

Oil and the Venezuelan Economy

In contrast to nearly all other petroleum producers, Venezuela has been a significant exporter of oil for more than half a century: for more than a quarter of a century it has been the prime mover of the Venezuelan economy. To say that it provides more than three-quarters of the current foreign exchange receipts, or one-quarter of the national income, understates the degree of reliance, because most of the other activities rely to a large extent on petroleum, which has stimulated a growth rate of more than 7% a year over the past 25 years.

REST OF WORLD	export receipts	PETROLEUM SECTOR	Taxes	GOVT	Wages, etc	REMAIN- ING SECTORS
	profits and inputs		Wages & purchases			
	Payments for Imports					

The petroleum sector purchases in Venezuela some goods and services and pays for labour, which in turn buys consumer goods and services. But petroleum extraction and refining together employ less than 1.5% of the labour force. By far the most important channel by which export earnings penetrate the economy is through government revenues (which used to account for about two-thirds of all revenues, but in 1974 87%). These are transmitted via the salaries and wages of the civil service (including the armed forces and all the other agencies financed out of the budget) and public works expenditures, though there are in addition loans to productive sectors, subsidies, etc.

Table 1: Petroleum price and the value of exports 1963 and 1970-73

	1963	1970	1971	1972	1973	1974
Crude petroleum price (\$ per barrel)	2.04	1.93	2.52	3.04	4.42	14.03
Exports of petroleum and products (Bs.cn)	7.2	11.0	13.8	15.1	22.2	60.3

Source: Ministerio de Hacienda, "Comentario sobre la evolucion de los precios de los hidrocarburos venezolanos" (Caracas, mimeo, 1974), and Informe Economico (Banco Central).

The relatively fast growth of the Venezuelan economy has been largely due to the rises in both volume and price of petroleum, which have taken it in turn to carry the economy forward. During the 1960s there was a fast rise in the volume of output, to more than 3 million barrels a day, and though this could hardly be maintained indefinitely, in view of the limited reserves, a decline in the volume of output in the early 1970s was more than compensated by the fast price rise as OPEC began to use its collective bargaining power - see Table 1.

The internal economy had expanded rapidly, with even agricultural output rising at about 5%,¹⁾ and by 1973, on the eve of the big rise in the price of oil, the average income per head in Venezuela was already over \$1,000, or higher than in the poorer countries of Southern Europe, such as Portugal and Greece. Although imports followed exports upwards, there was little strain on the balance of payments. The bolivar remained firm and exchange controls were not thought necessary. largely

The growth in agricultural output was due to mechanisation but the rate of urban expansion was fast enough to make it possible for the surplus rural population to migrate to the cities, and there (after a time) become assimilated into the urban economy, in some cases climbing rapidly into the top social strata. Open unemployment remained moderate, at 6-7% (though twice that among those aged under 25).²⁾ There is a chronic shortage of experienced, skilled personnel of all types.

But the oil revenues had by no means been spread evenly through the country. Much of the government bureaucracy had been created in Caracas, government spending on education and health was in large part focussed here (and in a few other large towns such as Maracay); and a high share of public spending was in

1) "Elementos para una interpretacion del Desarrollo Historico de la Agricultura Venezolano" (ILPES, mimeo, 1975).

2) Encuesta Nacional de Hogares, Direccion General de Estadistica y Censos. These surveys have recently been improved. 'Open' unemployment consists of those who in answer to a questionnaire, say that they have recently been seeking work.

urban areas or on highways connecting them. By 1973 immense gaps (perhaps the largest in the world apart from the Middle East) had opened between living standards at the top and at the bottom of society. On the one hand officials, private contractors and importers pay little income tax and enjoy a living standard at least comparable to (and largely modelled on) that of their opposite numbers in the United States. On the other hand, one-quarter of all dwellings are "ranchos" or shacks (about half of these in urban areas), 20% of the population have had less than 4 years' primary schooling, 8% are illiterate. Social security only covers those in employment, and less than half of these. Problems of homeless children are severe. About 20% of those in work earn (in 1974) less than Bs. 450 a month. The contrasts are evident to the eye of even the casual visitor travelling up the expressway from Maiquetia airport.

This whole mechanism received a sharp impulse from the more than trebling of the price of oil at the end of 1973 (See Table 1 again). A large surplus (Bs.25 bn) appeared in the balance of payments. There was naturally an intense struggle over the use of this windfall. One view was that it should be saved until the country was ready to spend it - the other that it should be largely spent at once, to help raise living standards, creating a momentum that would be self-perpetuating and solve the country's social problems.

In the event a mixture of strategies was followed. A Fondo de Inversiones was created to sterilise part of the surplus. Bs. 14 billions were paid into this fund in 1974 and reserves also. The fund was used in fact as a source of aid, most of which was channelled through multilateral agencies, but the greater part was invested in short-term securities so that it would be available for financing the heavy river valley and industrial schemes in the province of Guyana. However, government spending also increased rapidly due mainly to public works schemes to absorb unemployment. A minimum wage of about Bs.450 a month was established.

The GDP rose by 8% in 1974 (excluding petroleum). Consumer subsidies were raised from just over Bs 100 millions a year to Bs. 1,800 m. to cushion increased import prices, and retail prices only rose 8½%. The Ayacucho scholarship programme was established to create cadres by sending thousands of students overseas on technical; and professional training.

It was originally expected that a payments surplus would be maintained in the years ahead. A summary of the fifth development plan (1974-9) prepared by CORDIPLAN presented last summer by the Minister of Planning, Dr. Gumersindo Rodríguez, stated the plan's basic assumptions - a gradually declining volume of exports, and (since imports would grow) a "positive and descending" surplus until 1980. Then the surplus would grow again because the development of industry and the change in patterns of consumption (due to redistribution of income) would halt the growth of imports. The government would also be able to draw down the investment fund. Altogether it was envisaged that some Bs 157 billion would be invested in these 5 years, of which 40% would be in industry and agriculture, mostly in highly capital-intensive projects. Largely as a result of irrigation and other rural works, agricultural output would rise by 11.5% a year (!), somewhat faster than the national product.

Prospects have altered drastically while the plan has still been under discussion. The internal expansion was fuelled by a wage rise of 25%, further big increases in government employment, and a private construction boom. The sharp rise in imports continued through 1975.¹⁾ It was only slowed down by the exhaustion of port capacity at La Guaira at the end of the year (some ships being held up by more than 2 weeks). The GDP again rose by about 8%,²⁾ although it does not appear that the benefit was spread more widely than previously.

1) Cement production proved insufficient for the demands of both the public and private sectors and imports jumped sharply.

2) Excluding petroleum, see below.

Other developments also began to eat into the payments surplus. Import prices were rising sharply. On the other hand, oil prices, despite the rise of about 10% agreed by OPEC last autumn, remained barely steady, at the new level,¹⁾ and export volume fell in line with OPEC's policy of maintaining prices by cutting back supplies. The reduction in output was 18% for crude in 1975 (compared to 12% in 1974) - in products it was 25%. On the other hand, the rate of taxation rose from 64% to 72%. The net result was that the current account payments surplus fell back from Bs 25 billion in 1974 to Bs 13 billion in 1975.

The Fondo de Inversiones levelled off at nearly Bs 21 million. But it was expected that revenues from a volume of exports of 2.2 million barrels a day (m. b/d) would cover government expenditures in 1976, at their new level, about double those of 1973, and also be compatible with OPEC policy.

Economic prospects changed even more drastically after the nationalisation of petroleum companies on January 1 of this year. The companies accepted reluctantly the terms of compensation. Since the agreements with the government (somewhat surprisingly) did not provide for their oil purchases to be maintained, even during the period when compensation instalments were being paid, they were free to reduce considerably their take of Venezuelan oil, especially of products, and many did so. Exports fell to less than 1.5 m. b/d. It has been announced that firm contracts have been signed for deliveries of 1.7 m. b/d²⁾ and PETROVEN, the government's petroleum corporation, expected to sell 1.8 m. b/d by March, and by June 2.0m. - the minimum necessary to cover government expenditure.³⁾

1) The OPEC agreement implied an average of \$14.59 a barrel (as against an average of \$13.38 for January-September). "Declaraciones de fin del año del Presidente del Banco Central". (mireo 1976). However, the average is expected only to be \$13.74, because of a reduction in the price of residual fuel oil.

2) Dr. Zarraga, the assistant to the President of PETROVEN.

3) Ministerio de Minas y Hidrocarburos and Ministerio de Hacienda El Nacional 30/1/76

The immediate question is whether other OPEC members will step in and pick up the markets which Venezuela previously supplied. If they do (and are themselves feeling the effects of production cuts of 15 - 25% in 1975), it will be considered disloyal by the Venezuelan government, and - so one Venezuelan economist said to me - "OPEC will be dead within a year".¹⁾

Even if exports pick up to the projected level of 2.2 million barrels a day, it will no longer be possible to finance the large programme of the draft plan.²⁾ The change in mood has been dramatic. The euphoria of 1974 and 1975 has evaporated. In this new mood, a devastating attack on the government's ineffectiveness by Perez Alfonso, former Minister of Mines and "the father of OPEC", now an elder statesman and guardian of the conscience of Accion Democratica, was much discussed and had a tremendous impact. After describing caustically the "physical and moral degradation of the public", he attacked scathingly the waste of government funds and especially the "plan for National Destruction" produced by CORDIPLAN.³⁾

A presidential decree just issued froze the number of personnel in the public services, disallowed additional overseas scholarships (apart from the Ayacucho programme), and required special Presidential authorisation for research projects, consultancies, etc.⁴⁾ The 5-year plan will be reshaped before its publication which is due in March. It might (in view of the re-emergence of the prospect of unemployment) include less emphasis on capital-intensity. There could also be a somewhat warmer welcome to foreign capital.

1) A hint was dropped by the Minister of Mines that if Venezuela lowered its prices all round, it could sell 2.35 m. b/d.

2) An additional problem of a smaller order of importance is that PETROVEN now has to provide the trade credits which the companies previously extended.

3) Resumen 25/1/76

4) Gaceta Oficial 16/1/76

There is a good deal of fat that could be cut off the import structure, enabling the rate of growth of output and employment to continue. But because of the habituation of the majority of the public to a life style based largely on imports, this process would not be without social tensions. And the prevalent political tranquillity could disappear rapidly if it proves impossible to maintain the growth of employment.

There is no immediate threat to imports. Foreign exchange reserves (not including the foreign assets of the Fondo de Inversiones) amounted to Bs. 8½ bn. at the end of 1975. Still, difficult decisions clearly lie not too far ahead.

The longer term problem is more serious. With a birth rate at 37 per thousand and a death rate of 7, the natural increase of the population is 3%. Currently about 12.5 million (about half under 16 years old) the population is expected to reach 22-30 million by the year 2000, depending on what assumption one uses about fertility.¹⁾ The population of working age is growing at over 4% a year, reflecting the very high birth rate (around 45) of the late 1950s and early 1960s and also net immigration.

World petroleum demand will look more secure when the industrial countries resume their economic expansion, but in any case it is unlikely that the government would want to sell more than 2.2 m. b/d because (in contrast to Iran and Saudi Arabia) known reserves (less than 20 billion barrels, ie some 20 years' supply at recent rates of exports²⁾) will only permit even that level to be maintained for a few years. Although vigorous exploration is planned by PETROVEN, this can hardly affect production before the mid-1980s³⁾. Even then it would have to have been very vigorous to permit 2 m. b/d to be maintained for any length of time.

1) "Proyeccion de Poblacion de Venezuela", D.G.E. 1975

2) Contrast Saudi Arabia with known reserves 10 times as great, or more than 50 years' supply. (Source: The Oil and Gas Journal).

3) The last phase of large-scale exploration was in the late 1950s. No new concessions can be made to foreign companies since the Hydrocarbons Reversion Act of 1971, but some service contracts since then will affect marginally the course of future output.

The question for Venezuela is whether another dynamic source of exports can be developed in the next 5 years to take the place of petroleum. The official strategy relies on products of steel, petrochemicals and aluminium by making use of the availability of natural gas, iron ore and bauxite. However, it is now realised that a large part of steel and aluminium output will be needed for internal consumption, and markets for petrochemicals are becoming highly competitive. The Andean Pact will provide a degree of shelter for some industries, but there seems as yet no firm prospect of solving the long-term foreign exchange problems set by the speed of demographic advance and the need to continue raising incomes, especially at the lower levels.

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