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31 March 1975

MEMORANDUM FOR: Mr. William E. Knepper
Director, Office of Regional Economic Policy
Bureau of Inter-American Affairs
Department of State

SUBJECT : Venezuela's Current Account, 1974-80

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The attached report is in response to your request for information on the outlook for Venezuela's current account through 1980 for use by Assistant Secretary William D. Rogers. If we can be of further assistance, please contact [redacted]

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Office of Economic Research

Attachment:
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Venezuela's Current Account, 1974-80 1/

Summary

1. Venezuela is unlikely to have sufficient funds by the 1980s to support substantial foreign aid for any purpose, particularly the large amounts that would be required to create raw material stockpiles. Caracas probably will begin to eat into its foreign reserves as rapid import growth puts the current account in the red. Although petrochemical and metal exports will increase dramatically during the late 1970s, they will only be large enough to offset a probable drop in oil exports.

2. The service account will remain negative throughout the period. As foreign reserves fall, investment earnings will drop off. Other services, which probably will include large payments to oil companies for service contracts, will be in deficit.

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1. The assumptions in this paper are [redacted] Nominal oil prices in 1975 are those set on 1 January 1975. In 1976, oil prices are projected to increase 8% and in 1977, 5%. Import price increases are assumed to be 12% in 1975, 9% in 1976, and 6% in 1977. Constant export and import prices are assumed during 1978-80, however. Freight and insurance outlays are assumed to equal 12% of the f.o.b. value of imports. During 1975-80, Venezuela's acquisition of tankers and other ships is expected to have little impact on the freight account. Investment income receipts are assumed to equal 8% of the value of assets. The other services category includes payments on service contracts to foreign oil and iron companies, interest payments on foreign debt, and inflows and outflows of remittances.

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3. Capital inflows might ease the situation slightly, but large surpluses on capital account are unlikely. In recent years, diminished oil investments have caused the capital account to fluctuate between small deficits and small surpluses. Now, with Venezuela's membership in the Andean Pact and its strong support of the Pact's rules requiring majority domestic ownership in many areas and complete public ownership in oil and iron and steel, substantial new capital inflows may well be hindered despite the economy's probable increased attractiveness as a location for direct foreign investment.

4. Projections to 1980 are extremely tentative because of uncertainties in the world economic situation and thus in the range of opetions that might be open to Venezuela. Looking beyond the next few years multiplies the difficulties of forecasting -- particularly in the areas of world oil demand and supply, and of Venezuela's progress in developing exports of petrochemicals, steel, and aluminum.

<u>Exports</u>

5. Oil export earnings reached $10.3 billion in 1974 when production averaged nearly 3.0 million b/d (see Table 1). Earnings from oil are expected to drop gradually over the next few years because of the government's oil conservation policies. To conserve the country's declining oil reserves, Venezuelan

planners project that by 1980 production will be limited to about 2.0 million b/d, down from the 2.4 million b/d projected for 1975. Domestic oil consumption is now growing about 7% annually and is projected to rise to 10% after 1977, mainly because of expanding consumption by the petrochemical industry. By 1980, exports thus will slip to about 1.55 million b/d, contributing about $7.0 billion to export earnings.

6. The composition of oil exports is not expected to change substantially by 1980. About two-thirds of exports are now crude, while refined product exports consist mostly of residual fuel oil, priced below crude. The government is conducting extensive surveys to determine how to raise the value of oil exports. It has recently entered into an agreement with the Japanese to build a refinery designed to handle heavy crudes with high metal and sulphur content. Nevertheless, any significant shift in the composition of oil exports will not be felt until after 1980. The plants are expensive and time-consuming to build, and the shakedown period will be lengthy. Moreover, the resistance of traditional world marketing patterns will hamper Venezuela's attempt to export higher valued products.

7. We project non-oil exports to expand rapidly after 1977, reaching about $3.55 billion by 1980. Exports at

this level would nearly offset the drop in the value of oil exports -- just about restoring total earnings to the 1974 level. Major steel and aluminum projects are scheduled for completion in the late 1970s. Steel exports by then will more than offset the drop in the value of iron ore exports. The first phase of Venezuela's long-delayed petrochemical development also is expected to be fully operational by the late 1970s. At the same time, large fertilizer sales will also be adding to non-oil export earnings. Although the fertilizer plants are presently in operation, 1975 production is still far below capacity and is insufficient to meet domestic needs. Traditional exports such as coffee and cocoa are not likely to increase in volume during the period, however.

Imports

8. With the sudden sharp increase in foreign exchange availability in 1974, imports jumped about 65% -- approximately 25% in real terms -- to $4.6 billion. Trading partner data indicate that the major categories of goods generally increased proportionately. Thus, their shares of the total probably remain close to the recent levels; consumer goods, 20%; capital goods, 45%; and raw materials and intermediate products, 35%.

9. We project the volume of imports during 1975 to rise at about the 1974 rate. Assuming a 12% increase in prices, the value of imports thus will jump to $6.4 billion. Several factors are supporting the continued rapid growth of imports. Caracas' extensive development programs particularly in petrochemicals, steel, and aluminum, require large imports of capital goods. Many of these projects will just be getting underway this year. At the same time, rising consumer incomes will require increased imports of finished consumer goods and raw materials and intermediate products for import substitution industries to restrain inflationary pressures. Preliminary reports on tonnages moving through Venezuelan ports in the first two months of 1975 indicate that import volume is running ahead of last year.

10. Our projections assume, however, that real import growth will drop to 15% in 1976 and to 10% in each of the following years. To limit the growth of imports to these rates will require tightened import restrictions. It is assumed that the government will take such measures to postpone large trade deficits, thus stretching out the life of the foreign reserves. A 10% annual increase in the volume of imports probably is the bare minimum needed to support

real economic growth rates of 7%-8%. With the volume of imports growing only 10% annually during 1977-80, present government plans for industrial development probably will have to be trimmed.

Services

11. The services account probably will remain in deficit throughout the period. Inflows of investment income are expected to rise through 1977 but will decline as foreign reserves fall in subsequent years. It is assumed that the services account will be further dampened by large payments under contracts with foreign oil companies to maintain certain management and exploration operations in Venezuela. As trade deficits are incurred after 1977, it is further assumed that grant-type assistance will be terminated to ease strains on the current account.

Current Account Balance

12. Under our foregoing assumptions, the current account will be in surplus only through 1976. Considering only the current account, foreign reserves will reach a peak of $9.0 billion in that year. With growing trade deficits in subsequent years, the current account deficit will also rise, eating into foreign reserves. By 1980, foreign reserves would be depleted. If the rise in import prices after 1977 were to substantially exceed that of oil prices,

foreign reserves could be depleted even earlier.

Implications for Foreign Aid

13. Thus far, Caracas has made only a few, mostly small commitments to provide foreign aid for any purpose and has generally insisted on strictly commercial terms. As its balance-of-payments surpluses decline over the next few years, we expect Venezuela to be even less willing to undertake foreign aid commitments. This will be particularly true for schemes to finance commodity stockpiles and other measures to boost world raw material prices. To be effective, such schemes require large initial outlays and, because of the generally weak financial positions of the beneficiaries, concessional financing. Even in its present affluent situation, Caracas offered only short-term loans totaling $40-$80 million to finance a Central American coffee stockpile with repayment on commercial terms.

Alternative Projections

14. The foregoing analysis has assumed that Caracas will move to slow import growth after 1975 to conserve foreign reserves. An alternative assumption would be that the government would adopt a policy of allowing the volume of imports to grow at 20% annually while pushing development projects ahead as rapidly as possible in the hope that in the 1980s, exports -- particularly of petrochemicals -- would

be great enough to reverse the rise in the trade deficit. As is shown in Table 2, under such a policy a large trade deficit would develop by 1977 and foreign reserves would be depleted by mid-1979.

15. Another possible assumption would be that the government would adopt a policy of maintaining oil production through 1980 at an average rate of about 2.4 million b/d, the expected 1975 output level. Venezuela probably has the capacity to sustain production at this level. But, toward the end of the decade with large new non-OPEC supplies entering the world market, Venezuela's sustaining oil production at 2.4 million b/d would require further production cutbacks by other OPEC members. This in turn would further increase the stress on the cartel in coping with the problem of prorationing oil production. In this case, if imports were restricted after 1975 to the levels previously assumed, a trade deficit would be postponed until 1980 (see Table 3). Under these circumstances, however, Caracas probably would allow imports to grow at a much higher rate. If they continue to grow at 20% annually, a trade deficit would develop by 1977, and foreign reserves would be depleted by 1979. Either way, Venezuela's capability to provide foreign aid in the 1980s would be negligible.

Table 1

Venezuela: Projected Current Account Balance

Million US $

	1974	1975	1976	1977	1978	1979	1980
Exports f.o.b.	10.7	8.9	9.5	9.3	9.9	10.1	10.5
Oil	10.3	8.4	9.0	8.8	8.1	7.5	7.0
Non-oil	0.4	0.5	0.5	0.5	1.8	2.6	3.5
Imports f.o.b.	-4.6	-6.4	-8.0	-9.4	-10.3	-11.4	-12.5
Trade balance	6.1	2.5	1.4	0.0	- 0.4	- 1.3	- 2.0
Net services	-1.0	-0.9	-1.1	-1.4	- 1.6	- 2.0	- 2.3
Freight & insurance	-0.6	-0.8	-1.0	-1.1	- 1.2	- 1.4	- 1.5
Investment income receipts	0.3	0.6	0.7	0.6	0.6	0.4	0.2
Other	-0.8	-0.8	-0.8	-0.9	- 1.0	- 1.0	- 1.0
Grant-type assistance	-0.1	-0.2	-0.2	-0.2	....	....	....
Current account balance	5.0	1.4	0.2	-1.6	- 2.0	- 3.3	- 4.3

Table 2

Venezuela: Alternative Projection of Current Account Balance 1/

Million US $

	1974	1975	1976	1977	1978	1979	1980
Exports f.o.b.	10.7	8.9	9.5	9.3	9.9	10.1	10.5
Oil	10.3	8.4	9.0	8.8	8.1	7.5	7.0
Non-oil	0.4	0.5	0.5	0.5	1.8	2.6	3.5
Imports f.o.b.	-4.6	-6.4	-8.4	-10.6	-12.8	-15.3	-18.4
Trade balance	6.1	2.5	1.1	- 1.3	- 2.9	- 5.2	- 7.9
Net services	-1.0	-0.9	-1.1	- 1.5	- 2.1	- 2.7	- 3.2
Freight & insurance	-0.6	-0.8	-1.0	- 1.3	- 1.5	- 1.8	- 2.2
Investment income receipts	0.3	0.6	0.7	0.7	- 0.4	- 0.1	....
Other	-0.8	-0.8	-0.8	- 0.9	- 1.0	- 1.0	- 1.0
Grant-type assistance	-0.1	-0.2	-0.2	- 0.2	....	....	....
Current account balance	5.0	1.4	-0.2	- 3.0	- 5.0	- 7.9	-11.1

1. Assuming real import growth of 20% annually in 1976-80.

Table 3

Venezuela: Alternative Projection of Export Earnings 1/

Million US $

	1974	1975	1976	1977	1978	1979	1980
Exports f.o.b.	10.7	8.9	9.5	9.8	10.8	11.5	12.4
Oil	10.3	8.4	9.0	9.3	9.0	8.9	8.9
Non-oil	0.4	0.5	0.5	0.5	1.8	2.6	3.5

1. Export earnings if crude output is maintained at 2.4 million b/d through 1980.