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AUSTERITY AND MILITARY EXPENDITURES IN DEVELOPING COUNTRIES: THE CASE OF VENEZUELA

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Abstract—In times of economic austerity, governments faced with declining revenues and political restraints on increasing taxes, must resort to major budgetary cutbacks. However, relatively little is known about how the governments of developing countries make expenditure decisions, or perhaps more importantly, how they trade off between consumption and investment or between functional categories of expenditures. Some sectors are often thought to be more vulnerable than others to reductions; social sectors are usually considered more and defense sectors less susceptible. An analysis of Venezuelan military expenditures over the 1950–1983 period confirms the fact that a high level of stability exists in the country's pattern of defense expenditures and that during the country's current period of austerity, defense expenditures are likely to be cutback less than other functional expenditures such as health, education and economic development.

INTRODUCTION

Venezuela's years of economic boom and easy money are over. Income from petroleum exports, which make up around 95% of Venezuela's total exports and are the barometer of the nation's economic activity, have declined significantly in 1983 and 1984, causing serious strains on government finances and the economy as a whole.

Assuming that the world petroleum market remains stable over the short- and medium-term, prospects through the rest of the decade are for very little real price growth until the late 1980s. On the other hand, it is likely that Venezuela will continue to depend on oil as its chief source of income until the end of the century and it is not likely that nontraditional exports will play a major role in the country's balance of payments for at least a decade.

Venezuela is currently experiencing the highest unemployment levels in recent years, general dissatisfaction with the government, reduced government revenues, serious problems in the private sector and gloomy short- and medium-term prospects. In short, the country today faces a combination of economic, financial and social problems greater than any seen since the tumultuous days of the early 1960s. Furthermore, because of the recent softness on the world oil market, Venezuela cannot count on obtaining substantial sums of hard currency in return for its exports of crude and refined products.

PATTERNS OF AUSTERITY

In times of economic austerity such as Venezuela is currently experiencing, the government, faced with declining revenues and political restraints on increasing taxes, must resort to major budgetary cutbacks. However, relatively little is known about how governments make expenditure decisions or, perhaps more importantly, how they trade off between consumption and investment or between sectors and categories of expenditures. Anecdotal evidence suggests that officials follow rather ad hoc rules for making large contractions in a short period of time—cutting new rather than ongoing projects, new rather than present employment, materials and travel expenses rather than personnel, and favoring ministries that are politically powerful or reducing those that had expanded most rapidly in the past [1].

Some sectors are often thought to be more vulnerable than others to reductions; social sectors, in particular, are usually considered more and defense sectors less susceptible.

In general [2], the programs, once enlarged, seem difficult to reduce, particularly if they generate large employment benefits. Likewise, governments seem unwilling to reduce areas that are supported by foreign assistance, both because they fear antagonizing aid donors and for the more practical reason that savings from such expenditure cuts are significantly less, since aid is also reduced by a proportionate amount.

As to the choice of which sectors to cut back, it is often felt that some sectors are more "vulnerable" than others to reductions. The defense sector, particularly, is usually considered difficult to reduce, while other sectors, particularly the social sectors such as health, education and rural development are considered vulnerable. The alleged vulnerability of the social sectors is clearly evident in writings coming from the World Bank, as the following quotes indicate:

> In the difficult past few years, budgetary crises have often meant that social services were cut back, in the process unravelling carefully designed programs [3].
>
> Since many human development programs are publicly funded, they are especially vulnerable when growth is threatened and budgets are under pressure . . . The recurrent costs of social programs, especially salary costs, tended to make them a permanent and, therefore, vulnerable part of government budgets [4].
>
> Quick-fix relief through disproportionate cutbacks—in, for example, education or rural development—may well have negative consequences for the entire economy [5].
>
> Many member countries have had to reduce and reorient investment programs to curtail recurrent expenditures and to delay the completion of high priority development projects. Programs in health, education and other social sectors have been particularly vulnerable [6].
>
> In the crisis situations confronting African governments, education, training and health programs are continuously in danger of becoming the residual legatees of both resources and of attention by policymakers [7].

Despite these rather strongly held views and such circumstantial evidence, little empirical investigation has been made on the vulnerability of different sectors to reductions in public expenditures. In a recent study [8] of 37 cases of budgetary reductions (countries where real expenditures declined in one or more years), the vulnerability of different sectors to budgetary reduction was examined. Here, vulnerability was loosely defined as:

1. A sector was well-protected if expenditures on it were reduced by less than the percent of reduction in total expenditures.
2. A sector was vulnerable if its percentage of reduction exceeded the average.

In brief, a simple ratio of percentage changes in sectoral expenditures to those in total spending served as the measure of vulnerability. Where the ratio had a greater value than one, it indicated that the sector was highly vulnerable, while a value between zero and one indicated low vulnerability, with less than proportional reductions in the relevant sector. A negative value indicated that despite overall expenditure reductions, the sector was allowed to expand.

The result (Table 1) based on an aggregation of the results from 37 observations, showed an average decline of 13% in real government expenditures, while the decline for the social sectors was only 5%, producing a vulnerability index of 0.4. By contrast, the index is 0.6 for administrative/defense sectors and over 1 for production and infrastructure. In short, social sectors were less vulnerable to cuts than defense and administration, which in turn were considerably less vulnerable than production and infrastructure—contrary to the generally accepted view. The fact that social sectors and defense were both relatively protected suggests that there were high political costs associated with reducing them. On the other hand, countries appeared to have been more willing to cut spending on infrastructure and production which had adverse implications for longer-term growth prospects but fewer early, direct and immediate political costs.

These conclusions were not very different for countries belonging to different income groups. The low income countries (Table 1) appear to have afforded slightly more protection to the social sectors and production and slightly less to administration and defense, but the difference was marginal. The middle income countries, such as Venezuela and Argentina, by contrast gave more protection to administration and defense and less to the productive and infrastructural sectors.

The apparent bias toward maintaining expenditures in the social services and defense may reflect the government's preference for present consumption over investment and future consumption, since social sectors and defense typically have a heavy bias toward recurrent expenditures and within these there is a sizable employment component. Politicians in Venezuela, particularly in election years, may find it more acceptable to reduce investment, growth and future consumption, especially if these reductions are uncertain and far off, than to make politically difficult cost cuts in present consumption. Since the social sectors and defense/administration are relatively labor intensive with high recurrent costs, reducing expenditures on them not only cuts back services highly valued by the public, but also causes relatively high unemployment per unit of reduction.

THE VENEZUELAN CASE

These general observations on the manner in which governments deal with austerity seem to hold fairly well historically for Venezuela. Since 1950, there have been six years (not including 1984, for which exact official data is still pending) of overall real cuts in government expenditure: 1959, 1960, 1962, 1979, 1982, and 1983. In the earlier period, 1959 and 1960, military expenditures were reduced in line with overall expenditures in 1959 and slightly more in 1960. Starting in 1962, however, military expenditures have been reduced 4% compared to overall government expenditure reductions of 12% in 1962, 0.4% in contrast to overall government reductions of 15.3% in 1979, and 3.9% compared to an overall expenditure cut of 8.6% in 1982. The reduction of military expenditure by 0.8% in 1983 is certainly less than the actual overall reduction in real government expenditures for that year.

In examining longer term patterns in national priorities, various indices of Venezuela's military expenditures are available:

1. The nation's military expenditure as a percentage of GNP;
2. Per capita military expenditure—military expenditure divided by the nation's population;
3. The number of personnel in the nation's armed forces per se;

Table 1. Impact of reduction in government expenditures

	EXPENDITURE				
	Social	Defense Administration	Production	Infrastructure	Miscellaneous
Average percent change in real expenditures	-5	-8	-11	-22	-7
Index of Vulnerability	0.4	0.6	1.2	1.7	0.8
Low income (17 observatons)	0.2	0.9	0.6	1.2	0.5
Middle income (20 observations)	0.5	0.4	1.7	1.9	1.1

Source: Norman Hicks and Anne Kubisch, "Cutting Government Expenditures in LDCs" Finance and Development (September 1984), p. 38.

Notes: Capital and recurring expenditures for 32 developing countries for various periods during 1972-80.

Table 2. Venezuela: Patterns of military expenditures, 1950–1983

(Millions of Bolivares)

	Nominal Military Expenditure	Real Military Expenditure	Growth in Real Military Expenditure	Growth in Real Gov Expenditure	Growth in Real Gov Revenue	Real GDP	Real Military Expenditures as a % of Real Government Consumption	Real Government Expenditures	Real Government Revenues
1950	182.0	505.5	-	-					
1951	201.0	555.2	9.8	10.0	17.5	1.54	11.38	8.77	9.49
1952	212.0	577.7	4.1	1.6	4.8	1.54	11.55	8.76	8.87
1953	210.0	581.7	0.5	4.8	7.0	1.52	11.58	8.97	8.80
1954	270.0	745.9	28.2	6.2	3.6	1.42	10.94	8.62	8.29
1955	338.0	936.3	25.6	15.4	13.2	1.65	12.74	10.41	10.25
1956	381.0	1046.7	11.8	11.3	45.9	1.89	15.09	11.33	11.38
1957	496.0	1393.3	33.2	33.7	26.4	1.87	16.71	11.38	8.71
1958	601.0	1606.9	15.4	35.6	-17.1	2.08	19.38	11.33	9.71
1959	607.0	1548.5	-3.7	-3.7	10.3	2.45	16.83	9.63	12.77
1960	540.0	1330.1	-14.1	-10.7	-11.9	2.37	19.39	9.64	11.15
1961	533.0	1349.4	1.4	6.4	-16.5	2.10	14.67	9.27	10.86
1962	509.0	1295.2	-4.0	-12.0	2.6	1.97	14.68	8.84	9.20
1963	613.0	1544.1	19.2	12.2	10.5	1.72	14.34	9.64	8.61
1964	650.0	1600.0	3.7	5.3	5.7	1.90	14.84	10.24	9.29
1965	742.0	1796.6	12.2	8.6	0.1	1.82	15.37	10.09	9.11
1966	782.0	1681.9	3.6	5.8	4.9	1.96	15.85	10.42	10.21
1967	885.0	2107.1	13.2	10.7	10.2	1.97	15.27	10.21	10.08
1968	894.0	2103.5	-0.1	5.0	1.6	2.12	16.29	10.43	10.36
1969	867.0	1988.5	-5.5	4.2	3.9	1.99	16.08	9.91	10.19
1970	891.0	1993.3	0.2	1.5	14.2	1.87	14.72	8.99	10.01
1971	1113.0	2414.3	21.1	7.5	18.8	1.70	12.93	8.88	8.78
1972	1294.0	2729.9	13.1	11.2	2.5	1.94	14.34	10.00	8.96
1973	1400.0	2834.0	3.8	7.6	24.5	2.10	15.22	10.17	9.88
1974	2022.0	3779.4	33.3	47.7	141.1	1.91	14.59	9.81	8.24
1975	2520.0	4278.4	13.2	9.6	-13.1	1.80	15.83	8.85	4.56
1976	1997.0	3149.8	-26.4	10.1	-12.7	2.10	15.81	9.15	5.94
1977	2472.0	3614.0	14.8	19.9	7.6	1.47	10.10	6.11	5.01
1978	2673.0	3651.6	1.0	2.5	-0.3	1.58	10.77	5.85	5.76
1979	2993.0	3635.7	-0.4	-15.3	19.1	1.58	11.11	5.76	6.25
1980	3893.0	3893.0	7.1	4.1	30.5	1.44	10.78	6.79	5.88
1981	4550.0	3922.4	0.7	30.4	46.7	1.53	11.08	6.98	5.86
1982	4800.0	3770.6	-3.9	-8.6	-14.1	1.59	10.67	5.39	4.66
1983	5060.0	3739.8	-0.8	-	-	1.77	12.27		

OTES: Nominal Military Expenditures taken from Stockholm International Peace Research Institute, Yearbook, various isssues. Real military expenditures dervied by deflating with the International Monetary Fund consumer price index for Venezuela (1980 = 1.00. Government revenue and expenditures from International Monetary Fund, International Financial statistics Yearbook, various issues.

4. The number of military personnel divided by population;
5. Military expenditure divided by the number of military personnel;
6. Military expenditure per se;
7. Military expenditure as a percentage of the federal budget;
8. Military expenditure as a percentage of government consumption;
9. Military expenditure as a percentage of government revenues.

Of these, the most often and widely used is the first, military expenditure as a percentage of GNP. Clearly, however, there are some major problems with this particular measure. For example, the largest proportion of GNP is unavailable for direct allocation by national leaders and policymakers and, thus, the percent-GNP measure cannot demonstrate the priorities of such policymakers. In addition, since Venezuela's GNP is relatively large by Third World standards, it takes large changes in military expenditure to appear as anything more than a change of a few tenths of one percent in such an index.

As with the examination of austerity measures above, real military expenditure as a percentage of the nation's federal budget is probably the most useful measure of longer run movements in national priorities. It focuses precisely on the priorities of the nation's policymakers. By this measure, it is clear that there have been at least six major cycles (Table 2) in Venezuela's pattern of defense expenditures:

1. The 1951–54 period found Venezuelan military expenditure averaging 8.78% of government expenditures;
2. The 1955–58 period saw an upswing in defense spending, which during this period averaged 11.11% of total Central Government expenditures;
3. The 1959–63 period showed a downturn in defense expenditures, which averaged 9.4% of federal spending;
4. A slight upturn occurred between 1964 and 1968, with defense expenditures averaging 10.3% of the federal government's budgets;
5. Two downturns have occurred since 1968, the first from 1969 to 1976, when defense spending averaged 9.47% of the federal budget, and
6. During the period from 1977 to 1983, when defense expenditures averaged 7.58% of the federal budget.

Despite several cyclical patterns, military expenditures in Venezuela generally seem to enjoy a particular stability and are not all that vulnerable to financial-austerity-induced cutbacks. The stability in military expenditures is also apparent (Table 2) in examining longer term trends in the ratios of military expenditure to other major macroeconomic aggregates. In terms of real gross domestic product, military expenditures have averaged between 1.5 and 2 percent over the 1950 to 1983 period.

In terms of the shares of real government consumption or real government revenues, however, military expenditure seems to be somewhat more volatile. Several cyclical patterns seem to emerge:

1. In terms of real government revenues, a more stable pattern appears, with less fluctuation over time and fewer major cycles in military expenditure.
2. Military expenditure shows most stability in terms of the government's real level of consumption.
3. The link between all measures of economic activity—real GDP, real government expenditure, real government revenues and real government consumption and real defense expenditure seems to be weakening, i.e., there does not appear to be the degree of stability in the 1970s and 1980s that characterized the period of the 1950s and 1960s.
4. The historical stability in defense expenditures would seem to indicate that the government's current austerity measures will not result in major cutbacks in military-related activities.

CONCLUSIONS

On one hand, the results presented above suggest that a high level of stability exists in Venezuelan defense expenditures but that this stability may not hold up during the country's current period of austerity. On the other hand, the results suggest that cutbacks in defense expenditures are likely to be much lower than in other functional areas.

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