
I. THE ECONOMIC ENVIRONMENT

(1) INTRODUCTION

1. The performance of the Venezuelan economy has been highly variable in recent years, largely because of its heavy dependence on oil. Despite efforts to diversify the economy, supported by a variety of incentive schemes (chapter III), the weight of the hydrocarbons sector actually increased in the period 1996-2001, while the relative size of sectors such as manufacturing industry declined. The country's heavy reliance on the oil sector generates an anti-export bias in other sectors and makes them less competitive, by putting pressure on costs and making it harder for domestic producers to compete on international markets. In addition, the behaviour of the exchange rate, managed in a currency-band system up to February 2002, also eroded competitiveness in the non-oil sector. The subsequent floating of the exchange rate should provide a major stimulus to Venezuelan production by eliminating the exchange rate's anti-inflationary anchor role.

2. In keeping with the situation described above, Venezuela's external trade is poorly diversified in terms of export products, owing to a lack of competitiveness, and it is also limited in destination terms. Hydrocarbons account for over 80 per cent of all merchandise exports, and nearly 60 per cent of total exports go to the United States. Over 80 per cent of Venezuela's imports consist of manufactured products, particularly machinery and transport equipment, vehicles and autoparts, office machinery and telecommunications equipment, and automotive and chemical products. The consolidation of regional preference agreements has yet to produce significant growth in Venezuelan exports under these schemes, although imports have increased, particularly from Colombia and Mexico.

3. Following a period of modest growth in 2000 and 2001, the economy slid into recession in 2002, and fiscal accounts deteriorated. In response to a substantial rise in the fiscal deficit, steps were taken in May 2002 to reduce the shortfall by imposing revenue collection and raising several VAT rates. Major expenditure cuts were resisted, in view of the recession detected early in the year. Recourse to domestic borrowing to cover the deficit has aggravated the fiscal situation still further, and the widening fiscal gap has also fuelled inflation in 2002.

(2) RECENT ECONOMIC TRENDS

(i) Structure of the economy

4. Oil is by far the most important sector of the Venezuelan economy, accounting for more than one-quarter of gross domestic product (GDP), over 80 per cent of merchandise exports and about one-third of fiscal revenues. Wide fluctuations in oil prices have made the sector highly volatile, and this has affected the behaviour of GDP and trends in other sectors. The latter is mainly explained by the linkage between the oil sector and activities such as financial and professional services, construction, and certain manufacturing activities.

5. Generally speaking, the changes that occurred in the structure of GDP during 1996-2001 reflect a strengthening of the oil sector's role in the economy, and a reduction in the relative importance of manufacturing industry (Table I.1).

Table I.1
Sectoral composition of gross domestic product, 1996-2001
(Percentage share and annual rate of change on a volume basis)

Economic activity	1995	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
	Percentage of total							Rate of change (%)					
Oil activities	24.6	26.5	27.3	27.8	27.4	27.4	26.7	7.7	9.4	2.0	-7.4	3.2	-0.9
Oil and natural gas	19.8	21.5	22.2	22.6	21.8	22.1	..	8.4	9.9	2.1	-9.5	4.6	1.1
Refining	4.8	5.1	5.1	5.2	5.6	5.3	..	4.8	7.1	1.3	1.6	-2.5	-9.1
Non-oil activities	73.5	71.8	70.4	69.6	70.1	70.0	70.4	-2.5	4.2	-0.9	-5.4	3.0	4.0
Goods-producing activities	29.4	28.8	28.9	28.0	27.1	26.9	26.7	-2.3	6.6	-3.0	-9.0	2.3	4.8
Agriculture	4.8	4.9	4.7	4.7	4.9	4.9	4.9	2.0	2.4	0.6	-2.1	2.4	2.6
Mining	0.9	0.9	0.9	0.9	0.8	0.9	0.9	2.6	6.7	-4.4	-10.4	8.2	1.1
Manufacturing	16.6	15.8	15.5	14.6	14.1	14.2	14.3	-5.2	4.4	-5.6	-9.2	3.9	2.9
Electricity and water	1.7	1.8	1.7	1.8	1.9	1.9	1.9	1.2	4.7	1.3	1.1	2.2	3.8
Construction	5.4	5.5	6.1	6.1	5.4	5.1	5.1	1.1	17.2	-0.3	-16.5	-2.7	13.5
Services-producing activities	45.0	43.7	42.2	42.4	43.8	43.8	43.7	-3.3	2.8	0.6	-3.1	3.4	3.3
Commerce	9.8	9.0	8.8	8.4	7.9	8.1	8.2	-8.6	4.7	-4.3	-11.8	5.4	4.2
Restaurants and hotels	2.6	2.5	2.4	2.5	2.6	2.5	2.5	-2.0	1.8	1.7	-2.0	-0.5	0.7
Transport, warehousing and communications	4.9	5.0	5.2	5.5	5.9	6.2	6.6	1.7	9	5.9	1.6	8.1	8.8
Financial institutions and insurance	1.5	1.2	1.2	1.2	1.1	1.1	1.1	-19.4	4.1	-0.9	-13.8	3.2	1.1
Real estate	7.9	8.0	7.7	7.8	8.3	8.1	8.2	0.2	2.9	1.9	-1.1	1.7	2.5
Business services	3.5	3.4	3.3	3.3	3.3	3.3	3.3	-4.3	2.9	-0.5	-4.6	3.1	2.7
Non-profit services	6.4	6.5	6.3	6.4	6.8	6.7	6.7	1.4	3.0	1.9	-0.6	1.1	2.4
General government services	8.3	8.0	7.2	7.3	7.9	7.9	7.8	-3.8	-3.4	0.9	1.2	3.3	1.4
- Imputed banking services	1.0	0.7	0.7	0.7	0.7	0.7	0.7	-29.0	11.4	1.0	-9.7	4.7	0.7
Subtotal	98.1	98.4	97.7	97.4	97.5	97.4	97.2	0.0	5.6	-0.1	-6.0	3.0	2.6
+ Import duties	1.9	1.6	2.3	2.6	2.5	2.6	2.8	-13.0	50.2	10.9	-10.4	10.9	9.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	-0.2	6.4	0.2	-6.1	3.2	2.8

.. Not available.

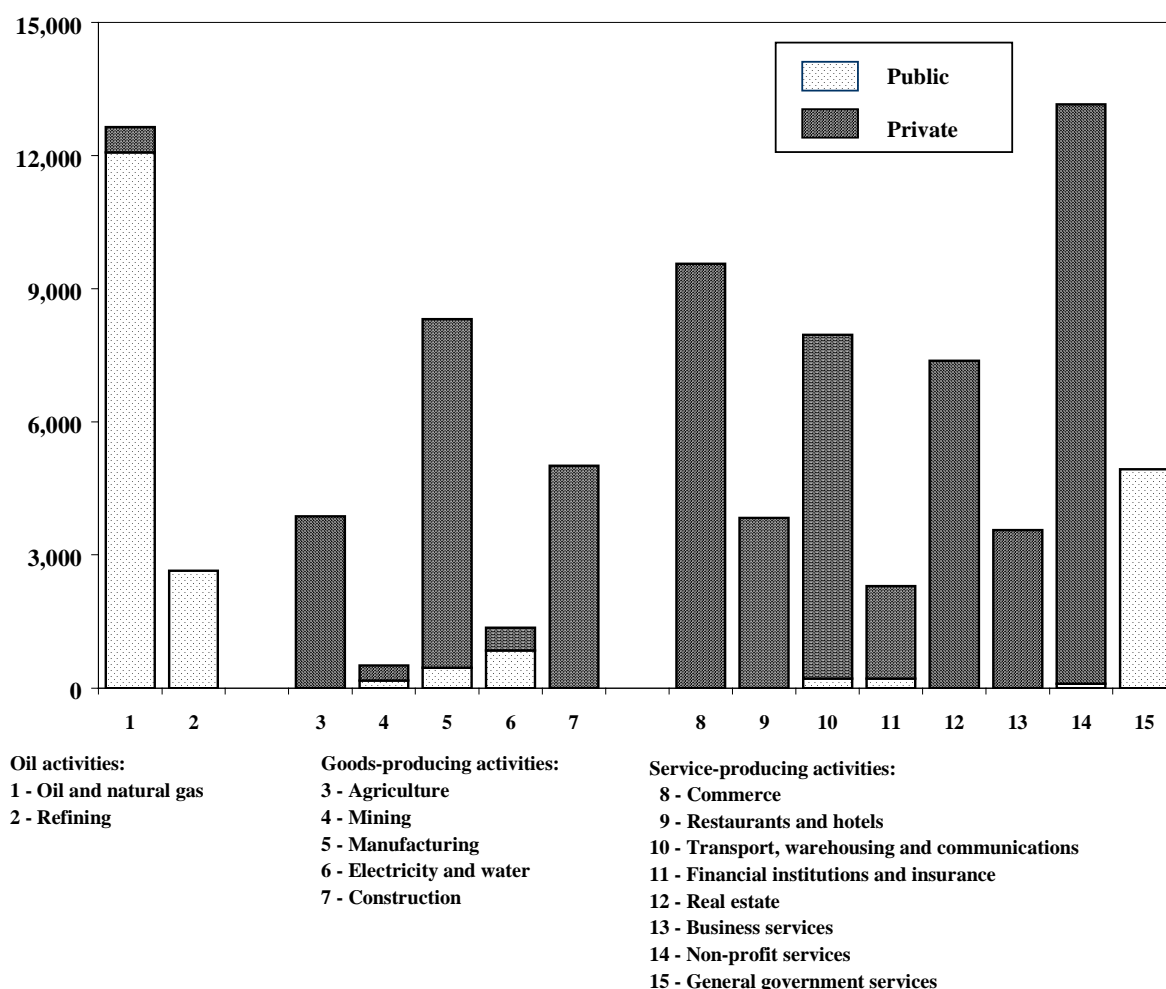
Source: Central Bank of Venezuela.

6. State participation in the Venezuelan economy remains large and is estimated to generate nearly 40 per cent of GDP and 80 per cent of exports. The public-sector share of the economy stems mainly from its dominant role in the oil sector, where it controls all refining and the majority of extraction activity (chapter IV.5)(ii)(a)).

7. The State also has a major presence in the electricity and water sector (figure I.1). The privatization process carried out in recent years has substantially reduced State participation in certain sectors, particularly among services, notably financial institutions (especially banking) and telecommunications (chapter II.(6)(ii)). Nonetheless, 1996-2001 saw faster growth in sectors with greatest State participation, such as oil production and refining, natural gas, and electric power generation and distribution, whereas private-sector growth slowed.

Figure I.1**Sectoral composition of gross domestic product, at current prices, 2001**

Billions of bolívares



Source: Central Bank of Venezuela.

(ii) Economic growth and employment

8. Economic growth has fluctuated considerably throughout the 1996-2002 period: there was a slight contraction in 1996, followed by strong growth in 1997; 1998 brought moderate stagnation, which was followed by a further contraction in 1999 and then a period of moderate growth throughout 2000 and 2001 (Table I.2). In the first half of 2002, the economy entered a new recessionary phase. The downturns in GDP were partly caused by circumstantial factors, such as lower oil revenues in 1999 and 2002, but, according to the authorities, they were also partly due to medium-term structural trends, including a decline in total factor productivity.

9. Total GDP grew by 2.8 per cent in 2001, which was faster than the Latin American average for that year, and growth in the non-oil economy averaged 4 per cent. Economic growth in 2001 was underpinned by a sharp increase in domestic demand – especially in gross fixed investment, which expanded by 13.6 per cent, while private consumption grew by 4.7 per cent. The expansion of gross

fixed investment in 2001 came on the heels of growth of just 1.1 per cent in 2000 and a drop of 16.4 per cent in 1999.

10. In the first quarter of 2002, GDP shrank by 4.2 per cent compared to the same period a year earlier, owing to a substantial slowdown in oil and non-oil activities alike. This can partly be explained by a reduction in oil production, together with the exchange-rate adjustment made in early 2002. The contraction in oil activities amounted to 7.8 per cent in real terms, and mainly reflected lower production volumes, which, as the authorities pointed out, is a consequence of upholding the policy of production cuts decided upon by OPEC. The economic slowdown intensified in the second quarter, when GDP fell by 9.9 per cent compared to the same period in 2001. In the first half of 2002, GDP came in at 7.1 per cent below its level a year earlier.

Table I.2
Basic macroeconomic indicators, 1996-2002^a
(Year-on year percentage change, unless otherwise indicated)

	1996	1997	1998	1999	2000	2001	2002 ^a
Gross domestic product							
Gross domestic product (billions of Bs.)	29,438	43,344	52,482	62,577	82,451	91,324	..
Real gross domestic product (billions of 1984 Bs.)	566	602	603	566	584	600	274
Gross domestic product (millions of US dollars)	70,620	88,803	95,937	103,400	120,578	125,062	..
Gross domestic product per capita (US dollars)	3,168	3,904	4,133	4,365	4,989	..	..
Share of gross domestic product (% of nominal GDP)							
Private consumption	63.2	65.8	71.8	69.1	63.4	68.2	..
Public consumption	5.0	6.5	7.5	7.5	7.2	8.0	..
Gross fixed capital formation (total)	15.8	18.7	19.0	15.7	14.2	16.4	..
Private	8.8	9.4	8.4	6.9	6.1	9.4	..
Public	7.0	9.4	10.7	8.8	8.1	7.0	..
Exports of goods and services	36.5	28.4	19.9	21.6	28.4	22.7	..
Imports of goods and services	21.3	21.7	21.1	16.4	16.3	17.6	..
Growth of GDP (in real terms, %)							
Total GDP growth	-0.2	6.4	0.2	-6.1	3.2	2.8	-7.1
Private consumption	-4.6	5.2	-0.2	-4.3	3.8	4.8	-8.2
Public consumption	-7.6	4.2	1.4	3.0	5.0	5.9	-5.8
Gross fixed capital formation (total)	-6.3	23.9	-2.5	-16.4	1.1	13.6	..
Exports of goods and services	7.8	9.4	4.2	-10.8	5.5	-0.9	-17.4
Goods	8.1	10.7	5.1	-10.7	5.8	-1.3	..
of which oil	9.4	10.6	2.7	-9.0	-1.1	4.7	..
Services	3.5	-12.6	-17.6	-13.7	-3.0	10.8	..
Imports of goods and services	-11.2	33.9	9.4	-14.6	15.4	11.0	-20.2
Goods	-15.2	42.3	13.1	-11.2	16.2	11.8	..
Services	3.4	8.2	-5.4	-30.9	10.5	5.9	..
Employment and prices							
Unemployment (percentage of labour force)	11.8	11.4	11.2	14.9	13.9	11.8	..
Consumer price index (year-on-year cumulative)	103.2	37.6	29.9	20.0	13.4	12.3	12.8
External sector							
Current account balance (percentage of GDP)	12.6	3.9	-3.4	3.4	10.9	3.5	..
International reserves (billions of US dollars)	15.23	17.82	14.85	15.38	20.47	18.52	15.14
of which FIEM (billions of US dollars)	..	..	..	0.2	4.59	6.23	3.70
External debt service (billions of US dollars)	3.14	2.8	3.3	3.5	3.8	3.3	1.9

	1996	1997	1998	1999	2000	2001	2002 ^a
General State finances							
Central government financial balance (percentage of GDP)	0.4	1.7	-3.8	-1.6	-1.6	-4.3	..
Income (percentage of GDP)	19.0	23.1	16.6	17.1	19.3	20.4	..
of which oil (percentage of GDP)	7.5	11.7	5.6	6.3	9.8	9.3	..
Expenditure (percentage of GDP)	18.6	21.4	20.4	18.8	21.2	24.7	..
Net transfers to FIEM (percentage of GDP)	n.a.	n.a.	n.a.	0.3	3.5	1.9	..
Total gross public debt (billions of US dollars)	30.2	28.2	27.5	28.3	31.8	36.4	..
Gross external public debt (billions of US dollars)	25.5	23.9	23.4	22.8	21.8	22.6	..
Gross domestic public debt (billions of US dollars)	4.7	4.3	4.1	5.5	10.0	13.8	..
Money and interest rates							
Money in circulation, M1 (annual average)	88.3	83.7	6.6	23.5	31.5	13.2	4.8
Monetary liquidity, M2 (annual average)	55.4	63.0	18.6	20.0	27.8	4.3	4.0
Broad liquidity, M3 (annual average)	55.3	63.0	18.9	20.2	27.7	4.2	3.9
Interest rate on loans: average of six main universal banks (per cent per year)	37.2	22.2	45.2	31.9	23.9	25.6	35.1
Real interest rate on loans: average of six main universal banks (per cent per year, deflated by the CPI)	-32.5	-11.2	11.8	9.9	9.3	11.8	..
Interest rate on deposits: average of six main universal banks (per cent per year)	18.4	6.8	10.3	7.1	3.4	2.4	3.7
Real interest rate on deposits: average of six main universal banks (per cent per year, deflated by the CPI)	-41.7	-22.4	-15.1	-10.8	-8.8	-8.8	..
Exchange rates							
Nominal exchange rate (bolívars per US dollar)	417.3	488.6	547.6	605.7	679.9	723.6	1,088.0 ^b
Real effective exchange rate (1995=100)	84.3	110.5	135.5	152.3	161.6	173.0	..

.. Not available.

n.a. Not applicable.

a First semester 2002 (provisional).

b Average of first nine months.

Source: Central Bank of Venezuela.

11. The GDP figures are heavily influenced by wide fluctuations in investment, particularly in the oil sector. The ratio of total investment to (nominal) GDP fell during 1997-2000, to stand at 14.2 per cent at the end of that period. Given State control of the oil sector and major State participation in mining, electricity and other activities, much of the country's investment is in public-sector hands, and this situation intensified in 1997-2000. Private-sector investment accounted for just 6.1 per cent of GDP in 2000, compared to 9.4 per cent in 1997. In 2001, in the wake of an upturn in the oil sector, the ratios of private investment/GDP and total investment/GDP both increased, but investment retreated once again in the first half of 2002.

12. The low rate of investment is a structural problem in the Venezuelan economy. The authorities have noted that the pattern of investment during 1996-2001 was heavily influenced by a variety of variables, such as the price cycle in the oil sector, and the multiplier effect of oil investments on other parts of the economy. A paper published by the Central Bank of Venezuela (BCV) states that a secular real GDP growth rate of 6 per cent is both optimal and viable, but this would involve raising the investment rate to at least 25 per cent of GDP.¹

¹ Parra Luzardo, Gastón, *Condiciones y perspectivas del crecimiento económico en Venezuela*, Central Bank of Venezuela, Caracas, 2002.

13. Private consumption contracted by 0.1 and 4.3 per cent in 1998 and 1999, before expanding in the two following years. Public consumption has been a major engine of growth, expanding faster than GDP during 1998-2001.

14. Exports of goods and services, which had grown faster than GDP between 1995 and 1998, contracted sharply in 1999, before expanding on the back of the oil sector in 2000, and then retreating once more in 2001 and the first half of 2002. While merchandise exports grew during 1996-2001, exports of services fell by one-third during the reporting period (see *infra*).

15. Unemployment rose from 11.8 per cent of the labour force in 1996 to 13.9 per cent in 2000, but then eased from the second half of 2000 before climbing again in the early months of 2002 to reach 16.2 per cent in June. In recent years manufacturing employment has declined in line with shrinking activity in that sector, while employment in services has expanded. The private sector accounts for the bulk of employment, with 82.2 per cent of the working population employed in that sector in June 2002.

16. A feature of the Venezuelan economy is its high rate of informal employment, which accounted for 50.4 per cent of the employed population in the first half of 2002, according to estimates by Venezuela's National Institute of Statistics (INE).² These high unemployment and informality rates generate a poverty index of 45 per cent according to INE estimates (18.7 per cent living in extreme poverty and 26.3 per cent in conditions of critical poverty).³

(iii) Prices

17. After peaking at 103.2 per cent in 1996, inflation was reduced dramatically between then and 2001, thanks largely to the counter-inflationary-anchor role played by the exchange rate. Cumulative inflation in 2001, measured by the rise in the consumer price index (CPI) for metropolitan Caracas, came in at 12.3 per cent (average inflation for the year was 12.5 per cent); this was below the 2000 figure (Table I.2).

18. In early 2002, the introduction of a free-floating exchange-rate system (see below) initially caused inflation to accelerate, and the CPI for March rose by 4.2 per cent compared to previous month. In the first three months of 2002 the CPI rose by a cumulative 7 per cent. This inflationary spike reflected adjustments made to the prices of goods and services, particularly those that use imported inputs, in the wake of bolívar depreciation after flotation, and was further fuelled by expectations concerning the level to which the exchange rate might rise. Nonetheless, the full extent of the devaluation has not been passed through to prices. The pace of inflation eased in April and May, before accelerating once more in the following months; during the first eight months of 2002 the CPI rose by 19.8 per cent.

(iv) Monetary policy

19. The BCV is responsible for formulating and executing monetary policy, and for participating in the design and execution of exchange-rate policy. The Bank does not receive instructions from the Government, and it cannot finance the fiscal deficit. Its fundamental objectives are to achieve price stability and preserve the value of the currency. The monetary programme includes establishing an inflation target, which was set between 10 and 12 per cent in 2001. The target for 2002 was set in July at 25-27 per cent, bearing in mind the impact of fiscal and exchange-rate policies. The strategy

² <http://www.ine.gov.ve> ("Tips informativos").

³ OCEI-UNDP, *Perfiles de la condición de vida. Informe sobre Desarrollo Humano en Venezuela, 2000*. Available on the Internet at <http://www.ine.gov.ve/ine/idh/tablaidh1.htm>.

to meet this target uses elements corresponding to a system of indicators reflecting agents' expectations, with interest rates as the operational instrument.

20. The BCV executes monetary policy mainly through open-market operations. It also adjusts reserve requirements, and sets interest rates on its own operations. Open-market operations are conducted mainly through auctions for the purchase and sale of public-sector national debt paper (repos). Competitive auctions are held for banks and stockmarket firms, with the corresponding repo rates being determined by supply and demand. Non-competitive auctions open to the general public were introduced in May 2001; in this case the rates are predetermined according to the results of the competitive auctions held earlier that same day.

21. The BCV sets the interest rate charged on its discount and rediscount operations, and on repos and advances (rediscount rate), thereby providing a top-tier indicator for market lending rates. On other occasions, however, interest-rate movements have responded to market trends instead of anticipating them; changes in the rediscount rate also reflect BCV expectations of market trends. The legal reserve requirement for private-sector deposits in local currency has remained unchanged at 17 per cent in recent years; but, in early 2002, it was decided to unify the reserve requirement and progressively lower it to 15 per cent, a level attained in May. In August 2001, it was decided to apply a higher reserve ratio on public-sector deposits (known as the *encaje especial*); this was initially set at 30 per cent, but was lowered to 25 per cent in the early months of 2002.

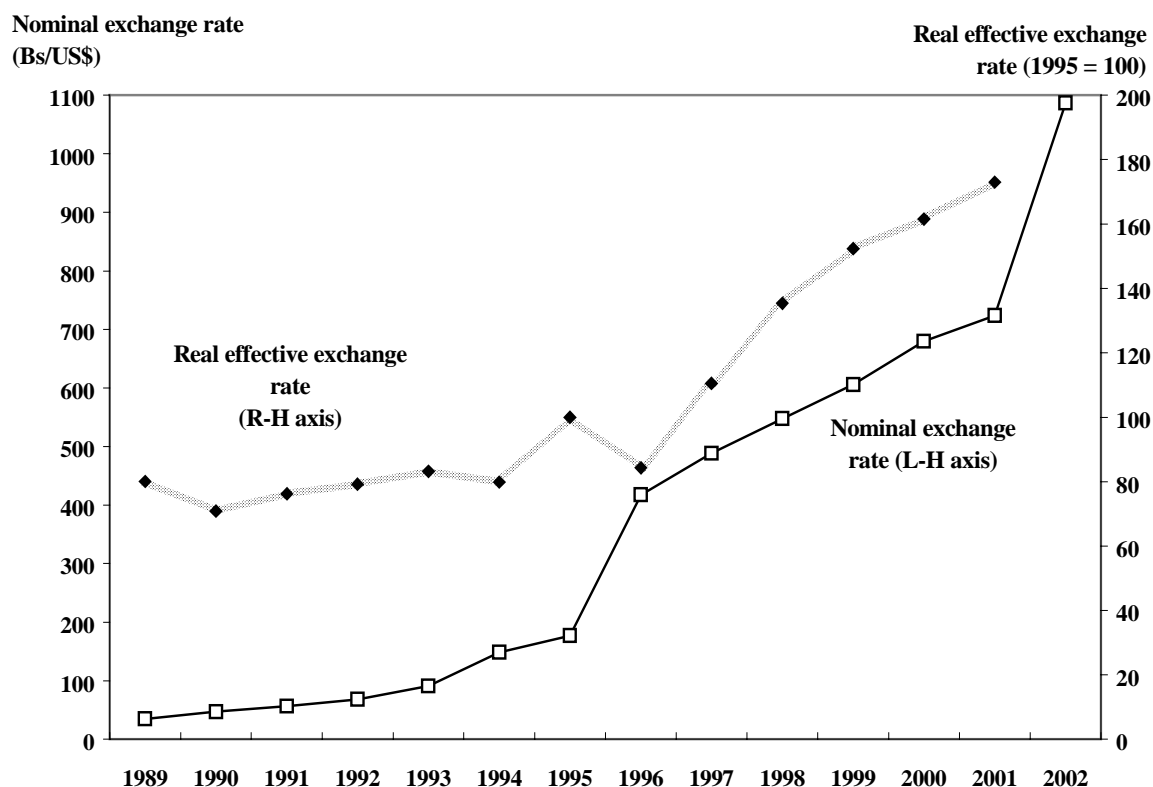
22. In line with the monetary policy pursued, growth in the monetary aggregates M1 (money in circulation) and M2 (monetary liquidity) slowed abruptly between 1997 and 1998, but outpaced inflation in 1999 and 2000. When a more stringent monetary policy was adopted in 2001, M1 growth approximately matched accumulated inflation, but the expansion of M2 implied a real tightening of monetary liquidity.

23. The monetary policy implemented since 1998 has resulted in real lending rates of about 10 per cent (WTO Secretariat calculations); deposit rates, in contrast, have been strongly negative. The spread between lending and deposit rates has remained large, and in an attempt to narrow this, repo operations with the general public have been increased, thereby introducing possibilities for saving at higher interest rates than those offered by the banking sector.

(v) Exchange-rate policy

24. Until early 2002, Venezuela's exchange-rate system consisted of a central parity subject to an annual devaluation of 7 per cent (10 per cent as from January 2002), with fluctuations of up to 7.5 per cent allowed on either side. Under this system the bolívar appreciated in real terms, because the nominal depreciation was less than inflation (figure I.2). This real appreciation eroded the competitiveness of non-oil exports, without producing any productivity gain. It also had a negative effect on import-competing activities, since import prices fell in relation to locally produced substitutes.

Figure I.2
Nominal and real effective exchange rate, 1989 - September 2002



Source: Central Bank of Venezuela and IMF, International Financial Statistics.

25. In response to pressures on the foreign-exchange market in anticipation of a bolívar devaluation, given deteriorating external balances and a worsening fiscal situation, the Government and the BCV introduced a floating exchange-rate system in February 2002. The declared objective of the new regime, which does not rule out interventions to prevent exchange-rate movements considered excessive, is to sustain the level of international reserves, supply foreign currency to match the needs of the economy, and enhance competitiveness in the productive sector. The authorities have noted that the new exchange-rate regime will help to make monetary policy more effective in its fundamental task of maintaining price stability, since the exchange rate will no longer be used as an anti-inflationary anchor.

26. The BCV holds at least one foreign-exchange auction every day, for a predetermined amount that is announced at the time of the auction. In the sale auction, authorized foreign-exchange operators (commercial banks, universal banks, saving and loan institutions and bureaux de change) can submit up to five bids to buy foreign exchange, indicating the amount and the exchange rate. At the same time, a purchase auction is held, in which foreign-exchange operators present quotes and amounts offered to the BCV. The Bank in principle accepts the lowest offers. The auctions determine the maximum, minimum and weighted-average exchange rates, the latter being considered

the reference or benchmark rate. The BCV announces the reference exchange rate every business day through its website.⁴

27. Following the introduction of a floating exchange-rate regime, the bolívar depreciated almost immediately, losing a cumulative 92.8 per cent of its value between February and September. This pushed up inflation in the early months of 2002, although not by the full amount of the depreciation.

(vi) Fiscal policy

28. Fiscal policy has generally been aimed at maintaining a surplus of current income over expenditure, in order to finance outgoings from the capital account which is structurally in deficit. These outflows are specially burdensome in the categories of public investment and (capital) transfers to the states.

29. To reinforce the stabilizing role of fiscal policy, a Macroeconomic Stabilization Investment Fund (FIEM) was created. This performs a stabilizing function by limiting the effect of oil revenues on the fiscal situation, smoothing out the business cycle and trying to prevent situations such as "Dutch disease" from arising.⁵ Transfers to the FIEM began in December 1999, but the deteriorating fiscal situation meant that no further transfers were made from the fourth quarter of 2001 till late 2002. Between October 2001 and March 2002, the Government drew US\$1.559 billion from the fund to meet fiscal needs; its total value in early 2002 stood at US\$5.586 billion.

30. A key element of fiscal policy involves redistribution of income from central government to the states and municipalities through a system of constitutionally mandated revenue-sharing, known as the *Situado Constitucional*. This is a specific budgetary item that absorbs between 15 and 20 per cent of total ordinary revenues as estimated annually by the National Treasury. It is distributed among the states and the capital district in the following manner: 30 per cent of the allocation in equal parts, and the remaining 70 per cent in proportion to population. In each fiscal year, the states are required to allocate at least 50 per cent of their revenue-sharing receipts to investment. Municipalities are entitled to at least 20 per cent of the total *Situado* transferred to their state.

31. Taxes collected by the National Integrated Customs and Tax Administration Service (SENIAT) accounted for 43 per cent of total tax revenue, including value-added tax (VAT), income tax (ISRL), and tariffs. Import duties accounted for 16 per cent of the central government's ordinary revenues in 2001, while the oil sector generates the bulk of fiscal revenue, accounting for 55 per cent of total central government income in that year. Dividends paid by Petr6leos de Venezuela, S.A. (PDVSA) provided 40 per cent of the sector's contribution, while the remainder came from hydrocarbon earnings, ISRL, and taxes on gasoline and other petroleum products, in that order.

32. Under the Budgetary Regime Law of 1999 a maximum of 62 per cent of revenue obtained from oil earnings can be used to finance expenditure, and this proportion will be reduced by one percentage point each year until it reaches a level of 50 per cent.⁶ The remainder of oil revenues have to be used for investment, oil industry development, and scientific and technological development projects, with up to 20 per cent eligible for use in operations to reduce and amortize the public debt.

⁴ www.bcv.org.ve.

⁵ "Dutch disease" occurs when revenues from a given export sector (hydrocarbons in the Venezuelan case) cause the exchange rate to appreciate in real terms. This reduces exports of non-natural resource products, and causes imports to increase and domestic production to shift towards non-tradable goods, forcing up their prices.

⁶ Decree 185 of 26 June 1999. Published in the Official Gazette, Special edition No. 5358, of 29 June 1999.

33. Central Government accounts have been in deficit since 1998, as a result of smaller oil revenues, compounded by a decrease in tax revenue collected from the non-oil sector and the relative inelasticity of public expenditure. The remainder of the consolidated restricted public sector⁷ has generally been in surplus, such that the overall position until early 2001 (except for 1998) displayed a consolidated surplus, which amounted to 4.3 per cent of GDP in 2000. Starting in the second half of 2001, however, the central government deficit was compounded by a deterioration in the financial situation of PDVSA and the rest of the public sector. This resulted in a deficit for the consolidated restricted public sector in 2001, equivalent to 4.5 per cent of GDP.⁸ The current surplus was smaller than in earlier years, and was used to finance part of the deficit on capital account. The original deficit target established by the Ministry of Finance for 2002 was 4.3 per cent of GDP, based on a GDP growth rate of 4.1 per cent and average inflation of 10.1 per cent.⁹ By mid-2002, however, these estimates were being revised in the light of the fiscal deterioration in the early months of the year, which saw a 38 per cent decline in fiscal revenue.

34. The government announced measures to tackle the deficit in May 2002, noting that total financing requirements amounted to 8.8 per cent of GDP; of this, 2.7 percentage points correspond strictly to financing the fiscal deficit while 6.1 percentage points are needed to amortize the debt. The government's lines of action in the taxation sphere aim firstly to broaden the tax base and then, in the medium-term, to lower domestic tax rates. Accordingly, the Government announced an increase in VAT to 16 per cent, with a view to gradually eliminating exemptions and lowering the rate. It also announced a second line of action to improve revenue collection in the customs service, which is expected to yield 1 per cent of GDP; in addition it raised the tax on bank debits from 0.75 to 1 per cent.¹⁰ The proposal does not envisage cutting expenditure, but reallocating it with a slightly expansionary effect. The government was also considering speeding up the concessions and privatization programme.

35. Fiscal deficits have mainly been financed through domestic borrowing, although both external and domestic public-sector borrowing is subject to limits imposed annually by special borrowing laws. The Special Law on Annual Borrowing for Fiscal 2002 sets a maximum of US\$10.884 billion.

36. In late 2001 the total public-sector debt amounted to US\$36.401 billion, or 28.7 per cent of GDP. Total service on this debt amounted to 9 per cent of GDP, a similar percentage to the 1996 figure, with the reduction in external debt offsetting the increase in domestic borrowing. External debt totalled US\$22.593 billion, of which 40 per cent has been restructured through Brady bonds. More than half of the unstructured debt is held in bonds by non-residents, while the remainder largely consists of debt owed to multilateral and bilateral organizations. In December 2001, Venezuela repaid its debt to the International Monetary Fund (IMF).

37. Domestic debt reached a level of US\$13.8 billion in late 2001. In local currency, it grew by 50.4 per cent compared to the previous year's level, to account for 11 per cent of GDP. Of this, 90 per cent is held in bonds, mainly national public debt bonds (DPNs) and treasury bills, which generally

⁷ The consolidated restricted public sector consists of central government, PDVSA, non-financial public-sector firms, the Institute of Housing and Social Security (IVSS), the Deposit Guarantee Fund (FOGADE) and Banco de Desarrollo (BANDES).

⁸ Ministry of Finance, Office of Macroeconomic Programming and Analysis, *Quarterly report on financial management*, First quarter 2001 (July 2001); Second Quarter 2001 (November 2001) and Third Quarter 2001 (February 2002).

⁹ República Bolivariana de Venezuela, *Exposición de Motivos del Proyecto de Ley de Presupuesto para el Ejercicio Fiscal 2002*.

¹⁰ Created by the Law Establishing the Tax on Bank Debits, Official Gazette No. 37.401 of 11 March 2002.

have short repayment terms (the average maturity of DPNs placed in 2001 was two years and eight months). The cost of borrowing is high: the effective weighted average rate at which DPN bonds were floated in the third quarter of 2001 was 19.8 per cent, equivalent to a real interest rate of about 7 per cent. This implies a high level of domestic debt service: including amortization and interest payments, this item absorbed 5.5 per cent of GDP in 2001, compared to 3.2 per cent in 1996.

(vii) Balance of payments

38. Given the substantial trade surplus generated by oil exports, Venezuela's balance of payments on current account is usually in surplus. This was the case throughout 1996-2001, except for 1998 (Table I.3) when a fall in oil prices coincided with an increase in imports, substantially cutting the trade surplus and generating the first current-account deficit since 1988 – equivalent to 3.4 per cent of GDP. The subsequent recovery of oil prices and a contraction in imports restored surpluses of 3.4 per cent of GDP in 1999 and 10.8 per cent in 2000. In the following year, the surplus fell sharply to 3.2 per cent of GDP, in the wake of another fall in oil prices, which was compounded by import growth associated with relatively resilient domestic demand, and, in particular, an upturn in investment.

Table I.3
Balance of payments, 1995-2002^a
(Millions of U.S. dollars)

	1995	1996	1997	1998	1999	2000	2001	2002
Current account balance	2,014	8,914	3,467	-3,253	3,557	13,111	4,080	1,757
Trade balance (goods)	7,013	13,770	10,025	2,471	7,606	17,544	9,360	5,199
Exports f.o.b.	19,082	23,707	23,703	17,576	20,819	33,035	26,751	11,910
Oil	13,862	18,660	18,301	12,134	16,697	27,885	21,574	9,456
Non-oil	5,220	5,047	5,402	5,442	4,122	5,150	5,177	2,454
Imports f.o.b.	-12,069	-9,937	-13,678	-15,105	-13,213	-15,491	-17,391	-6,711
Oil	-1,754	-2,205	-1,973	-2,232	-1,648	-1,759	-2,147	-750
Non-oil	-10,315	-7,732	-11,705	-12,873	-11,565	-13,732	-15,244	-5,961
Services	-3,165	-3,269	-4,006	-3,685	-2,462	-3,018	-3,215	-1,413
Transport	-846	-739	-1,265	-1,307	-1,050	-1,277	-1,423	-519
Travel	-865	-1,349	-1,619	-1,490	-932	-1,071	-1,117	-453
Communications	6	0	-32	-34	-30	-68	-98	-63
Insurance	-83	-85	-74	-71	-57	-75	-78	-53
Government services	-40	-92	-17	-70	-24	-29	16	40
Other	-1,337	-1,004	-999	-713	-369	-498	-515	-365
Interest	-1,943	-1,725	-2,408	-1,931	-1,527	-1,204	-1,458	-1,663
Transfers	109	138	-144	-108	-60	-211	-607	-366
Balance of financial transactions	-2,647	-1,495	1,523	1,780	-1,004	-2,790	-1,009	-4,002
Direct investments	894	1,676	5,036	4,262	2,789	4,357	3,076	434
Abroad	-91	-507	-500	-233	-501	-107	-333	-362
In Venezuela	985	2,183	5,536	4,495	3,290	4,464	3,409	796
Portfolio investments (net)	-801	739	506	1,289	1,938	-2,418	649	-1,031

	1995	1996	1997	1998	1999	2000	2001	2002
Other investments	-2,740	-3,910	-4,019	-3,771	-5,731	-4,729	-4,734	-3,405
Errors and omissions	-493	-892	-1,460	-1,442	-1,504	-4,503	-5,142	-1,530
Overall balance	-1,126	6,527	3,530	-2,915	1,049	5,818	-2,071	-3,775
Change in reserves (increase-) ^b	1,126	-6,527	-3,530	2,915	-1,049	-5,818	-2,071	3,775

a First semester 2002

b Excludes adjustments relating to exchange rates, prices and accounting updates of balances at the Central Bank of Venezuela.

Note: Part of the change in reserves in 2000 and 2001 corresponds to contributions to the FIEM.

Source: Central Bank of Venezuela.

39. The balance of trade in services posted deficits ranging between 2.5 and 4.6 per cent of GDP every year in 1996-2001, with particularly negative results in transport and travel. Net investment income is structurally negative, although the deficit has been smaller in recent years thanks to lower interest and dividend payments abroad. The capital account also runs a structural deficit, mainly because of large outflows of private capital (in the "Other investments" category of Table I.3) and because of external debt amortization. This deficit is in a range between 1.5 and 2.5 per cent of GDP. Apparent capital outflows under the heading "Errors and omissions" largely correspond to deposits made in the FIEM. Net international reserves, including FIEM deposits, totalled about US\$20 billion in 2000, equivalent to nearly 16 months' imports; but they shrank by about US\$2 billion in 2001 and continued to fall during the first half of 2002, reaching a level slightly below US\$15 billion in late June.

(3) DEVELOPMENTS IN TRADE¹¹

40. As the oil sector generates over 80 per cent of the value of Venezuela's goods and services exports, fluctuations in oil prices are the dominant factor in total export value. Total exports expanded at an average annual rate of 7.6 per cent between 1996 and 2000, before contracting in 2001. This performance is entirely explained by the behaviour of oil exports, which grew by an average of 7.9 per cent per year between 1996 and 2000, and then fell back in the following year. The value of non-oil exports shrank between 1996 and 2001, mainly because of a decline in agricultural exports (Table AI.2). The value of manufactured exports has remained flat in recent years.

41. On the other side of the equation, imports grew at an average annual rate of 13.9 per cent between 1996 and 2001, mainly on the back of a strong expansion in manufactured imports, amounting to 14.4 per cent per year. This was driven by imports of automobiles, office equipment and telecommunications, and non-electrical machinery. Import growth in these categories has reflected robust demand for industrial supplies, especially in the oil, investment and consumer durable goods sectors, and has also been encouraged by the overvaluation of the bolívar.

42. Exports of commercial services followed a downwards trend in 1995-2000, falling in value by about one-third during this period (Table I.4). There were reductions in all service areas, but these were most pronounced in transport, partly because of the bankruptcy of VIASA, Venezuela's international airline. Imports of services fell slightly between 1995 and 2000 – mainly in the "Other services" category, which covers computer and information services, royalties and licensing fees, financial services, other business services, and personal, cultural and recreational services, among others.

¹¹ Except as indicated otherwise, the data used in this section were obtained from the COMTRADE database of the United Nations Statistics Division.

Table L.4
Exports and imports of commercial services, 1996-2000
(Millions of US dollars)

	1996	1997	1998	1999	2000
Balance	-3,269	-4,006	-3,685	-2,462	-3,018
Exports	1,573	1,489	1,461	1,310	1,237
Transport	484	347	282	331	363
Public oil	182	175	117	178	195
Public non-oil	114	120	129	115	131
Private	188	52	36	38	37
Travel	884	933	961	736	634
Private	884	933	961	736	634
Communications	28	11	12	11	11
Public non-oil	3	3	5	4	3
Private	25	8	7	7	8
Insurance	2	2	2	2	4
Private	2	2	2	2	4
Government services	125	125	160	185	170
Public non-oil	125	125	160	185	170
Other services	50	71	44	45	55
Public non-oil	..	32	..	4	..
Private	50	39	44	41	55
Imports	4,842	5,495	5,146	3,772	4,255
Transport	1,223	1,612	1,589	1,381	1,640
Public oil	261	294	262	189	233
Public non-oil	92	119	71	80	77
Private	870	1,199	1,256	1,112	1,330
Travel	2,233	2,552	2,451	1,668	1,705
Public oil	13	27	20	9	8
Public non-oil	13	16	15	7	1
Private	2,207	2,509	2,416	1,652	1,696
Communications	28	43	46	41	79
Public non-oil	2	3	2	2	..
Private	26	40	44	39	79
Insurance	87	76	73	59	79
Public oil	43	35	29	25	31
Public non-oil	3	2	3	..	4
Private	41	39	41	34	44
Government services	217	142	230	209	199
Public non-oil	217	142	230	209	199
Other services	1,054	1,070	757	414	553
Public oil	801	800	544	238	253
Public non-oil	54	79	72	54	51
Private	199	191	141	122	249

.. Not available.

Source: Central Bank of Venezuela.

43. Of total imports in 2001, 81.3 per cent consisted of manufactured goods – in particular, machinery and transport equipment, vehicles and autoparts, office machines and telecommunications

equipment, products of the automotive industry and chemical goods. The most significant change in the composition of the import basket was a relative decrease in agricultural imports and an almost identical increase in manufactured goods. Imports of agricultural products represented 12.8 per cent of the total in 2001, well below the share recorded in 1996 (see Table AI.2). In value terms, however, these totalled US\$2,103.6 million in 2000, compared to US\$1,666.4 million in 1996 – an increase of 26.2 per cent. Imports of manufactured goods, on the other hand, grew by 96 per cent in value terms between 1996 and 2000 (rising from US\$6,818.6 million to US\$13,362.1 million in that period).

(i) Direction of trade

44. Venezuela's main trading partner is the United States, which absorbed 56.4 per cent of its exports, and supplied 33.9 per cent of its imports in 2001. The importance of the United States as the leading market for Venezuelan exports, particularly crude oil, was maintained throughout 1996-2001, despite fluctuations in relative percentage shares; but its importance as a supplier has declined considerably. Nearly 84 per cent of Venezuelan exports are sent to other countries in the Americas, while the remainder goes mainly to the European Union and Asia. Apart from the United States, the main sources of imports are European Union countries, followed by Colombia, Brazil, Mexico and Japan (Tables AI.3 and AI.4).

45. According to preliminary statistics from the Secretariat General of the Andean Community, intra-Andean Community trade totalled US\$5.68 billion in 2001 – an increase of 10 per cent over the previous year and matching the record level achieved in 1997 (Table I.5). However, exports from Venezuela to other members of the subregion shrank to about US\$1.29 billion, mostly represented by non-oil products, as a result of reduced oil exports. Information from the same source shows that trade between Andean partners encompasses 4,760 NANDINA subheadings, and 91 per cent involves trade in manufactured goods.

Table I.5
Trade within the Andean Community, 1999-2001

	1999	2000	2001	1999	2000	2001
	Millions of US dollars			Annual percentage rate of change		
Exports within Andean Community	3,940	5,175	5,680	-27.2	31.3	9.8
Bolivia	294	304	351	-7.9	3.4	15.5
Colombia	1,634	2,167	2,744	-23.3	32.6	26.6
Ecuador	445	663	779	-17.6	49.0	17.5
Peru	347	446	518	-25.9	28.5	16.1
Venezuela	1,220	1,595	1,288	-37.5	30.7	-19.2
Non-traditional products	890	1,031	1,043	-44.9	15.8	1.2
Oil and petroleum products	330	564	245	-1.4	70.9	-56.6

Source: General Secretariat of the Andean Community.

46. Since the G-3 agreement came into force, trade between Venezuela and Mexico has almost doubled, largely because of an expansion in Mexican exports, which totalled US\$772 million in 2001 compared to US\$357 million in 1996. As a percentage of the total, however, trade between the two countries remains limited.

(4) TRENDS AND PATTERNS IN FOREIGN DIRECT INVESTMENT (FDI)

47. In the reporting period, Venezuela has been striving to attract foreign direct investment (FDI), and has reformed its legislation for this purpose. Steps taken to enhance the protection afforded to

foreign investment include measures contained in the 1999 Investment Promotion and Protection Law, which have helped improve the investment climate (chapter II.6).

48. New foreign investments totalled US\$948.1 million in 2001, of which US\$727.7 million were made in non-oil activities and US\$220.4 million in the oil sector, particularly in hydrocarbons and petrochemicals. Although the level of FDI in 2001 was 47.5 per cent above the previous year's figure, it is still way below the five-year high achieved in 1998, which included privatization of the steel producer SIDOR in the manufacturing sector (chapter IV.6)(iii)(a). Excluding 1998, foreign investment flows have been relatively stable over the last decade, generally representing between 0.5 and 0.7 per cent of GDP.

49. During 1997-2001, the largest volumes of FDI were channelled into the manufacturing sector, which absorbed US\$2,343.2 million, or 46.5 per cent of the US\$5,044.4 million total (Table I.6). The second most important FDI recipient was hydrocarbons, although considering the size of this sector, the actual amount of foreign investment was quite small. The transport and communications sector was the third largest FDI recipient in 1997-2001, thanks to the opening up of telecommunications services.

Table I.6
New foreign direct investment, 1997-2001
(Millions of US dollars)

Economic activity	1997	1998	1999	2000	2001	1997-2001
Agriculture and livestock	49.2	0.2	16.7	4.1	0.6	70.8
Manufacturing industry	253.9	1,358.5	254.4	196.9	279.5	2,343.2
Construction	32.7	19.2	42.5	64.8	1.9	161.1
Commerce	23.0	41.2	80.0	153.6	28.3	326.1
Transport, warehousing and communications	4.7	9.3	38.1	77.1	381.1	510.3
Financial services	163.4	90.5	40.4	42.6	31.9	368.8
Social services	0.0	1.7	6.6	10.6	1.5	20.4
Electricity, gas and water	4.0	30.4	37.0	35.7	3.0	110.1
Other, not specified	175.5	19.6	232.7	0.0	0.0	0.0
Total non-oil sector	705.4	1,570.7	748.5	585.5	727.7	4,337.8
Hydrocarbons	139.1	28.6	233.9	56.6	110.5	568.7
Petrochemicals	20.1	4.2	2.8	0.8	109.9	137.8
Natural gas	0.0	0.0	0.1	0.0	0.0	0.1
Mining	0.0	0.0	0.0	0.2	0.0	0.2
Total oil and mining sector	159.2	32.8	236.8	57.4	220.4	706.6
Total	864.6	1,603.5	985.3	642.9	948.1	5,044.4

Source: Superintendency of Foreign Investment, Ministry of Energy and Mines.

50. The United States is the leading foreign investor in Venezuela, accounting for one-third of FDI accumulated up to 2001. This country is followed by the Cayman Islands (15.3 per cent), the Netherlands (10.3 per cent), Spain (5.9 per cent), and Switzerland (4.3 per cent) (Table I.7). United States FDI is distributed mainly in consumer goods production, financial services, manufactures, pharmaceuticals and telecommunications, and in electricity and the exploration and production of crude oil in marginal areas. Investments by the Netherlands are concentrated in consumer goods production and banking, Spanish investments are mainly in the financial sector and Swiss investments are in food and pharmaceutical products.

Table I.7
Foreign direct investment by country of origin, 1997-2001
(Millions of US dollars)

	1997	1998	1999	2000	2001	Cumulative total ^a	Percentage of cumulative total
	Flows						
Non-oil sector							
United States	248.0	122.2	98.2	85.9	93.2	4,351.7	33.6
Cayman Islands	4.4	1,203.5	202.1	34.7	71.0	1,986.2	15.3
Netherlands	0.0	0.0	0.0	83.5	371.0	1,334.3	10.3
Spain	118.3	14.9	19.7	59.7	24.0	761.3	5.9
Switzerland	8.7	16.2	15.4	42.8	3.4	557.0	4.3
United Kingdom	46.9	8.8	10.6	5.9	3.4	452.8	3.5
Panama	38.4	28.5	41.0	27.0	22.3	462.4	3.6
Japan	8.6	13.3	3.1	50.8	2.0	434.2	3.4
France	6.7	9.6	9.4	6.9	6.8	268.6	2.1
Colombia	9.8	61.4	55.9	51.8	34.9	242.5	1.9
Italy	1.6	0.2	0.0	0.7	0.8	194.0	1.5
British Virgin Islands	26.1	18.7	3.3	11.0	3.0	195.9	1.5
Chile	1.4	0.0	4.5	0.0	80.5	268.6	2.1
Bermuda	4.9	7.3	2.3	66.8	0.1	141.7	1.1
Canada	30.6	0.0	1.2	0.1	0.3	138.3	1.1
Bahamas	11.2	0.2	75.3	11.0	1.1	131.1	1.0
Germany	7.9	10.2	3.7	2.7	4.8	124.1	1.0
Curaçao	0.0	7.3	1.4	1.3	0.3	117.5	0.9
Other	131.9	46.6	201.4	42.9	4.8	798.5	6.2
Total non-oil sector	705.4	1,570.7	748.5	585.5	727.7	12,957.0	100.0
Oil and mining sector ^b							
United States	128.3	25.4	28.8	38.1	30.6	..	..
Cayman Islands	1.2	3.4	165.7	9.7	14.0	..	..
Netherlands	1.1	0.0	10.3	0.1	98.2	..	..
Panama	0.0	0.0	25.0	2.5	0.0	..	..
Virgin Islands	0.0	0.2	0.0	0.0	82.7	..	..
Canada	19.8	0.0	0.0	0.0	0.0	..	..
France	1.1	1.2	5.1	0.0	0.0	..	..
Other	7.7	3.3	2.0	6.9	5.3	..	..
Total	159.18	32.77	236.83	57.40	220.43	..	..

.. Not available.

a Includes cumulative investment up to 2001 unadjusted for depreciation.

b Includes hydrocarbons, petrochemicals, mining and natural gas.

Source: CONAPRI, based on information provided by SIEEX, and Ministry of Energy and Mines, Technology and Foreign Investment Division.

(5) OUTLOOK

51. In a report published in August 2002, the Economic Commission for Latin America and the Caribbean (ECLAC) forecast that Venezuelan GDP would contract by 3.5 per cent in 2002, largely as

a result of adjustment measures adopted to deal with macroeconomic imbalances. ECLAC also predicted that inflation would rise to an annual rate close to 30 per cent.¹²

¹² Economic Commission for Latin America and the Caribbean (ECLAC), *Situación y perspectivas 2002. Estudio Económico de América Latina y el Caribe 2001-2002*. Available on the Internet at <http://www.cepal.org/publicaciones/DesarrolloEconomico/4/LCG2184P>.