VENEZUELA

The following is a summary of recent legal and economic developments in Venezuela, dealing with foreign exchange, exports, imports and other areas.

I. PUBLIC SECTOR DEBT REFINANCING AGREEMENTS

The public sector debt refinancing agreements were signed on February 26, 1986. However, they did not immediately become effective, as they were pending ratification by the required number of creditors. Sufficient creditors have ratified agreements, except those relating to the Banco Industrial de Venezuela and CANTV and, therefore, the agreements should soon go into effect.

The refinancing agreements provide for payment over a twelve and one-half year period, with interest at one and one-eighth over LIBOR. An initial quota of 750 million dollars is to be repaid during 1986. However, principal payments originally due in 1985 (202 million dollars) and 1986 (721 million dollars) will be deferred and spread out over 1988-1997. On April 23, President Lusinchi announced that, in view of the country's difficult economic situation, and particularly, the prolonged weakening of oil prices, Venezuela would invoke the so-called "contingency clause" in the public sector restructuring agreement. The next day, a telex was sent to the coordinating creditor bank Chase Manhattan formally invoking the "contingency clause."

Venezuela seems to be seeking, not only a further extension of the present twelve and one-half year payment period and a reduction in the interest rate, but also a postponement of the 750 million dollar down payment that was to have been made in 1986. This possibility has angered some creditor banks, who regarded the down payment as a sign of good faith by the Venezuelan government, and who might not have signed the restructuring agreement without it. Refusal to make the down payment may be considered a breach of contract, such that a dissident creditor would have grounds for withdrawing from the agreement and suing Venezuela independently.

The President's action in invoking the contingency clause appears to have been in response to political pressures from the prin-
principal opposition party (COPEI), which has denounced the public sector restructuring agreements as validating allegedly illegal debts contracted for by various state entities and as violating article 127 of the Venezuelan Constitution. That article requires that in “contracts of public interest,” the parties must submit themselves to the jurisdiction of the Venezuelan courts, to the exclusion of foreign jurisdictions.

Some of the state-entity debt assumed by the Republic may have technically been illegal in the sense that it may have been incurred without the proper documentation and in violation of the Public Credit Law provision that certain short-term debt cannot be “rolled-over” without prior congressional approval, even though the original debt may have been valid.

II. SUBMISSION TO JURISDICTION IN FOREIGN COURTS

The Venezuelan Government’s agreement to allow Venezuela to be subjected to suit in foreign jurisdictions has evoked considerable criticism among opposing political parties, who claim that such an agreement is in violation of the Venezuelan Constitution.

The question of submission to the jurisdiction of foreign courts is an old and sensitive one in Venezuelan history, going back to the turn of the century when various European powers attempted debt enforcement by blockading Venezuelan ports. The charges of illegality and unconstitutionality seem to be primarily of a political nature, although obviously worrisome to foreign bankers, who fear a change in the rules of the game and disregard of the sanctity of contract if the opposition party’s views should prevail.

III. DECLINE IN PETROLEUM EXPORTS

Venezuelan petroleum exports have suffered with the decline in world oil prices. Although official figures are not available, it is estimated that crude and products exports fell well below one million barrels per day in late January and early February—far short of the stated export goal of 1.4 million barrels per day for the first quarter of 1986. In order to give Petróleos de Venezuela greater flexibility in reacting to worldwide price changes, President Lusinchi authorized the state oil company to abandon official price lists and to lower prices to competitive levels. Estimates indicate that if oil prices remain at current levels, oil export revenues will
Venezuela's crude production for 1985 was approximately 1,564,000 barrels per day, with condensates and LPG production at an additional 117,000 and 58,000 barrels per day, at an average price of $25.88 per barrel. Total foreign exchange earned by oil exports was $13.1 billion. PDVSA's liquid reserves at the end of 1985 were estimated to be Bs.19.8 billion.

Venezuela's concern over decreasing oil revenues has been exacerbated by proposed legislation introduced in the U.S. Congress which would impose a five to ten dollar-per-barrel surcharge on imports. Over forty percent of Venezuela's crude and petroleum products are presently exported to the United States; approximately ninety percent of the country's foreign exchange revenues come from petroleum. As a "one-crop economy" country, the consequences of the imposition of oil import fees or an oil import quota would create major problems for the Venezuelan economy, despite the government's recent adoption of measures designed to reduce public payrolls and reduce public sector's participation in the economy.

IV. Imports

In view of Venezuela's declining dollar export revenues, the governmental agency RECADI is delaying the processing of all applications for import permits at the preferential Bs.7.5:$1 rate. Depending upon the RECADI-perceived national priority granted imports of raw materials of finished goods, local manufacturers calculate a lead-time of up to six months in applying for preferential dollars for imports.

The Venezuelan Government has announced that it will reduce its planned expenditures of foreign exchange for 1986 by almost fifty percent—from $1.2 billion to $670 million—and will give priority to expenditures which permit savings in foreign exchange. Imports of capital goods that are also produced in Venezuela may be prohibited. State-owned entities such as CVG are seeking methods to pay for imported goods and services with iron ore or other means of counter-trade.

In his State of the Nation address to Congress in mid-March, President Lusinchi stated that Venezuela must adopt austerity
measures and renounce a life-style stimulated by the consumerism arising from abundant oil revenues. It is generally expected that many items currently imported at the preferential Bs.7.5:$1 rate will be moved to the free market rate or the prohibited-imports list.

V. FOREIGN EXCHANGE

In an attempt to prevent sharp swings in the free market exchange rates, the Central Bank reached an agreement with the principal foreign exchange brokers to quote a uniform rate at the opening and closing hours and to temporarily close the market for half an hour if quotations should fluctuate more than five percent from the market-opening rate:

The Central Bank has ceased to release figures on the amount of foreign exchange pumped indirectly into the market by the government through such entities as the Banco Industrial. In October, this figure was approximately $80 to $90 million per month. This figure was estimated to have risen to over $120 million per month during the first two months of the current year.

The special Presidential Commission to study reforms of the State (CPRE) has recommended, among other measures, the reinstatement of sales by the Central Bank of 180-day dollar futures, at rates to be fixed by the Central Bank. This system was first adopted in the late 1960's but later abandoned because the bolivar was then stable.

Some banks have agreed to capitalize their unpaid interest claims against Cerveceria Nacional for the issuance of Class A preferred shares. Similarly, local banks agreed to take Class B preferred shares as payment for the interest accrued during the second half of 1984. The Comisión Nacional de Valores resolution, which authorized the capital increase, left the dollar-bolivar conversion rate to be established by mutual agreement between the debtor and the foreign bank's committee of creditors.

VI. INCREASED TAX RATES FOR EXPORTS

Tax reference values for petroleum crude and products exported from Venezuela during 1985 were fixed retroactively at realized prices plus twenty-five percent. Tax reference values for exports during 1986 were fixed at realized prices plus twenty percent.
Although applicable primarily to the nationalized oil companies, these increases in tax rates would be equally applicable to any other exporters who may take title in Venezuela under counter-trade agreements and become the exporters of record.

VII. EXCHANGE RATES FOR INCOME TAXES

In connection with 1985 year-end tax declarations, many dollar-earning companies found themselves in a quandary as to the applicable exchange rate to be used in translating dollar income into bolivars for Venezuelan income tax purposes, particularly where a state-owned entity may be reporting bolivar deductions of (and making withholding on) its dollar payments at a different exchange rate. Similar questions have arisen, both with tax and SIEX authorities, as to the rate of exchange to be used in translating foreign debt into bolivars where such credits are to be capitalized. Furthermore, there is the problem as to the year in which tax losses are to be taken where RECADI applications for registration of foreign debt at the preferential Bs.4.3:$1 rate are denied. The Tax Administration has issued a few, inconclusive rulings regarding the applicable exchange rates; these rulings are not binding precedent.

VIII. FOREIGN INVESTMENT

Foreign investors are reacting slowly to the more liberalized rules embodied in foreign investment Decree 656 of June 1985. However, SIEX has announced that exemptions from foreign investment restrictions have been granted to twenty-six companies classified as agroindustry, ten companies qualifying as agricultural enterprises, and to four companies fitting within the tourism exception. It is generally believed that these are the exceptions granted to existing investments.

IX. EXPIRATION OF TECHNOLOGY TRANSFER AND ROYALTY AGREEMENTS

Many of the technology transfer and royalty agreements currently in effect are due to expire, having reached the end of their normal five-year durations. Parties to such contracts must present new agreements to SIEX for approval because the government does not permit automatic renewals of existing agreements.
X. THE INTERNATIONAL MONETARY FUND

The Venezuelan Government, although rejecting any International Monetary Fund (IMF) program, did accept an enhanced IMF article IV surveillance at the time the Public Sector Restructuring Agreements were signed in New York on February 26, 1986.

Pursuant to article IV of the IMF Articles of Agreement, member countries carry out consultations with the IMF on an annual basis. IMF staff reports are not binding upon member countries. However, in the restructuring agreements Venezuela agreed that, for 1986 and successive years during the restructuring period, it would prepare annual economic program reports including information on broad economic policies, macroeconomic objectives, and certain specific targets (such as non-oil GDP, unemployment rates, inflation rates, monetary growth, etcetera). These programs—and such developments as credit expansion by the Central Bank, changes in the level of international reserves, and growth of external debt—will be monitored. IMF staff members will visit Venezuela more frequently and the Venezuelan Government will provide creditor banks with copies of all reports from the IMF and other international agencies.

If majority banks determine that the results of the economic program of the Republic of Venezuela are or will be materially incompatible with a viable external payments position consistent with continuing debt service, or that the IMF or other monitoring procedures contemplated are not being complied with, such incompatibility or such lack of compliance may constitute an event of default under the restructuring agreement. In short, although no IMF program as such has been imposed as a condition to the Venezuelan public sector restructuring agreement, IMF monitoring findings could result in the declaration of an event of default under the restructuring agreement.

XI. EFFECTS OF DECLINING OIL INCOME

The Venezuelan Government estimates that oil income will be approximately forty percent less than originally projected for 1986 because of falling oil prices; the fiscal deficit will thus be Bs.15 billion or more. Venezuela has marketing flexibility, with an advantageous mix of crudes and products, and expects to obtain an average price of $14-$15 per barrel, even at depressed prices, which
would produce oil exports income of about $7.7 billion for the year—considerably less than the $12 billion originally budgeted. Imports have been cut sharply by RECADI, and the attempted forced trade financing contemplated by Decree 1072 may cut them further.

International reserves still stand at over $13 billion, and inflation is reported by the Central Bank to be only 4.2% for the first quarter of 1986, despite the abolition of the Bs.4.3 rate for certain imports (such as wheat, sorghum, and soybeans). Rumors of a further official devaluation of the bolivar have been denied by officials, but the transfer of many imported items to the free market list is likely.

XII. NEW LEGISLATION GOVERNING IMPORTS OF GOODS

New rules for the import of goods at the preferential exchange rate of 7.5 bolivars to the dollar were enacted in Decree 1072 of April 21, as modified by Decree 1109 of May 21st, to go into effect June 3, 1986. The principal features of the new legislation are as follows:

1) In order to obtain exchange at the preferential rate for the payment of imports, the importer must first apply for and receive an import permit (Conformidad de Importación) issued by RECADI prior to the dispatch of the goods.

2) Import permits at the preferential exchange rate will be granted based upon the availability of foreign exchange and national priorities.

3) Import permits will be valid in most cases for 180 days from date of notification to the importer.

4) Once the import permit has been received, a letter of credit may be opened, with the Central Bank advancing a percentage (twenty percent) of the total exchange required to pay for the imports.

5) Once the goods arrive in Venezuela, the corresponding duties have been paid, and a certificate of origin presented indicating the quantity, quality, and price of the merchandise, together with such other documentation as RECADI may require, RECADI will then issue an authorization for foreign exchange (Autorización para la Obtención de Divisas) within thirty days from presentation of all necessary documents.
6) Importers are no longer required to post bonds with RECADI to guarantee proper use of their foreign exchange.

7) The principal feature of the new legislation is that the importer must now wait for his foreign exchange until the goods have arrived in Venezuela and all required documents have been presented to and approved by RECADI. In effect, the importer must either obtain credit terms from the exporter or a bank, or finance the price of imported goods with foreign currency bought at the free market rate.

8) The government has designated three internationally known companies (Bureau Veritas, Caleb Brett, and Société Générale de Surveillance) as the entities to issue certificates of origin, quality, and price required by RECADI pursuant to the new decree.

XIII. TAX EXEMPTIONS FOR NEW INVESTMENTS

New decrees were published which provide for tax exemptions of new investments in coal-mining and petrochemicals. The project must be submitted to the respective ministry, which will decide whether or not to approve the exemption. If approved, the exemption will last for five years from the date the project begins operations.

By Decree 1099 of May 14, 1986, the Venezuelan Government exempted profits derived from the development of new hotels constructed for purely tourist purposes from income taxation; income derived from the expansion of existing hotels which results in greater tourist capacity is also exempted. The Ministry of Fomento must approve an application for the exoneration, which must be accompanied by details of the proposed construction or expansion, as well as market and feasibility studies. Once approved, and providing that the construction is in accordance with the date submitted, the tax holiday will be for five years from date of start-up of the new hotel or expanded facilities.

XIV. LIQUIDATION OF Banco de Comercio

The government announced that the intervened Banco de Comercio and its affiliated financiera would be liquidated. The government has put approximately 2.5 billion bolivars (U.S. $125 million) into the bank and is not prepared to provide additional
support. Local depositors will be paid first. The government will take no responsibility for payment of the Banco de Comercio group's foreign debt.

XV. Promotion of the National Electronics Industry

The Venezuelan Government is considering the adoption of norms designed to promote the national electronics, telecommunications, and informatics industry. This highly protectionist and nationalistic proposal, similar to the controversial Informatics Law of Brazil, could easily provoke an investigation by the U.S. Trade Representative's Office and possible suspension of GSP privileges for Venezuelan products as a retaliatory measure.

XVI. Regulations for Venezuela's Security Zones

On May 14th the Venezuelan Government issued new regulations designed to govern the security zones along Venezuela's frontiers, maritime boundaries, rivers, and lakes: areas where ownership by foreign nationals and foreign companies may be restricted. Procedures are established for determining security zones and fixing their width. Subsequently, the appropriate military authorities will take a census of persons and properties within such zones; foreign nationals and companies within who are considered necessary for the security and defense of the country must, within stipulated time periods, register with the authorities and request permission to continue carrying on their activities there. If permission is denied, they must then offer their property for sale to Venezuelans within a one-year period. Foreigners seeking to acquire property in such restricted areas must obtain prior approval of the military authorities.

XVII. Impact of U.S. Legislation on Venezuelan Exports

New and sweeping trade legislation pending in the U.S. Congress would transfer the authority to determine whether certain foreign trade practices are unfair under existing U.S. laws from the President to the U.S. Trade Representative's Office. President Reagan has repeatedly resisted protectionist pressures, despite findings of injury to U.S. producers. Thus, the U.S. Congress would mandate retaliatory action in certain legislation because the executive branch has given too much weight to diplomatic considera-
tions and not enough to the protection of American jobs. This revi-
val of the Gibbons Bill could have considerable impact on most
Venezuelan exports to the United States. Similarly, failure of U.S.
trading partners to respect U.S.-perceived intellectual property
rights (for example, patents on pharmaceutical products, pirating
of copyrighted items) may result in denial of market access to the
United States. One section of the bill requires negotiations with
any major trading partner considered to have an “excessive trade
surplus” with the United States. (Trade figures released by the
U.S. Department of Commerce for the year 1985 indicate that the
total U.S. exports to Venezuela during 1985 are $3.16 billion. Im-
ports from Venezuela (mostly oil) are $6.8 billion; but the “excess
trade surplus” provision would not apply to oil exporters.)

Political pressures on President Reagan have already resulted
in investigations of perceived unfair trade practices by Brazil and
Mexico. The annual USTR report to the U.S. Congress has identi-
fied such items as high tariffs and restrictive import licensing, ex-
port subsidies, inadequate intellectual property protection, barriers
to service industries, and Andean Pact investment and technology
transfer restrictions as significant foreign trade barriers in
Venezuela.

U.S. Government policy-makers increasingly emphasize that
the key to the economic future of Venezuela and other countries in
Latin America is growth achieved through a flexible, market-ori-
ented, economic system rather than the rigidities of state-owned
entities with attendant inefficiencies and protectionist policies.
The Under-Secretary of State, John Whitehead, recently stated
that even if the debt of the major debtor countries were to be com-
pletely written off tomorrow, most countries in Latin America
would still be faced with uncertain economic prospects in the ab-
sence of basic structural reforms in the management of their econ-
omies. According to a recent Morgan Guaranty Study, many past
borrowings merely increased consumption and capital flight rather
than productive investment. Although country debt problems
should be approached on a case-by-case basis, there is a lack of
enthusiasm on the part of investors, both domestic and foreign, to
invest in Latin America until there is an improvement in the busi-
ness environment. Critics state that whatever the possible merits
of the Baker Program—proposing structural reforms with the sup-
port of multilateral bank loans and commercial bank financ-
ing—such resources, even if forthcoming, will be totally inadequate
if local conditions conducive to private investment and reduced capital flight are not created. The way out of debt is to grow out of debt, which means, in many cases, increased exports to those industrialized nations which must resist protectionist pressure to keep their markets open to free and fair trade.

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