were experienced from 1983-1988. Labour productivity in manufacturing was no higher in 1995 than 30 years previously.

The Venezuelan economy has not become a modern democratic economic system because, among other reasons, it has failed and continues to fail to operate on market principles. If a politically important industry is going bankrupt then it will be rescued. Populist governments can afford to be magnanimous with oil revenues. After all such expenditure does not come from taxation and it is difficult for a population to appreciate the concept of opportunity cost – i.e. what could otherwise have been done with the oil revenues in terms of productive investment. The Venezuelan economy is dominated by political decisions (Enright et al. 1996). Extensive red tape and expense characterizes all economic effort. Frequently the government came to arrangements with a small group of firms that new entrants to the industry were to be excluded. The government that began the reforms of 1989 openly acknowledged the faults of these policy orientations and attempted to bring market reforms to the closed economy and open it to the globalization process. The lessons of tiger economies such as Singapore and Honk Kong had penetrated parts of the leadership of Venezuelan society (Herring 1993). However it proved extremely difficult to change the structure of the Venezuelan economic system.

The Venezuelan economy is dominated by a small number of very powerful groups who operate as "insiders" to the economic system participating in its benefits. The majority of the country are "outsiders" at the margins of the economic system. This includes the whole informal sector for example. SMEs also fall into this category. This small group of powerful vested interests includes the government and state apparatus, nationalized industries, trade unions, a small number of multinationals and a small number of families who dominate large areas of industry and the service sector. Industrial structure is typically catelised and highly concentrated. Barriers to entry are not only economic (e.g. economies of scale, capital/output ratios and the like) but are also political since government very actively control entrance to certain industries as well as manipulating subsidies and contracts to those whom it favors. Throughout the whole first period, 1958-1989, the government never promoted competition or attempted to create a competitive business environment. Quite the contrary it believed in state control, nationalized industries and extensive intervention and regulation. Cartels were favored over more competitive business structures since they allowed more control. Corruption was rife.

Venezuela's *labour policy* has been designed to protect the worker in the formal sector. It was not designed to promote new employment, economic growth or competitiveness. Venezuelan labour laws are similar to many that have existed throughout Latin America, which gave many rights to workers. They make no discrimination between large and small firms. For example wage increases are often mandated by government and apply across the board regardless of local market conditions or size of company. Dismissal laws and severance payments have been very exacting on the employer. The impact upon small firms has been especially harsh since they possess none of the advantages of the larger firms yet they have to abide by the same contracts and laws established in the large firm and state sector. For example small firms contracted to work for the oil industry have to adopt the same labour contracts and conditions that exist in the privileged nationalised oil industry. Marginal costs to the employer are substantially driven up. The impact of trade unions and labour laws can be quite negative upon SMEs. In this sense they differ from trade unions in some other parts of the world, such as Italy, where they have been part of the development of the small firm stratum.

In Venezuela there is little opportunity for small firms to have access to *capital markets* since these markets possess no depth. For example there is no venture capital market. The stock exchange is very weak with limited dealings that are only for the big players. Sources of funding are extremely limited and depend upon very expensive bank loans or access to privileged State credit. Highly discriminatory differential bank lending rates between large and small firms has been common while interests rates themselves have been prohibitively high (between 30-60% over the last decade). With the dominance of the state and its major control over credit and monetary policy there have not developed deep capital markets to fund small firms for example, help them with finance for setting up the enterprise, provide loans for new technology and the like.

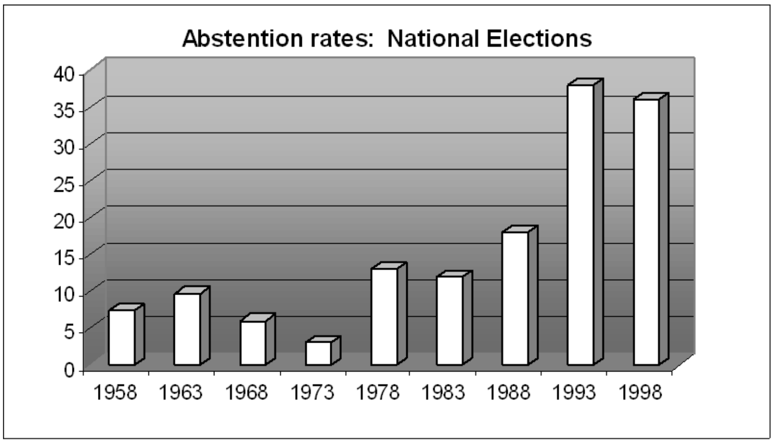
Government regulations and bureaucracy have been extensive and powerful in many Latin-American countries. Traditionally many governments have not had a pro-business orientation. Rather the contrary, state enterprises and extensive state intervention were favoured and protection of privileged interests was rife. Small business interests have always been marginal to the main thrust of government policy. Governments have not traditionally been concerned with the development of clear market and property rights or a well-regulated and functioning market place. However this does not imply that Venezuelan SMEs require complete free markets and an absence of intervention. Rather the contrary they need extensive government help - but of the right kind. e.g. provision of information, training, enforcement of rights, security, a fair legal environment, access to finance, protection against uncompetitive practices, monopolies and cartels. They need extensive help in training personnel and access to new technologies. Even more than large firms they rely more on public infrastructure. Large firms can compensate for the severe infrastructure deficiencies of the country to some extent in a way that is impossible for small firms: for example they can install their own electricity generator to compensate for the frequent cuts in electrical supply; they can have its own planes to transport personnel; they can invest extensively in information technology and compensate for the deficiencies in communication that plague the rest of the economy. Small firms need, in short, extensive government help to correct the paucity, deficiencies and distortions of their market structures and provision.

Venezuela is not the only economy characterized by the structure briefly outlined above (state dominance, oligarchic private interests, a burgeoning informal sector, declining SMEs in manufacturing and an over-reliance on a limited range of commodity production. Like the rest of Latin-America it adopted strategies of import substitution and the dominance of large scale enterprise. It has had extensive state control accompanied by styles of government that are populist, paternalistic, clientilistic and socialist inclined. Its labour markets and labour laws resemble many other Latin-American countries. The populist and socialistic policies of Venezuela have been pan-continental. Venezuela is an unusual example of this economic policy genre because its oil wealth permitted their continuances long past their sell-by-date. Its corruption, market inefficiencies, statist and rentist mentality have been prolonged and believed in longer than other Latin-American counties and have allowed the country to avoid the fundamental reforms it so clearly faces.

5. The Current Situation

The latter half of the 1990s have seen a much greater awareness in government circles of the importance of SMEs. International attention is also focused on this question in developing countries. Nevertheless it is going to some time before the data emerges so as to make a proper assessment of the period 1995-2000. However with serious declines in GDP in 1999 and with the economic consequences of the natural catastrophes of December 1999 yet to impact on the 2000 accounts there is little room for optimism. However the implicit argument of this paper is that the SME will not be helped until deep structural change occurs in the economy and that this change needs to be towards the promotion of a competitive business environment in which the state plays the role of helper rather than that of controller. However for this to happen deep vested interests, including those of the state, will have to be challenged and the mentality of government will have to be changed.

Democracy in Venezuela visibly deteriorated from 1950-1998. We can observe this in the rising abstention rates in national elections. Figure 6 tells the story of a country enthusiastically starting its democracy in 1958 with one of the lowest abstention rates in the world to and 40 years later being so disillusioned with democratic process that it had one of the world's highest.



Figure

It is interesting to note that there is a structural break in voting behaviour in the late 1970s (Buxton and Phillips 1999) at the same point we have identified a structural break in all our previously mentioned economic variables. From the point of view of this paper the reason for this is straightforward. It is because there was no real economic democracy there to support the political system. The political voting system was a mask for private vested interests to acquire and often pilfer the immense riches of this country - rather like the conquistadors before them. The growing abstention rates in Venezuelan elections were the expression of a profound alienation of the mass of its population. The absolute and relative decline of the SME manufacturing stratum is one important symptom of the failure of the economic and political system. Its absence signifies not only a loss of national wealth - employment and production but also the failure of transition to a modern state.

6. Conclusion

This paper has presented clear evidence of the relative decline of the PYMI from 1962-1995 and its absolute decline from the late 1970s. It has demonstrated the weakness of the manufacturing sector as a whole. Explanatory economics variables (structural, efficiency and innovation) have proved significant in econometric testing providing some level of insight into the reasons behind this decline. However it is in political and economic deep structures where the roots of this phenomenon lie. It is argued that Venezuela has a deeply uncompetitive structure dominated by vested state and private interests that have stymied not only SMEs but also economic prosperity in general. The paper also briefly presented the evidence for rising abstention rates and has put it in the context of economic decline, crisis and the failure of transition. In particular it has argued that the lack of economic participation manifested in the experience of SMEs indicates a profound lack of economic participation without which a genuine transition founders.

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Notes

[i] SMEs are defined in Venezuela as firms employing between 10 and 100 employees. This is equivalent to a small firm definition in the larger industrial economies already mentioned. Micro firms are those employing up to 9 employees.

[ii] Maldonado, Carlos -OIT - Organización Internacional de Trabajo. 1997. Conference Costa Rica. 1997.

[iii] Of the eight explanatory variables six have a history in the literature (especially Acs and Audretsch (1990) Thomadakis and Droucopoulos (1996). We used two new variables. RWS is self evident as an explanatory variable. GDP, however, was our proxy for a business environment prejudicial to SMEs.

[iv] The specific measure that we used was wider than that of wages and included bonuses, holiday payments, social security payments, insurance, pensions etc..

[v] For example, it is very well known that there is a wide interest rate differential for large and small firms. However, data constraints prevent us using this as an explanatory variable.

[vi] Time series data is not available on any of these factors. Hence they could not be used in our model. Their combined effect, producing a hostile business environment, is subsumed under the GDP proxy variable.

[vii] See Roberts and Araujo (1997), ch. 3, who detail “the blocked society” in Latin America.

[viii] Previous studies have used the structural barrier advertising as an explanatory variable. Data constraints prevent us doing this for Venezuela. However Thomadakis and Droucopoulos (1996) found it to be insignificant in the case of Greece and we believe that it would also be insignificant in the small manufacturing sector of Venezuela.