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“VENEZUELA: CAN PRESIDENT CHÁVEZ AND THE OPPOSITION REACH AN AGREEMENT THAT PRESERVES DEMOCRACY?”

“How the current situation is affecting the business climate, the economy, and investment”

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INTRODUCTION

- ✓ **VenAmCham, the Venezuelan American Chamber of Commerce and Industry, is a bi-national institution founded 53 years ago. It includes around 1250 corporate and 7000 individual members, and operates out of 4 cities in Venezuela. It is closely associated with the US Chamber of Commerce in Washington, the Council of The Americas in New York City, and other bi-national institutions around the United States. It is one of the largest overseas American Chambers in the world.**
- ✓ **VenAmCham's mission is to promote trade and investment between the United States and Venezuela. It defends and promotes free enterprise, free trade and free markets, in which member companies can prosper, generate employment and create economic growth in Venezuela.**



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INTRODUCTION

- ✓ **VenAmCham represents around 98% of US investment in Venezuela, and around 80% of total direct foreign direct investment in the country. The Chamber is non partisan, does not receive funding from either government, and values its credibility as an objective observer of national events. It represents the business views of Venezuela's principal private, national and international investors, trading partners and creditors.**
- ✓ **According to our members, here's how the current situation is affecting the business climate, the economy, and investment:**



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LEGAL CONDITIONS

- ✓ **The 1999 Venezuelan Constitution created numerous ambiguities that bear upon the activities of companies operating in and with Venezuela, particularly in matters concerning private property, the limits of government intervention into economic affairs, and discretionary powers granted to the Government.**
- ✓ **The Venezuelan National Assembly has failed to comply with explicit Constitutional mandates to enact important economic legislation vital to private sector planning and operations, to clarify existing ambiguities and limit discretionary powers.**
- ✓ **In late 2001, forty nine laws were dictated by President Chavez based on Enabling powers granted to him by the National Assembly, which compromise property rights in different areas. In signing these laws, the President did not comply with a constitutional obligation to consult with civil society and the National Assembly when enacting laws adopted under an enabling act.**



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LEGAL CONDITIONS

- ✓ **Enactment of these laws led to intensified political conflict in Venezuela, and the first strike called by national business organizations. Despite Presidential assurances after the events of April 2002, these laws have not been modified to eliminate features that inhibit doing business in Venezuela.**
- ✓ **The Venezuelan Supreme Court has recently established precedent reserving itself the right to review any legislation, even retroactively, it deems it to be of “social interest”. This practice generates increased uncertainty for companies working in and with Venezuela.**
- ✓ **Persons and companies doing business in Venezuela have little recourse to effective judicial redress since the court system, as well as the offices of the attorney general and public defender (established as separate powers of the State in the 1999 constitution) do not operate on a timely and transparent basis.**



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LEGAL CONDITIONS

- ✓ **Over 85 % of Venezuelan all judges have now been appointed on a temporary basis since 1999, many lacking proper credentials and with criminal records including homicide, and World Bank loans to promote judicial reform have not been adequately executed.**
- ✓ **In defiance of current legislation and an explicit ruling by the Supreme Court, the National Land Institute currently issues so-called “Agrarian letters” authorizing alleged farmers to take over the property of third parties. There is no due process, and Venezuela’s Armed Forces are often used to impose decisions.**
- ✓ **The Government has enacted a Security Zones decree covering large city areas, within which foreigners must apply for the right to enjoy their property (which may be denied) and their right to by real property is subject to restrictions, in violation of Venezuelan law and international conventions.**



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LEGAL CONDITIONS

- ✓ **Corporate installations have been raided by the Venezuelan military with no due process. Personnel was manhandled and merchandise taken and sold with no compensation. Key perpetrators were subsequently praised and decorated by the President.**
- ✓ **Legislation is currently being promoted by the official majority in the Assembly would subject broadcast companies to arbitrary decisions, and confiscatory penalties. The Constitution requires a two thirds vote by the Assembly in all matters concerning human rights.**



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OPERATING CONDITIONS

- ✓ For the past 140 days Venezuela has been operating under a foreign exchange freeze on the part of the Executive, which has effectively paralyzed almost all operations, Unlike previous exchange control regimes, this one has been almost completely inoperative to date.
- ✓ In essence, no company has been able to secure FX to import either finished products, or raw/packing materials for the past 140 days. This has already led several smaller companies to curtail operations. Larger, well-established multinational companies have maintained their operations by accruing major debts with their parent company or foreign suppliers.
- ✓ However this situation cannot continue indefinitely. Third party suppliers are starting to curtail shipments due to lack of payment, and the patience of Corporate Treasury Officers is wearing thin: indeed the accrued liabilities are creating a governance issue given the 50% spread between the official rate of Bs. 1600/dollar and the "parallel" rate of about Bs. 2400/dollar.



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OPERATING CONDITIONS

- ✓ **Although there has been some relaxation of price controls in the past few days, such controls render it impossible for companies operating in consumer areas to transfer exchange costs to consumers, in an already contracted internal market.**
- ✓ **No effective exchange provision has been implemented for companies attempting to conduct export operations from Venezuela. Debt repayment, royalties, licenses and other payments of a similar nature have not been covered. Venezuela is already in default internationally with the private sector.**
- ✓ **There is increasing evidence of discriminatory allocation of foreign exchange, as well as other government related operations. Companies dealing with officials in search of Government permits are often arbitrarily accused of presumed sympathy for “coups”, with no legal or judicial process sentencing them as such.**



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OPERATING CONDITIONS

- ✓ **Several companies have reported that once their initial registration with the FX Administration Board - CADIVI - as an importer was concluded, they began receiving calls from several different sources with offers to "expedite" the operations. Net, it appears that similar to past experiences this Exchange Control Regime is already starting to foster corruption.**
- ✓ **Authorities are only occasionally accessible to affiliates and business institutions, and in general such encounters generate little effective response to problems presented, with virtually no actual follow up on actions promised.**



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OPERATING CONDITIONS

- ✓ **Transparency in the allocation of contracts and resources has been called into question in several instances, with preferential conditions clearly involving Cuban, Chinese, Brazilian and French companies.**
- ✓ **Companies operating in Venezuela, including multinational concerns, are constantly subject to altered working conditions due to political conflict, and to operating decisions that could eventually involve issues of legality, transparency and human rights. This adds to uncertainty on all sides.**



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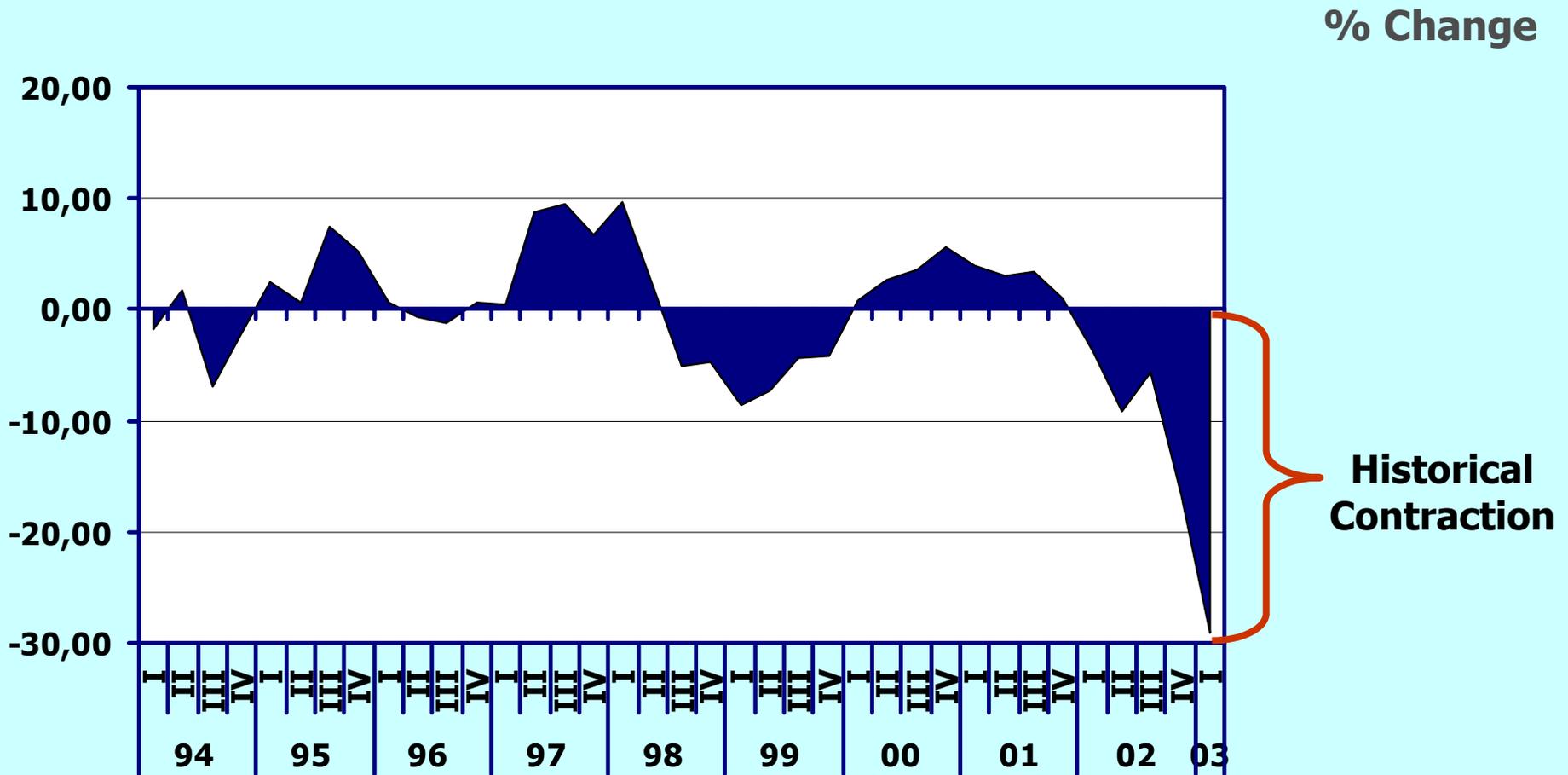
ECONOMIC CONDITIONS

- ✓ **According to the Central Bank, Venezuela's economy shrank by close to 30% during the first quarter of 2003. Projections now range between 15-20% for the whole year.**
- ✓ **Contraction during 2002 was over 9% (our previous historically worst economic contraction).**
- ✓ **Projections now range between 15-20% for the whole year.**
- ✓ **These contractions are dramatic, historically unprecedented in the Hemisphere except for Cuba and Haiti.**



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REAL TOTAL GROSS DOMESTIC PRODUCT



Source: Central Bank
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ECONOMIC CONDITIONS

- ✓ **Real GDP per capita grew 7,7% between 1990 and 1997.**
- ✓ **Real GDP per capita dropped 15,9% between 1998 and 2002.**
- ✓ **Real GDP per capita dropped 10,6% in 2002. Worst historical economic contraction**

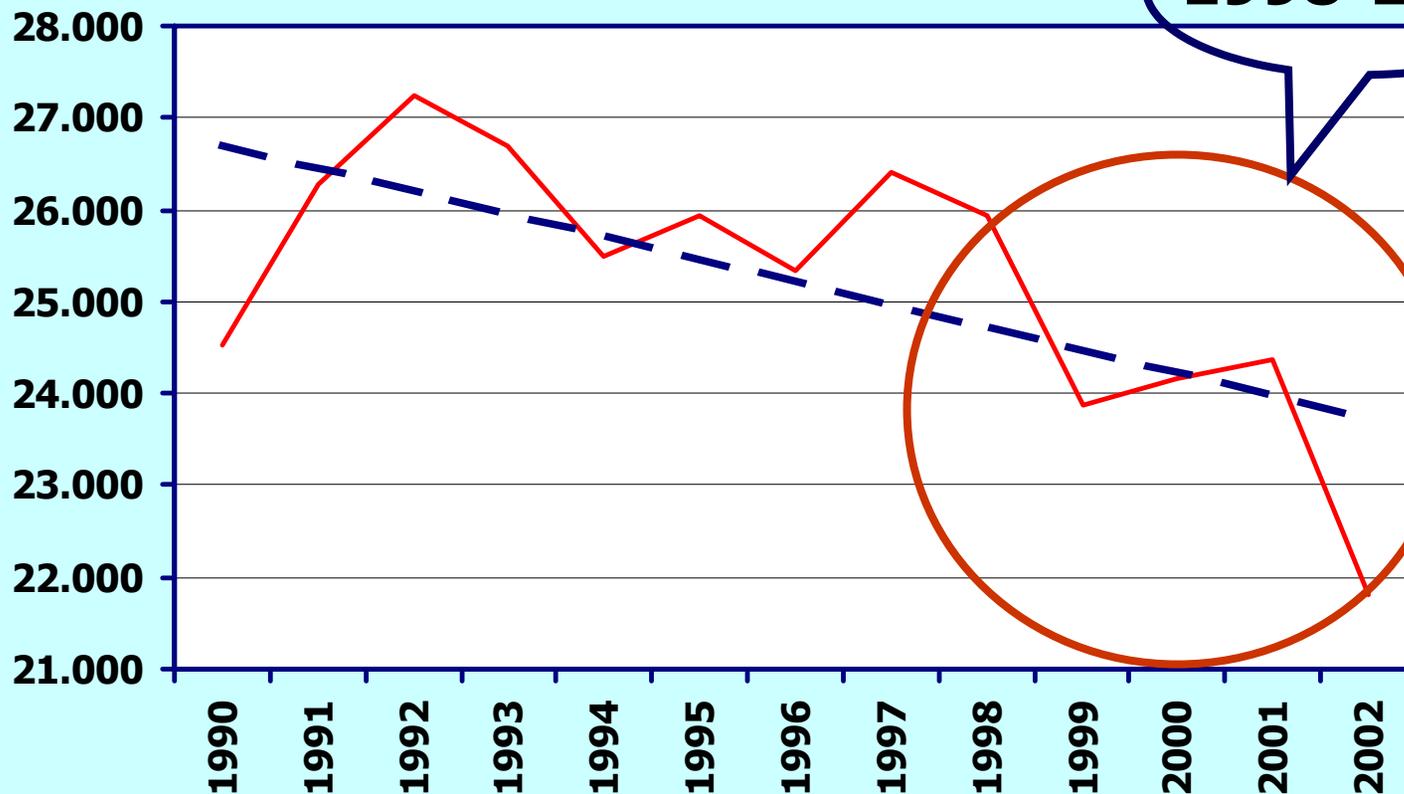


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REAL PER CÁPITA GROSS DOMESTIC PRODUCT

In 1984 VEB



1998-2002

Source: Central Bank, National Institute of Statics and Own Calculation

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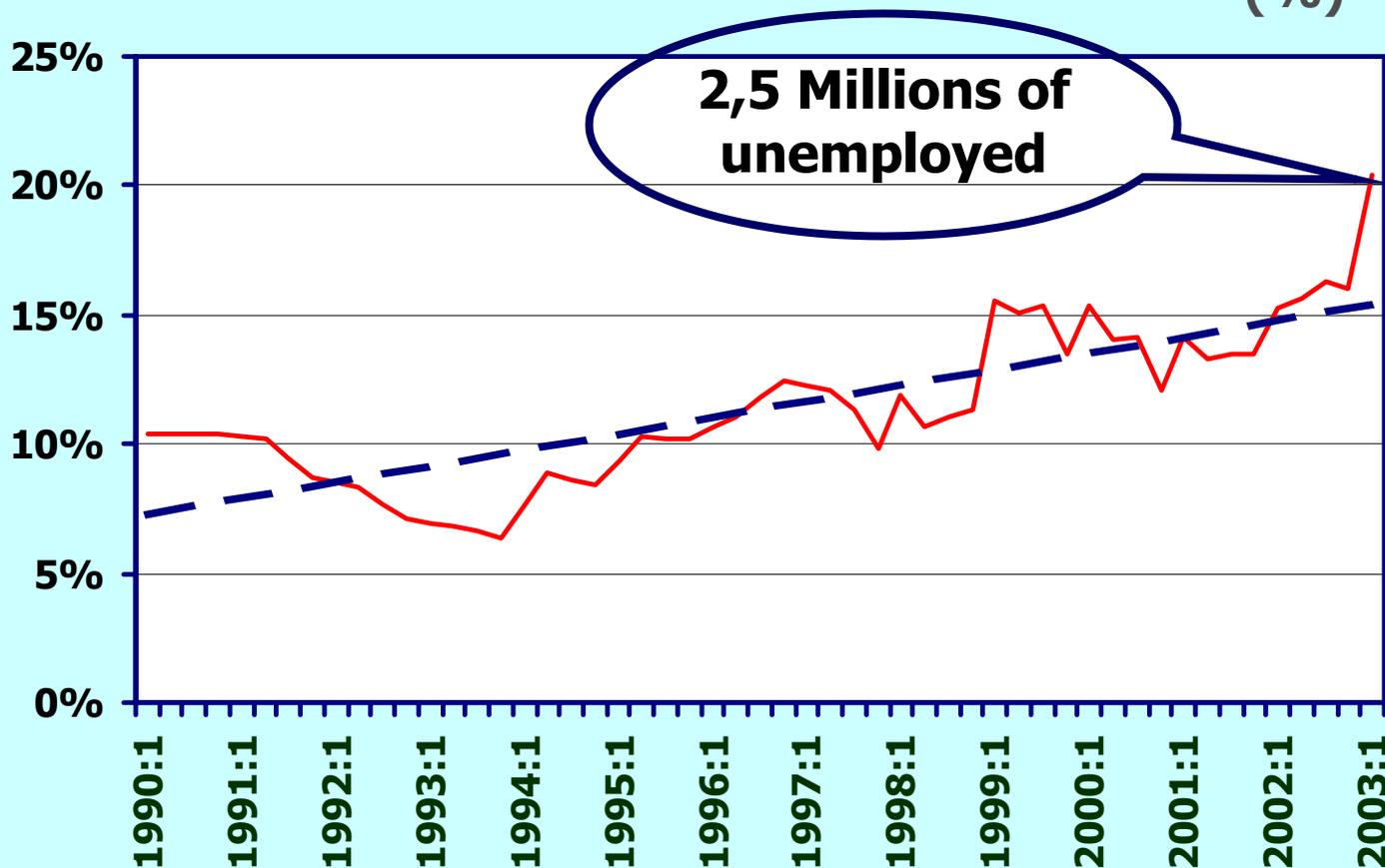
ECONOMIC CONDITIONS

- ✓ **Unemployment has risen from 11% in 1998 to 20% in the first quarter of 2003.**
- ✓ **Currently unemployment is around 22-24%, representing more than 2.5 million people.**
- ✓ **Unemployment projections range as high as 27-30% by the end of the year.**
- ✓ **Informal and part-time employment are now calculated around 55% of the entire labor force, which indicate that around 80% of the total labor force is currently unemployed or within the informal economy.**



UNEMPLOYMENT RATE

(%) - Quarterly



Source: Central Bank and National Institute of Statics



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ECONOMIC CONDITIONS

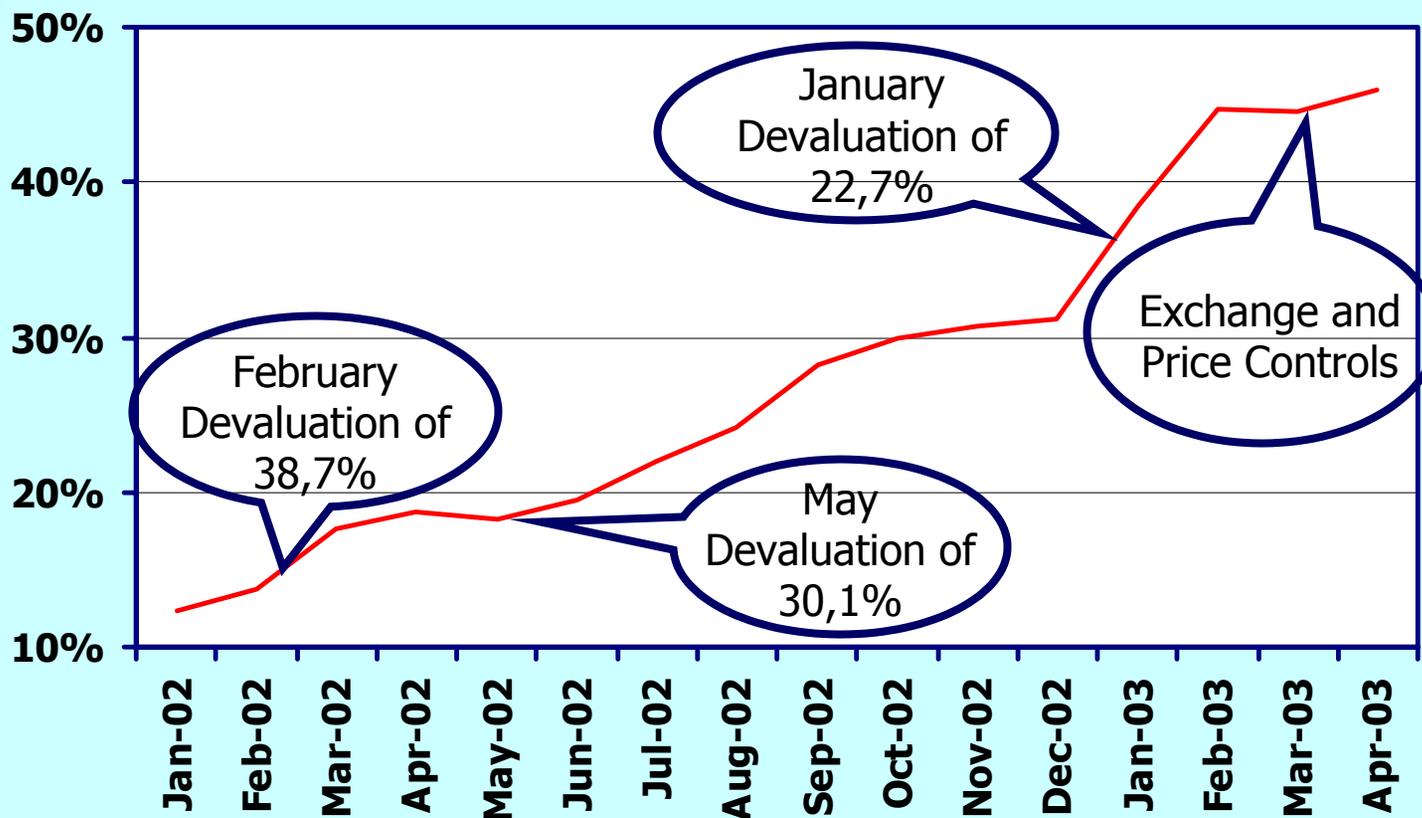
- ✓ **Central Bank's statistics show an accumulated inflation until April of 11,05%, and an annualized inflation of more than 45%**
- ✓ **Inflationary pressures from fiscal imbalances and currency devaluation (by excessively expanding liquidity on the economy in order to increase internal debt).**
- ✓ **Distortions created by exchange and price controls on the economy.**



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INFLATION RATE – CPI VARIATION

(%) - Annualized



Source: Central Bank

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ECONOMIC CONDITIONS

- ✓ After more than four months of "foreign exchange restriction", the Foreign Exchange Administration Commission (CADIVI) has allocated less than 0.4% of the country's imports need, even though international reserves are more than 16 billion dollars (more than a year of imports) and that the Central Bank has set aside 1.2 billion dollars a month to meet import demands.
- ✓ Current projections indicate economic conditions will deteriorate with even further severity between August and December 2003, where the effects of the exchange and price controls will have their greatest impact. The unemployed population is expected to be more than 3 million people and inflation is expected to be higher than 50%.



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ECONOMIC CONDITIONS

- ✓ **Ministry of Finance results for the central government's fiscal situation show an increase of primary deficit of 280% for the first to month of the year compared to the same period last year. This is due to an increase in nominal terms of government's current spending on goods and services of 64,49% and interest payments of 60,86%, and a contraction of fiscal revenues of 13,60% in the same period.**
- ✓ **Estimates indicate that for each percentage point that non-oil GDP drops non-oil fiscal revenues drop by 0.33%. Given the economic forecast for 2003, fiscal revenues are expected to drop in more than 6% in nominal terms and more than 40% in real terms.**



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ECONOMIC CONDITIONS

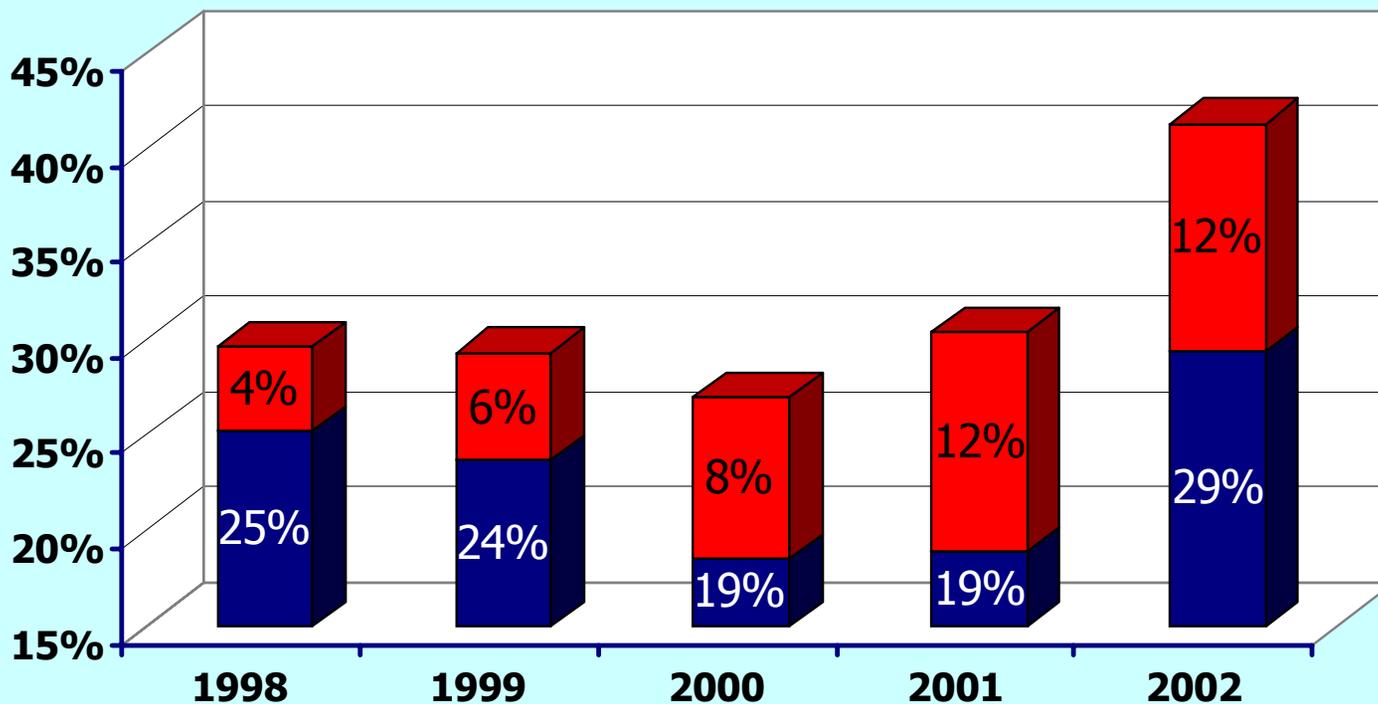
- ✓ **The complicated budgetary situation implies a tight restriction of government spending and the allocation of its limited resources among its debt payment, public imports and any other social and political expenditures.**
- ✓ **According to the Minister of Finance the external debt to GNP ratio has grown from 30% in 2001 to 41% in 2002, mainly due to the increase of the external debt share.**
- ✓ **In March, Standard & Poor's downgraded its long-term foreign currency sovereign credit rating on Venezuela to 'CCC+' (extremely speculative).**



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NATIONAL PUBLIC DEBT

- Total Gross Domestic Public Debt/GNP
- Total Gross External Public Debt/GNP



Source: Minister of Finance
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ECONOMIC CONDITIONS

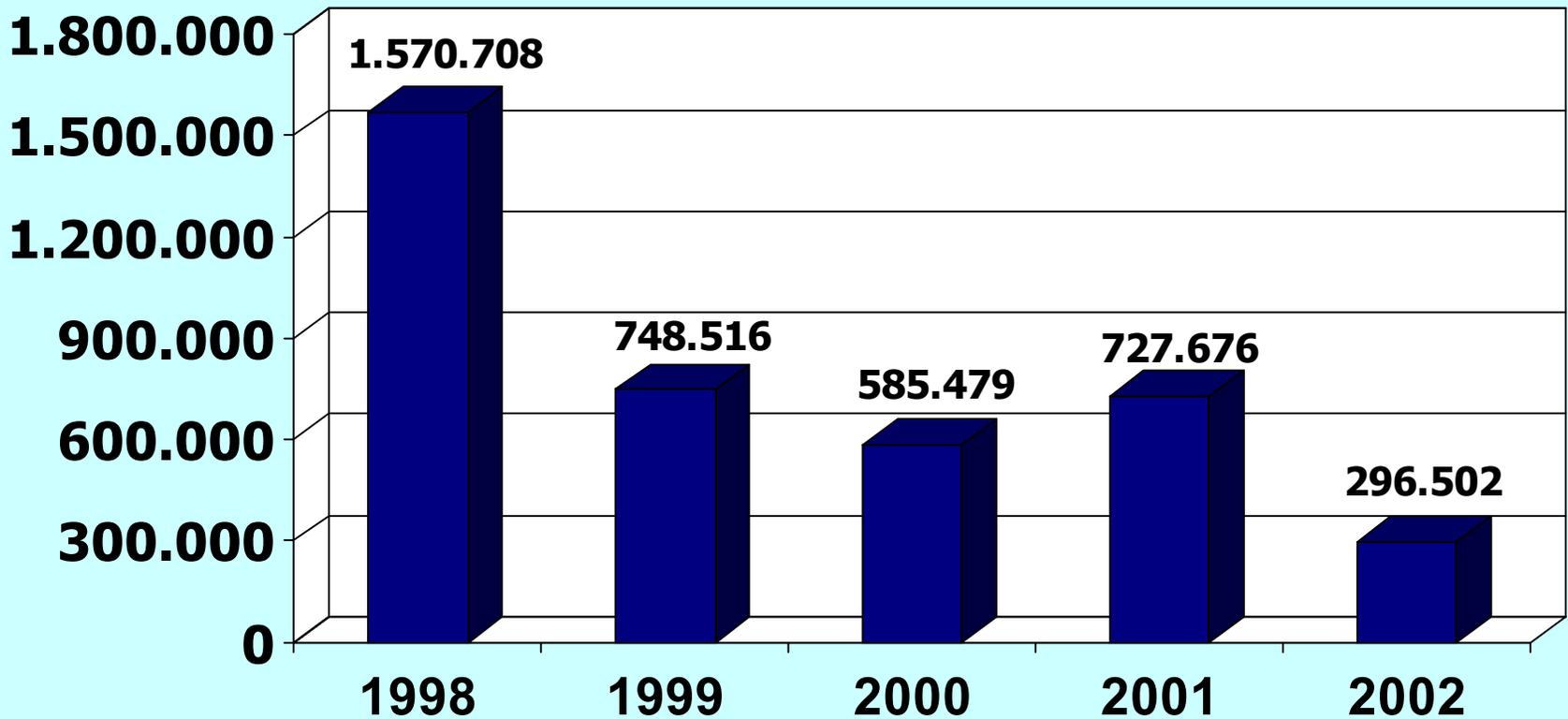
- ✓ **Foreign Direct Investment declined by 81,12% between 1998 and 2002.**
- ✓ **Foreign Direct Investment declined by 59,25% in 2002.**
- ✓ **US Foreign Direct Investment declined by 55,55% between 1998 and 2002.**
- ✓ **US Foreign Direct Investment declined by 42% in 2002.**



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TOTAL FOREIGN DIRECT INVESTMENT

Thousands of USD



Source: SIEX

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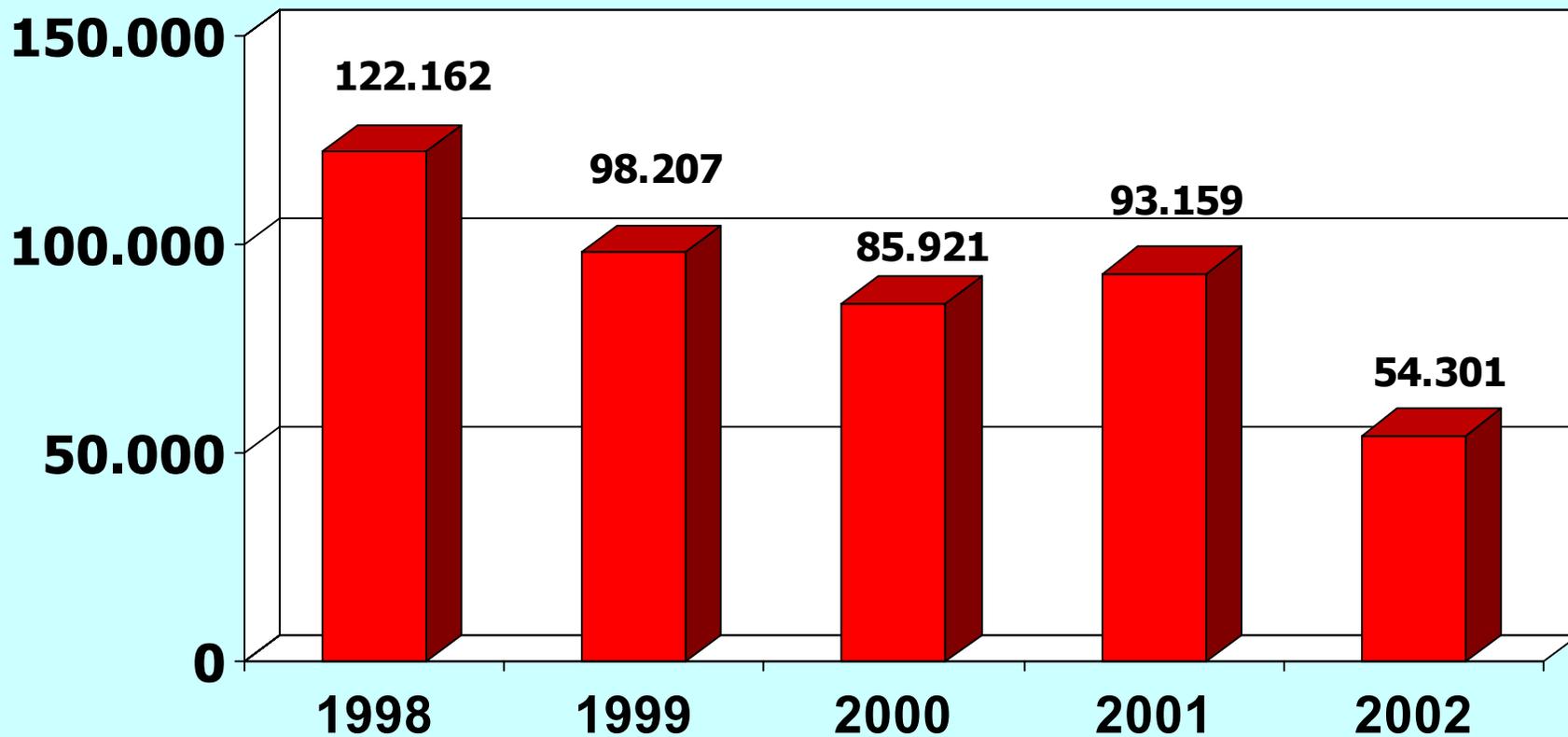


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US FOREIGN DIRECT INVESTMENT

Thousands of USD



Source: SIEX

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ENERGY CONDITIONS

- ✓ **Human rights are now a primary concern to companies operating in Venezuela's petroleum sector. Serious labor issues can arise from the massive firings at PDVSA, and there are potentially important human rights cases that could emerge internationally from letters allegedly sent by PDVSA authorities enjoining operating companies to discriminate against employees fired by PDVSA for protesting during December 2002 and subsequent events.**
- ✓ **Environmental responsibilities are another area of concern to companies in the energy sector, as reports emerge of serious ecological damage to Venezuela in sensitive areas. There are highly credible reports of billions of barrels of oil reserves condemned as a result of indiscriminate extraction in the Maracaibo region.**



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ENERGY CONDITIONS

- ✓ Sustained production capability is also questioned by qualified experts, on the basis of internal personnel problems within PDVSA, as well as severely reduced investment possibilities. It has been estimated that at least \$ 2-3 billion investments will be needed to restore and maintain PDVSA's pre strike production levels.
- ✓ The 2001 Hydrocarbons Law, which established over 51% government ownership in the main petroleum operations, places most project financing toward Venezuela in the category of "sovereign risk", considerably higher than generally deteriorated risk ratings for this country.



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ENERGY CONDITIONS

- ✓ **Respect for sanctity of contract is in question between the Government of Venezuela and at least two US companies, SAIC (INTESA) and the Enbridge Williams Company, with possible consequences into future EXIMBANK and OPIC operations.**
- ✓ **Experts are forecasting a severe electric energy crisis in Venezuela in the coming months, for lack of maintenance and investment in the sector. An energy crisis would also hamper petroleum production operations.**



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INTERNATIONAL ECONOMIC CONDITIONS

- ✓ **The Venezuelan Government has become the most active adversary of the Free Trade Area of the Americas within the group of nations that signed the Quebec Agreement in 2000. It does not, as Brazil, pose negotiating points: It opposes the concept in and of itself.**
- ✓ **Negotiations for a Treaty for the Reciprocal Protection of Investments with the United States have been abandoned since 1998, while initiatives toward other nations, notably Cuba, China and Brazil, have been promoted.**
- ✓ **International credit rating agencies increasingly downgraded Venezuela's official and PDVSA ratings. EXIMBANK and other credit agencies have suspended operations with Venezuela.**



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INTERNATIONAL ECONOMIC CONDITIONS

- ✓ **During the first quarter of 2003, due to the impact of the exchange control and the economic contraction international trade has contracted by 38%, with a contraction of 17% on exports and a 59% of contraction on imports (and a contraction of more than 73% for non-oil imports). Also trade volumes with the US has contracted by 21%, due to a contraction of 6% on exports and a 56% of contraction on imports.**
- ✓ **Corporate headquarters are generally reviewing and limiting credit extended to their Venezuelan operations, scaling down and transferring operations, and delaying new projects wherever possible.**



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SECURITY CONDITIONS

- ✓ **Crime skyrocketed by 77% between 1999 and 2002 in Venezuela. It continues to rise.**
- ✓ **Violence in crimes has multiplied dramatically, to the point where robbery and theft are almost equal in statistics.**
- ✓ **There were 193 reported kidnappings during 2002, up from 44 in 1999. The trend continues to increase.**



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SECURITY CONDITIONS

- ✓ **There were 9620 murders during 2002, as opposed to 4225 during 1999. Venezuela is now second only to Colombia in per capita homicides within Latin America.**
- ✓ **Lack of Government restraint over heavily armed “spontaneous popular groups” that violently attack opponents. They are a real cause for concern within a context of increasing violence and impunity.**
- ✓ **Lack of restraining action on the part of authorities, and unreported crime are the standard in Venezuela today, more than ever before in history.**



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SOCIAL CONDITIONS

- ✓ **The social situation continues to deteriorate, existing deficiencies have increased, the network of public social services and the NGO systems have been weakened, and newly impoverished segments are appearing.**
- ✓ **Today 7 out of 10 Venezuelans live below the poverty level, and 4 out of 10 cannot meet their needs for food. Around 880,000 families live in extreme poverty. The nation's standards are deteriorating even with regard to the rest of Latin America.**
- ✓ **Housing deficiencies, health conditions and malnourishment have all been significantly aggravated over the past four years.**



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WHAT IS BUSINESS DOING?

- ✓ Closing operations, selling out
- ✓ Curtailing activity in a wait and see pattern.
- ✓ Operating at a loss and meeting reduced payrolls with imported foreign exchange, as long as possible.
- ✓ Importing materials and finished good on local account.
- ✓ Importing needs and paying with free market exchange, as long as possible.
- ✓ Most home office credit to local subsidiaries has now been curtailed.
- ✓ The business community in Venezuela currently lacks adequate guarantees of safety, legal protection, economic stability, or working conditions for investing and operating in Venezuela. The situation will most likely persist until a political solution is reached.



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WHAT IS THE OUTLOOK?

- ✓ Resources from oil revenues seem to be applied to building an internal power based on patronage and welfare, in order to bolster short term political goals. Rapidly deteriorating economic conditions, and multiplied needs, will tend to render these practices unsustainable. Corruption and incompetence continue to flourish at all administrative levels.
- ✓ The real international danger posed by deteriorating economic and political conditions in Venezuela is that it can rapidly become a failed state and generate situations of near anarchy, with scarce control over extensive and fuzzy borders, as well as over large rural and urban areas. All of this can lead to an area of ample opportunity for terrorist activities, drug trafficking and money laundering, with increased support from paramilitary forces and rogue military elements.



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WHAT IS THE OUTLOOK?

- ✓ **Currently the Legislature is debating three key issues: naming an Electoral Council, the Media Law and Supreme Court reform. In each of these cases a two thirds majority is explicitly required by the 1999 Constitution. Any attempt to impose any of these issues by a simple majority within the Assembly will probably lead to increased political conflict.**
- ✓ **Despite the aspirations of some officials, it is impossible to separate economic issues from political conditions. A key Central Bank Director, economist Domingo Maza, has said that a prerequisite to economic recovery is "an improved political and social climate, a national agreement to solve problems and open roads toward economic reactivation."**



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WHAT IS THE OUTLOOK?

- ✓ **As the economic and political crises mount, all public instances that depend on central government transfers will deteriorate severely, particularly in the local governments, provinces and universities. Internal pressure for a political solution will mount.**
- ✓ **On the positive side, Venezuela has had 45 years of uninterrupted democratic rule, a record shared by few countries in the region. Venezuelans accepted the 1998 election results and supported the new government in its first stages. An overwhelming majority of Venezuelans firmly adhere to democratic principles and practices, and reject alternate means for conflict resolution.**
- ✓ **Despite rancor within the political discourse, actual violence has been held to a minimum within the context of Latin American and global politics, thus reflecting Venezuelan adherence to peaceful and negotiated solutions.**



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WHAT IS THE OUTLOOK?

- ✓ In the end, internal and external conditions will probably come together with the same forces that helped restore Mr. Chávez to power in April 2003, to ensure an electoral and constitution solution that will ultimately preserve Venezuelan democracy. Those conditions will be shaped by the same community that Mr. Chávez credited for his return to office when he was reinstated in April last year:
- ✓ The Inter American Democratic Charter
- ✓ Independent national and international media
- ✓ Venezuela's institutional Armed Forces



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WHAT IS THE OUTLOOK?

- ✓ **If current confrontation can be channeled into normal political controversy, within peaceful and electoral activities, as called for in the symbolic agreement reached yesterday between the government and most of the opposition under the auspices of the OAS, the Carter Center and UNDP.**
- ✓ **If the spirit, not only the words, of yesterday's agreement is respected, then there is hope. As in any nation on earth, the chief responsibility for peace, governance and well being lies with the Government.**