Foreign Debt and Latin American Economic Development

EDITED BY
Antonio Jorge
Jorge Salazar-Carillo
Rene P. Higonnet

PERGAMON PRESS
New York Oxford Toronto Sydney Paris Frankfurt

VENEZUELA'S FOREIGN PUBLIC DEBT

Pedro A. Palma

FOREIGN PUBLIC DEBT IN THE 1970's

For several decades, Venezuela considered itself conservative with respect to foreign indebtedness. It financed most of its public sector expenses with oil income, both elements grew in a relatively moderate fashion, oblivating the need for external financing. This situation changed radically during the 1970's, when not only the public sector, but the private sector as well, began to resort increasingly to international financial markets to cover investments, and in some cases, operating expenses.

Thus, foreign public indebtedness in Venezuela topped $1 billion in 1972, equivaent to 7 percent of the gross domestic product and 20 percent of the value of goods and services exported. In only eight years, this debt increased to $18 billion, or 28 percent of the gross domestic product and 83 percent of goods and services exported.

Paradoxically, this process occurred at the height of the oil boom which began in 1974, when exports and public revenues coming from the oil sector tripled. This bonanza encouraged the economic authorities to undertake an ambitious development plan requiring great outlays during the second half of the 1970's. From the beginning, it was understood that some of these expenditures would have to be financed through public sector indebtedness, which would largely be contracted abroad, since oil and other ordinary revenues estimated for the period corresponding to the Fifth National Plan (1976-1980) were not sufficient to cover projected expenses.[1]

Therefore, it was decided that Venezuela should begin acquiring debt at the start of the development plan's implementation, since Venezuela, as an oil exporter, had excellent creditworthiness in international financial markets. In syndicated loans, Venezuela was required to pay a spread of only 3/4 percentage points above LIBOR, while other countries such as Brazil, faced a two-point spread.

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[1] CORDIPLAN. V Plan de la Nacion. Caracas, Gaceta Oficial No. 1960 Extraordinaria, Marzo 11, 1976, ps. 14 y 22.

Since the development plan was first initiated, it became even more evident that the gap between expenses and projected income needed to finance the different investments was growing due to the stagnation of oil exports and prices in 1975-1978. In addition, real costs of investment projects greatly surpassed initial estimates, increasing the need for foreign indebtedness, so that the public sector's debt grew much faster than was originally foreseen.

This process of growing indebtedness did not correspond to any preconceived plan which would have attempted to optimize conditions and characteristics of the loans. The legislation of the time encouraged decentralized public entities and state-owned enterprises to seek loans for themselves in international financial markets. Most of these were short-term loans used to finance investment projects and in some cases, to fund ordinary operating expenses. This explains why Venezuela's short-term public debt grew explosively during the second half of the 1970's and early 1980's, to the extent that by mid-1981 more than 45 percent of the public sector's foreign debt consisted of short-term loans, an excessive proportion for any economy.

Paradoxically, this process was accompanied by a large growing accumulation of foreign assets held by Petroleos de Venezuela and the Fondo de Inversiones de Venezuela (Venezuelan Investment Fund). Since the Venezuelan oil industry was nationalized in 1976, Petroleos de Venezuela and its affiliate companies have followed the policy of accumulating abroad, sufficient financial assets to permit self-financining of their operations and ambitious investment plans. These financial assets were estimated at $8.6 billion at the end of 1981. In addition, the Central Bank of Venezuela and the Venezuelan Investment Fund, held over $11 billion by the end of 1981, so that public sector foreign financial assets totaled around $20 billion for that date.[2] Net foreign public debt, then, defined as the difference between gross public debt and public sector, amounted to one billion dollars. This explains why Venezuela is currently obtaining international loans under optimal conditions, even though its traditional creditworthiness indicators are not substantially better than those of many developing countries which use those same markets.

TABLE 1 Indicators of Creditworthiness (1980)
(percentages)

	Venezuela	Avg. Non-oil LDC's
1. Gross Debt/Exports	83.0	100
2. Gross Debt/GDP	27.7	20
3. Gross Debt Service Exports	15.7	20*

Source: William R. Cline
*On long-term debt only.

[2] Banco Central de Venezuela: Resena Preliminar de la Economia Venezolana en 1981, Caracas, Enero, 1982, ps. 10 y 17.

Why does Venezuela maintain this high and growing level of foreign indebtedness at the same time that it holds large financial assets in international markets? The explanation is principally political, since from the purely economic viewpoint such an approach is not justified. As W.R. Cline observed, the yield from Venezuela's foreign financial assets, equivalent to the US treasury Bill rate of approximately 14 percent, is substantially lower than the average interest it must pay for syndicated loans in those markets which, to repeat, are equivalent to LIBOR plus an approximate spread of 3/4 of a percentage point. This implies that differences between yields obtained by financial assets and the interest rates payable on foreign loans are sometimes over three percentage points.[3]

This situation has recently unleashed a growing controversy. On the one hand, some affirm that the accumulation of large amounts of foreign financial assets by Petroleos de Venezuela is not justified, since other public entities must seek out international loans under relatively unfavorable conditions. These critics advise that Petroleos de Venezuela's assets be used to finance the needs of other decentralized government entities. While this position is valid from a strictly financial viewpoint, others oppose it claiming that it would be extremely risky for Venezuela to use the resources which assure the future financial solvency of its major industry to finance the current needs of multiple state enterprises and decentralized organisms, characterized by inefficiency and serious managerial and financial problems.

THE FUTURE OF VENEZUELA'S FOREIGN DEBT

In contrast to events in many Latin American and other developing countries, the step-up in Venezuelan foreign debt as of 1975 was not based on the external imbalance of the economy, since from 1974 to 1981, Venezuela enjoyed a considerable surplus in its current account, with the exception of two years (1977-1978), accumulating a net surplus in the current account of over $6.5 billion during that period. The cause of Venezuela's foreign indebtedness lies in the imbalance of the public sector as a whole, since, as explained above, the ambitious development plan undertaken in the mid-1970's implied a large sustained increment in public sector spending, while this sector's ordinary income expanded much less rapidly during the period, due to the relative stagnation in oil income, artificially low prices of many public services, and other factors.

A change in this situation is expected in the immediate future, since the public sector has shown its intention during the latter 1970's and early 1980's to limit the rate of expansion in spending. Thus, it is possible that the consolidated public sector deficit may not grow disproportionately, which would also help limit the need for new foreign indebtedness. At the same time, measures have been taken to restrict isolated and often uncontrolled indebtedness by state enterprises and decentralized entities, which, as previously mentioned, often seek short-term loans under conditions which weigh heavily on the nation's finances, frequently applying the proceeds to finance their ordinary operations. Legislation recently approved by the National Congress is aimed at converting short-term debt to long-term, which, in addition to reducing the service of the total debt, favors the national interest by increasing the maturity of the outstanding debt: average maturity would extend from slightly over two years at present, to a range of six

[3] William R. Cline recently finished an excellent and extensive study on Venezuela's foreign public debt. This work has not yet been published.

to eight years in the future.[4]

Another action planned particularly for 1982 to limit the growth of foreign public debt, consists of reducing the Venezuelan Investment Fund's foreign assets, which would then be used to finance part of the investment programs planned for this and the next few years. Thus, although in the future there may still be deficits in the public sector, these may not be disproportionately large, so that the need for new indebtedness would be lessened. According to certain estimates recently prepared by William Cline, if, in the next five years, said deficit is equal to 2 percent or 3 percent of the gross domestic product, and only 55 percent is financed with foreign debt, new loans of slightly over $6 billion would have to be obtained, which, by Cline's reckoning, does not constitute a substantial deterioration of the future debt-covering capacity.[5]

Unfavorable perspectives requiring the possible need for increasing indebtedness are seen in the potential deterioration of Venezuela's foreign sector. Weak international oil market conditions and the consequent reduction of oil prices, together with Venezuela's growing difficulty in placing its heavy crudes and residual products on the East coast of the United States, call for reflection regarding the future of Venezuela's foreign transactions. According to our recent estimates, even an average oil sales price increase of 10 percent in nominal terms as of 1983, could lead to a worrisome deterioration of the current account in the relatively near future, since following a surplus of over $4 billion in 1980 and $2.7 billion in 1981, a deficit of over $0.5 billion is foreseen for 1982, possibly increasing to over $4 billion by 1985.[6] If this tendency should continue during the second half of the 1980's, the current account deficit could obviously go even higher by the end of the decade. All of this implies that if Venezuela wishes to have relatively acceptable amounts of international assets, it must strive to counteract the adverse balance of payments situation, either through stimulation of non-traditional exports, restriction of less necessary imports, attraction of foreign capital, perhaps by offering more favorable conditions than the international financial market in general, or increasing foreign indebtedness to finance the mentioned deficits.

This problem has opened a debate on the advisability of devaluing the bolivar in order to stimulate non-traditional exports and discourage less necessary imports. We feel that in the short-term, a devaluation would not be advisable as a means of curbing the deterioration in the balance of payments, since it would not stimulate the vast majority of Venezuelan exports (oil, iron ore, and aluminum), whose prices are established in dollars on the international market. Only 2 percent of current exports would be stimulated by a devaluation. While it is true that non-traditional exports must be encouraged in every way possible, we believe that a devaluation per se would not immediately lead to their expansion, since Venezuela's productive infrastructure is not oriented toward the export of diversified products.

At the same time, Venezuela is highly dependent on foreign supplies, and a large part of its imports consist of mass consumer goods, intermediate goods,

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[4] Cline, W.R.: Venezuela's External Debt. December, 1981. Unpublished. p. 12-13.

[5] Ibid, p. 115.

[6] MetroEconomica. Proyecciones Revisadas de la Economia Venezolana para el Periodo 1981-1985. Caracas, Febrero 1982. Mimeograph.

raw materials for local industry, and machinery and equipment required by the public and private sectors. Such imports may be considered as highly price inelastic, and would not greatly reduce in volume should the currency be devalued. We thus feel that a devaluation would not necessarily reverse the deterioration in the balance of payments' current account, but would add fuel to internal inflationary pressures, widening the gap between local and foreign inflation, stimulating imports and aggravating the foreign imbalance even further.

In conclusion, we foresee that in future years Venezuela will continue seeking financing in the international financial market, no longer simply to finance its public sector deficit, as in the past, but rather to cover growing deficits in the current account. It is imperative that Venezuelan authorities exert every effort to optimize Venezuela's debt management, and to minimize or dampen the causes of this foreign indebtedness. Such an approach would require perhaps not a devaluation aimed at reducing the current account deficit, but rather the implementation of a series of measures other than exchange rate adjustments, designed to stimulate non-traditional exports and reduce luxury or less necessary imports.

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