

Venezuela's Economic Recovery: Is it Sustainable?

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Executive Summary

For most of the past 13 years, most of the discussion of Venezuela's economy has either assumed or concluded that it was headed for some type of collapse. During the first four years of the Chávez administration, when the government did not control the national oil company (PDVSA), there was indeed a great deal of economic instability. This culminated in the military coup of April 2002, and then an economically crippling oil strike (December 2002-February 2003). The oil strike caused an extremely severe recession, with a loss of 29 percent of GDP. However, even after the strike was over, analysts predicted a dire future and a slow, difficult recovery. International Monetary Fund (IMF) forecasts repeatedly underestimated GDP growth by a gigantic 10.6, 6.8, and 5.8 percentage points for the years 2004-2006.¹ Instead, the recovery was very rapid and the economy grew at a record pace over the next five years, with real GDP nearly doubling from the end of the oil strike (first quarter 2003) through the fourth quarter of 2008.

When oil prices collapsed in the fourth quarter of 2008, many analysts concluded that Venezuela's day of reckoning had finally come. A recession began in the first quarter of 2009, and forecasts remained dire well beyond the beginning of the recovery in the second quarter of 2010. In 2011, the Venezuelan economy defied most forecasts by growing 4.2 percent, and is up 5.6 percent for the first half of 2012.

Nonetheless, most prognoses remain gloomy. Venezuela's current growth is generally described as unsustainable, with various negative scenarios put forth, including spiraling debt, inflation, and balance of payments crises. However, these pessimistic forecasts have been far off the mark for most of the past decade. This paper looks at the available economic data to see if Venezuela's economic recovery could be sustained, or even accelerated. We find that Venezuela's current economic growth is sustainable and could continue at the current pace or higher for many years.

Venezuela's economy went into recession in the first quarter of 2009, which lasted for five quarters, until the second quarter of 2010. International oil prices had dropped precipitously in the fourth quarter of 2008, falling by 50 percent (from \$118 to \$58 a barrel). Although at first glance the recession appears as though it was part of an inevitable "oil boom and bust," this was not the case. Although most of the countries in the Western Hemisphere experienced recessions during the 2008-2009 world economic crisis and recession, many did not, and it was possible to mitigate the recession or even avoid it altogether with counter-cyclical macroeconomic policy. Venezuela was in a position to do so, since it had a low public debt (and most importantly, low foreign public debt) when oil prices began to fall, and could have borrowed and spent as much as necessary in order to keep the economy growing.

But government spending was pro-cyclical as the economy slowed and fell into recession, and then during the recession. There was a jump in spending in the second quarter of 2010, as the economy emerged from recession. In 2011, government spending boosted and consolidated the recovery.

The Venezuelan economy has now grown for nine consecutive quarters – beginning with the second quarter of 2010; and the current quarter, which ends at the end of September, and will also show positive growth. Although this recovery has gotten a boost from increased government spending, it

¹ See Rosnick and Weisbrot (2007) and Forero (2003).

has been relatively broad-based throughout various sectors. In 2011, utilities, construction, transportation, commerce and repairs, communications, finance and insurance, and mining all grew faster than overall GDP (4.2 percent). Manufacturing, which makes up about 14 percent of GDP, grew somewhat less, at 3.8 percent.

For 2012, the economy grew 5.6 percent in the first half of the year, as compared with the first half of 2011. Here growth was led by construction, which expanded by 22.5 percent over the first half of 2011, due to the government's program to build housing and alleviate a national housing shortage. In 2011, there were about 147,000 houses built under this program, with two-thirds built by the public sector and one-third from the private sector. Some 200,000 are planned for this year, with over 50 percent of these having been built by September.² These are large numbers relative to Venezuela's population; a comparable number for Venezuela's 2011 construction in the U.S. would be more than 1.6 million homes, or two and half times the number of houses actually built in the U.S. in that year.

Venezuela still has a relatively low debt burden. The most common measure of debt is the ratio of debt to GDP.³ By this measure, the IMF reports Venezuela's public debt for 2011 as 45.5 percent of GDP.⁴ Central government debt is just 25.1 percent of GDP; the IMF number includes other public entities, most importantly PDVSA, the national oil company. This is still a relatively low level of public debt – the European Union, for example, has a debt of about 82.5 percent of GDP.

But for most purposes the interest burden of the debt is a more important measure, since countries that pay lower interest rates can obviously afford a bigger debt stock.⁵ It is also important to distinguish between external and internal debt. Debt owed in domestic currency can always be paid; but the same is not true for foreign debt.

Also, Venezuela's exports are about 95 percent oil, and the oil sector is publicly owned. So the Venezuelan government receives this income in dollars. Given this situation, it is best to look at the external and domestic debt separately, and measure the burden of each debt by the appropriate yardstick.

For external public debt, the most important measure for Venezuela is its debt service relative to public sector exports, which are oil and oil products. Since the principal can be rolled over (see below), this means that interest payments as a percent of public sector export earnings are the most relevant measure.

For 2011, interest payments on the central government external debt are 3.4 percent of export earnings; they are projected to rise to 4.1 percent by 2012, decreasing thereafter. This is not a large percentage of public sector export earnings going to debt service, so there is no obvious problem regarding debt sustainability for the external debt. If the government decides to increase its spending, and borrows to do so, it will borrow mostly domestically, and so should not need to add

2 Ministerio del Poder Popular Para la Comunicación y la Información (2012).

3 The most commonly used measure is gross debt; net debt is a more relevant measure but it is not always readily available from official data. The numbers here represent gross debt.

4 The IMF figure for 2011 is higher than what can be added up from government sources, by 3.5 percent of GDP: The IMF reports 45.5 percent of GDP while government sources total to 42 percent of GDP.

5 Despite much political debate about the problem of public debt in the U.S., for example, the government is currently paying less than one percent of GDP in net interest on the federal public debt.

much to the foreign public debt. Also, these projections are based on the assumption that revenues are the same as in 2011, so they are conservative; most likely revenues will increase and the interest burden will be lower.

The state oil company also borrows on its own, and its debt is almost all external; its interest payments in 2011 were 1.5 percent of export earnings, and are projected to peak at 3.1 percent in 2012. Although it is a separate entity and its debt should not simply be added to that of the central government, even if we were to add this debt service, we get a peak of 7.2 percent of export earnings in 2012, declining to 5.7 percent in 2017. So PDVSA's debt service does not change the picture of Venezuela's debt sustainability.

For internal public debt, the relevant measures are the debt-to-GDP ratio and interest payments as a share of GDP. These are both very low for Venezuela: for 2011, internal public debt was just 11.4 percent of GDP, and interest payments were 1.4 percent of GDP. The government therefore has much room to borrow domestically in order to finance public investment and, if private demand were to fall again, a stimulus program.

The Venezuelan economy has had two recessions in the past thirteen years. The first was brought on by an oil strike, and the second – which could probably have been avoided with sufficient counter-cyclical policies – was during the world recession of 2009. The predictions of economic collapse, balance of payments or debt crises and other gloomy prognostications, as well as many economic forecasts along the way, have repeatedly proven wrong.

The sharp fall in inflation over the past year – while economic growth was accelerating – indicates that the government has the ability to keep inflation under control while maintaining economic growth. Venezuela's internal debt burden is very low, and its external debt burden is modest. Even if oil prices were to crash as they did in 2008-2009, the government would have plenty of capacity to borrow in order to counter a drop in private demand. The previous economic recovery showed that private investment was forthcoming, as would be expected when the economy grows; but the government can also replace lagging private investment with public investment. Such investment in infrastructure, including water, transportation, utilities, roads, bridges, ports, communications (including Internet), hospitals, and electricity is very much needed.

With a sizeable trade surplus, Venezuela is unlikely to see any balance of payments crisis in the foreseeable future, and its currency does not need to be devalued. Even if the currency were devalued, the resulting inflation would likely be modest. The biggest devaluation during the Chávez years, in January 2010 produced no increase in the core rate of inflation, and only a temporary increase in the headline rate. Inflation has since fallen to an annual rate of 13.7 percent over the last quarter, the lowest it has been in more than four years.

While in the long run the government may want to consider other currency regimes – especially to make its manufacturing and tradable goods sectors more competitive -- there is no obvious reason that the current system could not be maintained. For all of these reasons, the current economic recovery is sustainable.

An unsustainable economic expansion is one in which there are imbalances that cannot be maintained. Examples would include the U.S. economy in 2006, or a number of other economies

(e.g. Spain, U.K., Ireland) that had large real estate bubbles that would inevitably have to burst and cause a downturn. Economies with unaffordable debt service, or large current account deficits can also face inevitable adjustment – although even in these cases, including those of asset bubbles, there are generally feasible alternatives to recessions, or at least to severe or prolonged recession. But Venezuela does not face any such inevitable, sharp adjustment that would push the economy into recession.

Looking at Venezuela's economy historically, from 1980-1998, the country's per capita GDP actually declined by 14 percent. It was one of the worst economic performances in a region that, as a whole, experienced its worst long-term growth failure in a century.

Since 1998, the economy has had modest per capita GDP growth, and much higher growth since political stability was restored and the government got control over the oil industry. Measuring from 2004, when the economy reached its pre-recession peak, GDP per person has grown by an average of 2.5 percent annually. This growth led to a large reduction in poverty and extreme poverty, as well as numerous other gains in health care and education due to increases in social spending. And as high as Venezuela's 22 percent annual rate of inflation has been (since 1998), it was much worse (34 percent) in the pre-Chávez years.

Venezuela has about 500 billion barrels of oil, according to the U.S. geological survey estimates, the largest in the world. Its proven reserves are about 300 billion barrels. The country is currently using about 1 billion barrels of those reserves per year. So long as political stability is maintained – and it has been since the government got control of the national oil industry in 2003 – Venezuela will have the ability, with reasonable macroeconomic policies, to maintain solid rates of economic growth.

Introduction

For most of the past 13 years, much of the discussion of Venezuela's economy has either assumed or concluded that it was headed for some type of collapse. During the first four years of the Chavez administration, when the government did not control the national oil company (PDVSA), there was indeed a great deal of economic instability. This culminated in the military coup of April 2002, and then an economically crippling oil strike (December 2002-February 2003). The oil strike caused an extremely severe recession, with a loss of 29 percent of GDP. However, even after the strike was over, analysts predicted a dire future and a slow, difficult recovery. IMF forecasts repeatedly underestimated GDP growth by a gigantic 10.6, 6.8, and 5.8 percentage points for the years 2004-2006.⁶ Instead, the recovery was very rapid and the economy grew at a record pace over the next five years, with real GDP nearly doubling from the end of the oil strike (first quarter 2003) through the fourth quarter of 2008.

When oil prices collapsed in the fourth quarter of 2008, many analysts concluded that Venezuela's day of reckoning had finally come. A recession began in the first quarter of 2009, and forecasts remained dire well beyond the beginning of the recovery in the second quarter of 2010. In 2011, the Venezuelan economy defied most forecasts by growing 4.2 percent, and is up 5.6 percent for the first half of 2012.

Nonetheless most prognoses remain gloomy. Venezuela's current growth is generally described as unsustainable. In some scenarios, the government will have to cut spending and throw the economy into a downturn after the election. Others see inflation, which has fallen sharply to a more than four year low of 13.7 percent annually over the last quarter, as inevitably rebounding as price controls lose their effect, and with the added assumption that the government must devalue the currency after the election.⁷ In standard pessimistic scenarios, inflation leads to more devaluations and more inflation, leading to increased capital flight and balance of payments crises.⁸ Other analysts reach similar results from predictions of catastrophic levels of public debt. For all of these reasons and more, Venezuela's recovery is once again seen as something that cannot be sustained.

However, these pessimistic forecasts have been far off the mark for most of the past decade. This paper looks at the available economic data to see if Venezuela's economic recovery could be sustained, or even accelerated. We find that Venezuela's current economic growth is sustainable and could continue at the current pace or higher for many years.

⁶ See Rosnick and Weisbrot (2007) and Forero (2003).

⁷ See, for example, China (2012).

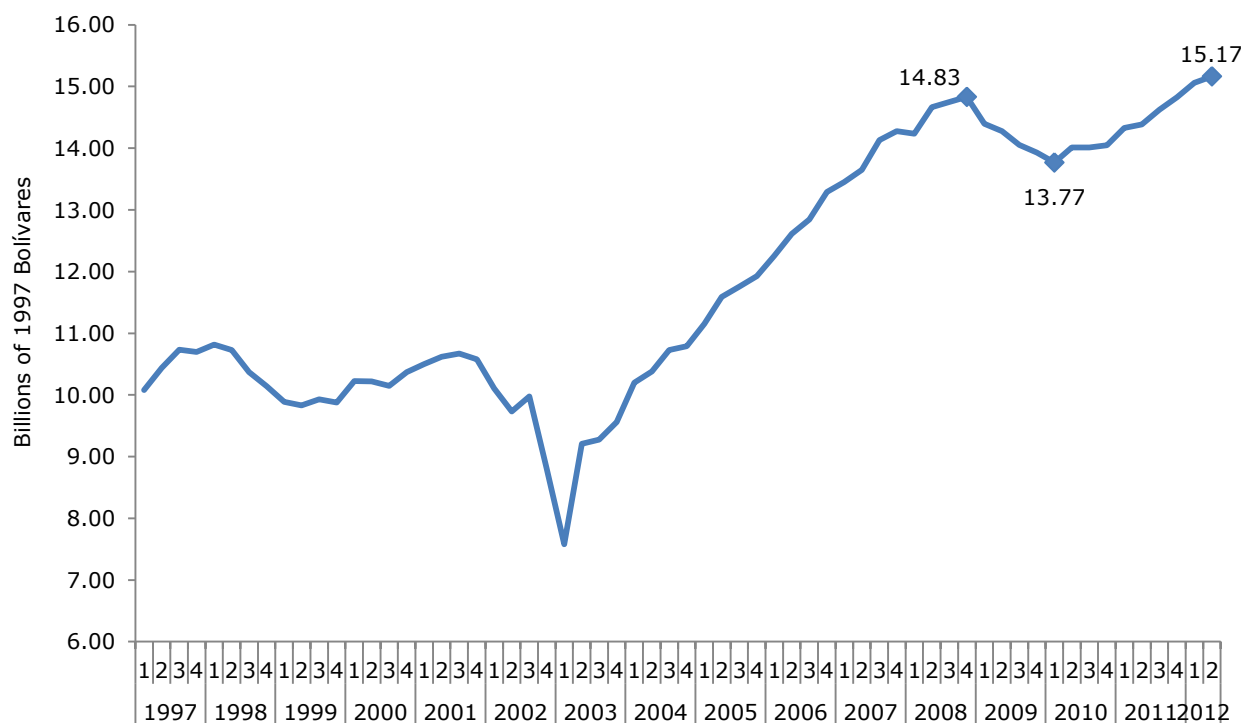
⁸ See, for example, Cancel (2012).

Recession and Recovery

Venezuela's economy went into recession in the first quarter of 2009, which lasted until the second quarter of 2010. This can be seen in **Figure 1**, which shows real, seasonally adjusted quarterly GDP in billions of 1997 Bolívares. The recession lasted five quarters, with a loss of about 7.2 percent of GDP from pre-recession peak to the bottom.

International oil prices dropped precipitously in the fourth quarter of 2008, falling by 50 percent (from \$118 to \$58 a barrel). As can be seen in **Table 1**, private sector GDP collapsed – it had grown by 7.7 percent in 2007, and fell to 0.4 percent for 2008. The slowdown began earlier, probably in response to reduced government spending in 2007 (see below); also, the U.S. recession began in December of 2007. The collapse of oil prices probably convinced investors and consumers that there would be a recession, as Venezuela had experienced in the past when oil prices plummeted. Private consumption growth fell from 16.9 percent in 2007, to 6.3 percent for 2008, to -2.9 percent for 2009. Capital formation fell earlier and harder: from 25.6 percent growth in 2007, to 2.4 percent for 2008 and -8.3 percent for 2009.

FIGURE 1
Venezuela: Real GDP (Seasonally-Adjusted)



Source: Banco Central de Venezuela 2012, Table 5.2.4; authors' calculations.

Note: For an explanation of the seasonal adjustment, see Weisbrot and Ray (2010).

Although at first glance it appears as though this was part of an inevitable “oil boom and bust,” this was not the case. Although most of the countries in the Western Hemisphere experienced recessions during the 2008-2009 world economic crisis and recession, many did not, and it was

possible to mitigate the recession or even avoid it altogether with counter-cyclical macroeconomic policy. Venezuela was in good position to do so, since it had a low public debt (and most importantly, low foreign public debt) when oil prices began to fall, and could have borrowed and spent as much as necessary in order to keep the economy growing. As we shall see below, even after the expansion of public borrowing that has occurred since the recession, the Venezuelan government still has a relatively low debt burden.

Unfortunately, Venezuela continued cutting back on public spending as the economy fell into recession. This can be seen in **Table 2**. The top part of the table shows Venezuela's central government spending, which is included in its budget and approved by the Congress. But this does not include all government spending. A significant amount of government spending, including social spending, is undertaken directly by PDVSA, the national oil company, and Fondo de Desarrollo Nacional (FONDEN), the national development fund. This spending must also be included, in order to see what is happening to government spending over time. However, there is no accurate way, using available data, to separate out the public spending of PDVSA and FONDEN from budgeted central government spending.

We therefore include in Table 2 the total of government social spending plus public investment, which is available. This includes the spending of PDVSA, FONDEN, and the central (and state and local) governments. This is shown in the bottom half of Table 2. Of course there is a large overlap between these two totals, since the bottom table is including all of the central government social spending and public investment spending; so they cannot be added to get total government spending. Nonetheless, the two tables together show a picture of what happened to government spending before, during, and after the recession.

As can be seen in Table 2, there was a large increase in central government spending as a share of the economy from 1999, the year that President Chávez took office, to 2006 – it went from 19.8 to 29.8 percent of GDP. It dropped sharply in 2007, to 26 percent of GDP, undoubtedly contributing to the slowdown in GDP growth in 2008. It stayed about constant in 2008, at 26.1 percent, when counter-cyclical policy was needed as the economy fell into recession in the last quarter. For 2009, it went up slightly to 26.7 percent of GDP, but was falling in absolute terms as the economy shrank – when a big boost from the public sector was necessary given the collapse of private spending. It then fell sharply in 2010 – nearly four percentage points to 22.9 percent of GDP, thus helping to prolong the recession through the first half of that year. Finally, in 2011, government spending moved up significantly, to 26.5 percent of GDP, and a robust recovery got under way.

The figures on social spending and public investment in the bottom half of the table show the same story but even more strongly. Social and public investment spending peaks at 40 percent of GDP in 2006 (up enormously from 24.5 percent in 1999), then falling sharply by more than 5 percentage points to 34.9 percent in 2007. It continues to fall steeply throughout the recession: to 32.5 percent (2008); and another enormous drop when the recession is under way to 28.3 percent (2009); and another 5 percentage point drop to 23.9 percent in 2010. In 2011 it shoots up sharply to 29.3 percent of GDP.

These numbers show that government spending was strongly pro-cyclical as the economy slowed and fell into recession, and then during the recession. In 2011 we can see government spending

boosting and consolidating the recovery; although quarterly data shows that there was also a big temporary jump in the second quarter of 2010, when the recession ended.

The Venezuelan economy has now grown for nine consecutive quarters – beginning with the second quarter of 2010. This does not include the current quarter, which ends at the end of September, and will also show positive growth. In **Table 1** we can see that although this recovery has gotten a boost from increased government spending, it has been relatively broad-based throughout various sectors. In 2011, utilities, construction, transportation, commerce and repairs, communications, finance and insurance, and mining all grew faster than overall GDP (4.2 percent). Manufacturing, which makes up about 14 percent of GDP, grew somewhat less, at 3.8 percent.

For 2012, the economy grew 5.6 percent in the first half of the year, as compared with the first half of 2011. Here growth was led by construction, which expanded by 22.5 percent over the first half of 2011, due to the government's program to build housing (see below). Finance and insurance, which has been one of the fastest growing sectors over the past decade, grew even faster (31.8 percent). Commerce and repair, transportation, and communications all expanded faster than the overall economy, but manufacturing only grew by 0.7 percent.

A significant part of the government's stimulus has been its housing program, initiated last year to reduce the nation's housing shortage. In 2011, there were about 147,000 houses built under this program, with two-thirds built by the public sector and one-third from the private sector. Some 200,000 are planned for this year, with over 50 percent of these having been built by September⁹. These are large numbers relative to Venezuela's population; a comparable number for Venezuela's 2011 construction in the U.S. would be more than 1.6 million homes, or two and half times the number of houses actually built in the U.S. in that year. Not surprisingly, construction has been a significant contributor to the recovery, as noted above.

⁹ Ministerio del Poder Popular Para la Comunicación y la Información (2012).

TABLE 1
Venezuela: Real Sector, 2000-2012 (real annual percent change)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012a
Overall GDP	3.7	3.4	-8.9	-7.8	18.3	10.3	9.9	8.2	4.8	-3.2	-1.5	4.2	5.6
Public Sector	3.0	-0.6	-11.1	-1.3	12.5	2.8	2.7	7.5	16.9	1.1	0.0	3.8	3.0
Private Sector	4.2	4.9	-5.8	-8.9	17.2	12.9	11.3	7.7	0.4	-4.3	-2.1	4.0	6.4
By Sector													
Petroleum	2.3	-0.9	-14.2	-1.9	13.7	-1.5	-2.0	-4.2	2.5	-7.4	0.1	0.6	1.6
Non-Petroleum	4.2	4.0	-6.0	-7.4	16.1	12.2	10.9	9.6	5.1	-1.7	-1.6	4.5	5.8
Mining	15.3	2.8	4.3	-4.4	14.2	3.0	7.2	1.5	-4.2	-10.3	-13.0	5.2	-4.8
Manufacturing	5.1	3.7	-13.1	-6.8	21.4	11.1	8.3	7.4	1.4	-6.4	-3.4	3.8	0.7
Utilities	4.7	4.8	2.1	-0.5	8.5	11.2	4.9	-1.5	5.7	4.1	-5.8	5.0	3.0
Construction	4.0	13.5	-8.4	-39.5	25.1	20.0	30.6	15.5	3.7	-0.2	-7.0	4.8	22.5
Commerce and Repairs	5.7	4.6	-13.6	-9.6	28.6	21.0	15.7	16.7	4.6	-8.2	-6.1	6.5	8.9
Transportation	12.5	-1.3	-10.4	-8.0	24.6	14.7	14.3	13.3	3.8	-8.4	-2.0	5.8	8.5
Communications	2.1	8.1	2.5	-5.0	12.9	22.4	23.5	19.8	18.2	12.1	7.9	7.3	7.3
Finance and Insurance	-0.7	2.8	-14.5	11.9	37.9	36.4	47.2	16.4	-4.6	-1.5	-7.6	12.0	31.8
Real Estate and Res. Rent	0.8	3.5	-0.7	-6.0	11.1	7.9	8.6	5.8	2.7	-1.1	-0.7	3.5	4.1
Commty. Svc., Non-profits	0.9	2.1	0.1	-0.3	9.4	8.2	16.5	10.9	9.5	2.0	-0.1	5.8	6.8
General Gov't Services	2.8	2.5	-0.4	4.9	11.1	8.0	3.0	5.7	5.3	2.4	2.6	5.5	5.2
Other ^b	5.2	1.8	-1.0	-2.9	7.2	12.6	3.7	5.0	5.6	-0.5	-1.0	-1.4	3.3
By Expense Type													
Govt Consumption	4.2	6.9	-2.5	5.7	14.2	10.7	9.6	13.8	4.8	1.5	2.1	5.9	5.4
Private Consumption	4.7	6.0	-7.1	-4.3	15.4	15.7	15.5	16.9	6.3	-2.9	-1.9	4.0	6.2
Gross Fixed Capital Formation	2.6	13.8	-18.4	-37.0	49.7	38.4	29.3	25.6	2.4	-8.3	-6.3	4.4	18.4
Exports	5.8	-3.5	-4.0	-10.4	13.7	3.8	-3.0	-7.6	-1.0	-13.7	-12.9	4.7	-2.4
Imports	12.4	14.1	-25.2	-20.9	57.7	35.2	34.8	33.0	1.4	-19.6	-2.9	15.4	30.9

Source: Banco Central de Venezuela (2012), Tables 5.2.1, 5.2.7, 5.2.4.

a. 2012 data is for the first half of 2012 compared to the first half of 2011.

b. Includes private agriculture, restaurants and private hotels and various public sector activities.

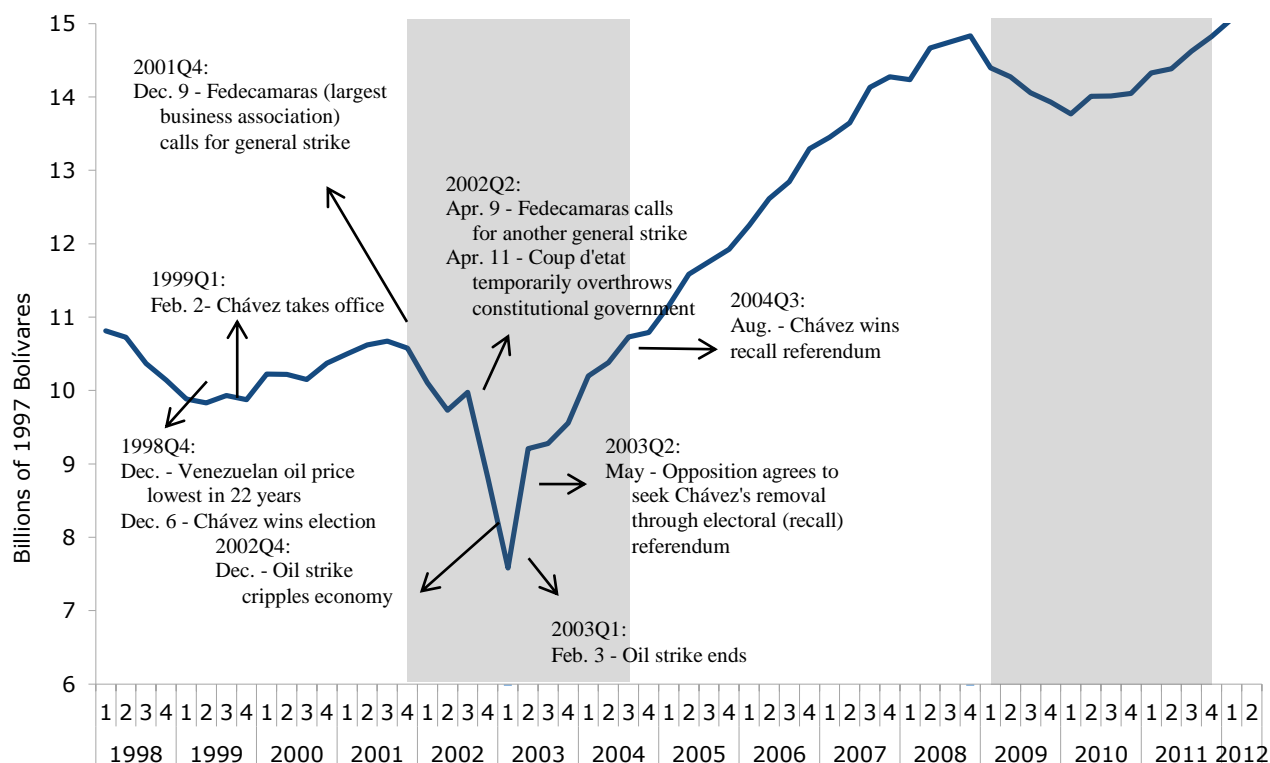
TABLE 2
Central Government Expenditure and Total Public Investment

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total Expenditure and Net Lending	19.8%	21.8%	25.1%	26.1%	27.8%	25.9%	25.9%	29.8%	26.0%	26.1%	26.7%	22.9%	26.5%
Current Expenditure	16.4	17.5	19.3	19.1	20.8	19.6	19.0	22.0	19.7	19.8	20.5	19.0	21.7
Capital Expenditure	3.0	3.3	4.4	5.1	5.5	5.0	5.8	6.7	5.9	5.8	5.5	2.9	3.1
Off-Budget Expenditure and Net Lending	0.4	1.0	1.5	2.0	1.5	1.3	1.1	1.1	0.4	0.5	0.7	1.1	1.6
Total Public Investment Plus Social Spending	24.5%	29.6%	31.6%	29.4%	31.3%	29.5%	30.3%	40.0%	34.9%	32.5%	28.3%	23.9%	29.3%
Total Social Spending	12.8	14.9	16.7	16.3	16.7	18.1	17.6	21.9	21.3	19.5	18.5	15.4	22.8
Education	4.9	5.4	5.7	5.7	5.8	6.0	5.7	6.4	5.8	6.2	6.3	4.8	5.1
Health	2.5	2.6	3.0	3.4	2.5	3.2	2.6	3.7	4.4	3.0	2.9	2.5	3.3
Housing	1.6	2.6	2.4	2.4	2.1	2.5	3.0	3.8	2.9	2.4	1.7	1.5	4.2
Total: Education, Health, and Housing	9.0	10.7	11.0	11.5	10.4	11.7	11.4	14.0	13.0	11.6	10.9	8.8	12.6
Social Security	2.3	2.7	3.8	3.2	4.2	4.0	3.8	4.9	4.8	4.7	4.9	5.0	5.0
Social Development and Participation	1.1	1.1	1.2	1.1	1.6	1.8	1.7	2.5	2.8	2.1	2.0	1.4	4.7
Culture and Social Communications	0.2	0.3	0.2	0.2	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.3	0.3
Science and Technology	0.1	0.2	0.4	0.3	0.1	0.3	0.3	0.2	0.3	0.3	0.2	0.2	0.2

Source: SISOV, Ministerio del Poder Popular de Planificación y Finanzas, República Bolivariana de Venezuela

Figure 2 shows the recovery in the context of the last decade and a half of economic growth. As can be seen, the economy declined from 1998-2002, as it was plagued by political turmoil (including a military coup and other unrest), and the government's lack of control over the oil industry. It then plummeted by 29 percent due to the oil strike of 2002-2003. From the second quarter of 2003, when the government finally gained control of the oil industry and political instability subsided, the economy grew extremely rapidly. It expanded by ninety-six percent in real (inflation-adjusted) terms, nearly doubling in size over the ensuing 5.75 years, until the recession that began in the first quarter of 2009.

FIGURE 2
Venezuela Real GDP (Seasonally-Adjusted)



Source: Banco Central de Venezuela (2012), Table 5.2.4; authors' calculations.

Note: Shaded areas indicate recession and recovery.

After five quarters of recession, the economy began to grow in the second quarter of 2010. Nearly two years later, in the first quarter of 2012, the economy passed the level of real GDP that it had reached before the most recent recession.

Finance and Debt

As noted above, the government had the capacity to counter the last recession, which it finally used decisively in 2011. To see this, and to consider how much room the government has to stimulate growth and development going forward, we must look at the government's current finances, revenue, debt, and debt service.

There are a number of ways to measure a government's current debt burden. The most common measure that one sees in the press is the ratio of debt to GDP.¹¹ By this measure, the IMF reports Venezuela's public debt for 2011 as 45.5 percent of GDP.¹² Central government debt is just 25.1 percent of GDP; the IMF number includes other public entities, most importantly PDVSA, the national oil company. This is still a relatively low level of public debt – the European Union, for example, has a debt of about 82.5 percent of GDP.

For most purposes, however, the interest burden of the debt is a more important measure, since countries that pay lower interest rates can obviously afford a bigger debt stock.¹³ But it is best to use measures that are most appropriate to the Venezuelan economy; and it is also worth looking separately at PDVSA's debt.

There is also a big difference between borrowing in a foreign currency, for most countries, and borrowing in domestic currency. Debt denominated in a foreign currency is the most important constraint facing the government. Debt owed in domestic currency can always be paid; but a shortage of foreign exchange to pay foreign debt can lead to a crisis in the balance of payments.

Also, Venezuela's exports are about 95 percent oil, and the oil sector is publicly owned. So the Venezuelan government receives this income in dollars. Given this situation, we should look at the external and domestic debt separately, and measure the burden of each debt by the appropriate yardstick.

External Public Debt and Debt Service

The main measure that matters for Venezuela's external public debt is its debt service relative to public sector exports, which are oil and oil products.

The external public debt-to-GDP ratio is not as good a measure, since (1) it varies considerably depending on what exchange rate is used and (2) since the money to service the external debt comes from export revenue.

External debt service consists of principal and interest payments. However, the principal can be rolled over, and will be rolled over unless the government is trying to actively pay down the debt. The only time that the principal payments are considered a problem with regard to debt sustainability is when (a) there is some sort of crisis and it cannot be rolled over, or can only be rolled over at exorbitant interest rates (as has happened to Greece in the past two years) or (b) when it is "lumpy" – a big portion is due at once, and causes financing problems. As we will see below, Venezuela does not appear to be having either of these two problems. So we can assume, for the foreseeable future, that Venezuela's principal payments for external foreign debt will be rolled over.

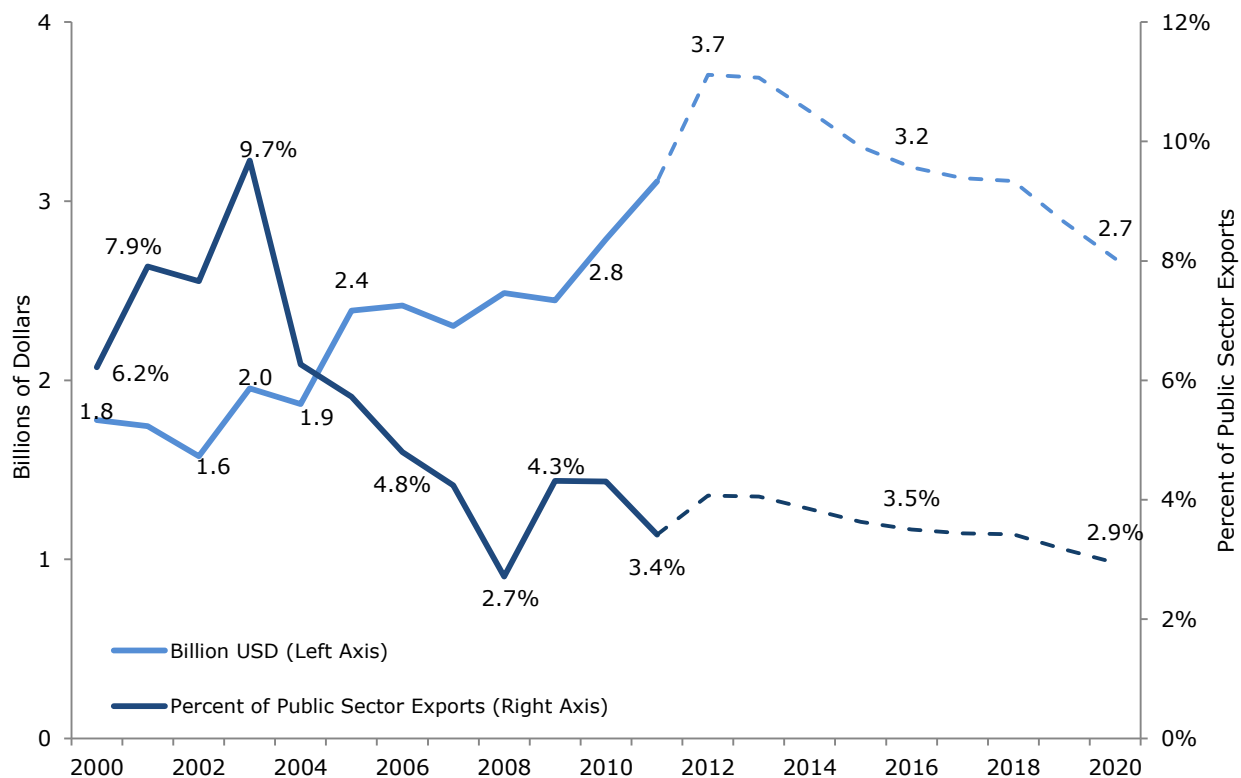
11 The most commonly used measure is gross debt; net debt is a more relevant measure but it is not always readily available from official data. The numbers here represent gross debt.

12 The IMF figure for 2011 is higher than what can be added up from government sources, by 3.5 percent of GDP: The IMF reports 45.5 percent of GDP while government sources total to 42 percent of GDP.

13 Despite much political debate about the problem of public debt in the U.S., for example, the government is currently paying less than one percent of GDP in net interest on the federal public debt.

The relevant measure for external debt is therefore interest payments as a share of public export earnings. This is shown in **Figure 3**, along with the dollar amount (in billions of \$USD). For 2011 this amounts to 3.4 percent of export earnings, and is projected to rise to 4.1 percent by 2012, decreasing thereafter. These projections are based on the assumption that revenues are the same as in 2011, so they are conservative; most likely revenues will increase and the interest burden will be lower.

FIGURE 3
Venezuela: Interest Payments on Central Government External Debt

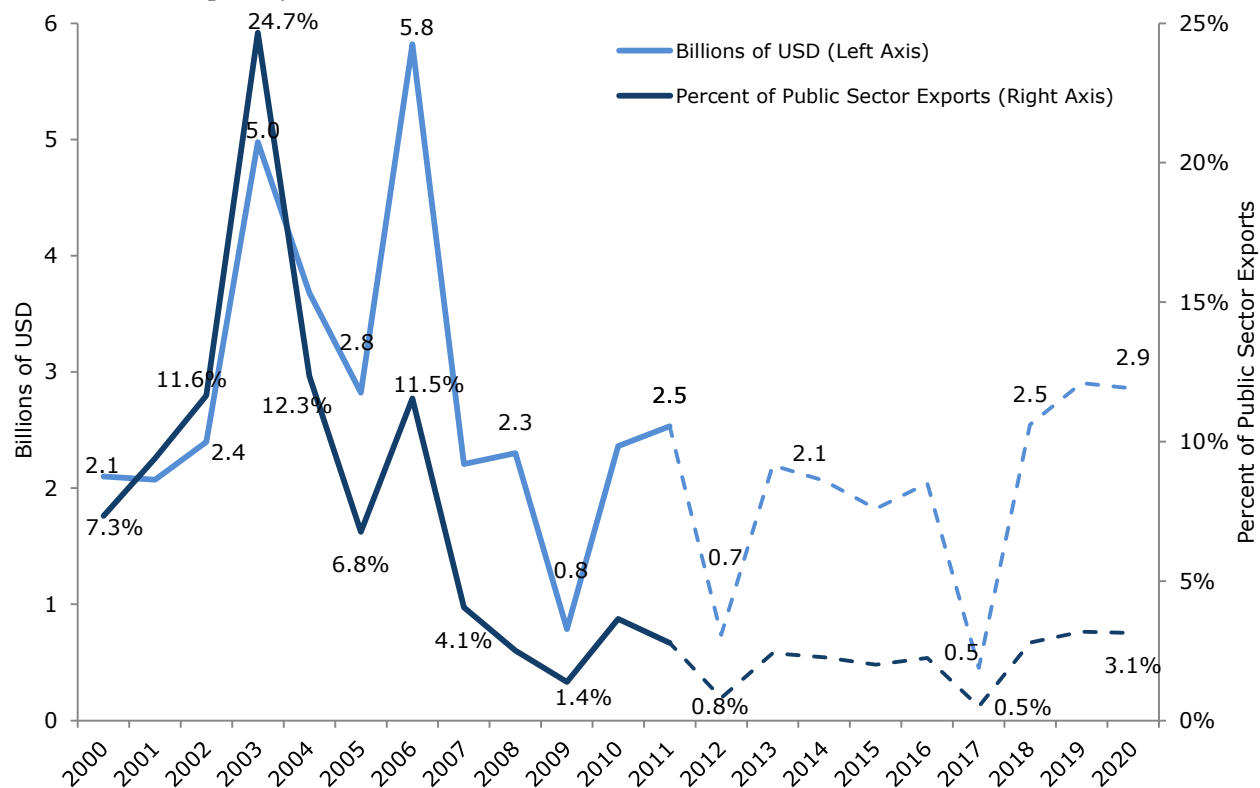


Source: Oficina Nacional de Crédito Público, Ministerio del Poder Popular de Planificación y Finanzas, authors' calculations.

This is not a large percentage of public sector export earnings going to debt service, so there is no obvious problem regarding debt sustainability for the external debt. If the government decides to increase its spending, and borrows to do so, it will borrow mostly domestically, and so should not need to add to the foreign public debt, except insofar as it is financing imports (e.g. imported materials or equipment for infrastructure or oil production).

Figure 4 shows the government's payments of principal for external public debt in dollars and as a percent of public sector exports. As can be seen, there are no surges in principal that would appear to cause any potential difficulties in financing. It is therefore reasonable to assume that the interest payments are a good measure of the government's debt burden.

FIGURE 4
Venezuela: Principal Payments on Central Government External Debt



Source: Oficina Nacional de Crédito Público, Ministerio del Poder Popular de Planificación y Finanzas

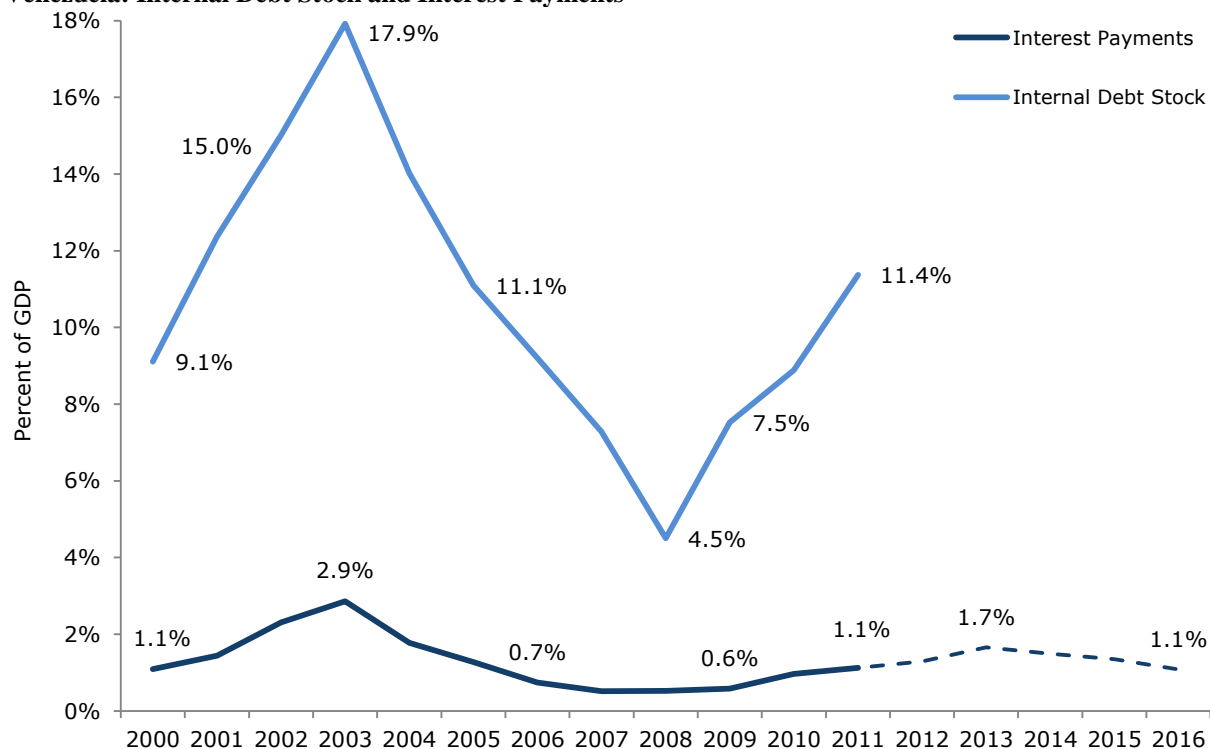
Internal Debt

For Venezuela, internal debt is a different story than external debt, since it is paid in domestic currency, and therefore not dependent on the public sector's foreign exchange earnings, or reserve holdings. Sustainability should therefore be measured differently. What matters most here is the government's interest payments and total debt as a percentage of GDP.

This is shown in **Figure 5**. Interest payments on the internal debt are very low, just 1.1 percent of GDP in 2011.

The top line shows the total central government internal debt as a percentage of GDP. This is quite low, at 11.4 percent of GDP in 2011. Although it has increased by 7 percentage points in the last three years, no government would be worried about an internal debt of this level. Of course, the interest on the debt is the important measure, since there isn't any threat of not being able to roll over the principal on domestic debt.

FIGURE 5
Venezuela: Internal Debt Stock and Interest Payments



Source: Oficina Nacional de Crédito Público, Ministerio del Poder Popular de Planificación y Finanzas

Note that interest payments have remained quite low, as a percentage of GDP. This is partly because the government can borrow domestically at less than the rate of inflation.

This is important because it means that any domestic stimulus or public investment program can be financed through domestic borrowing for quite some time without having to worry about the burden of the internal debt.

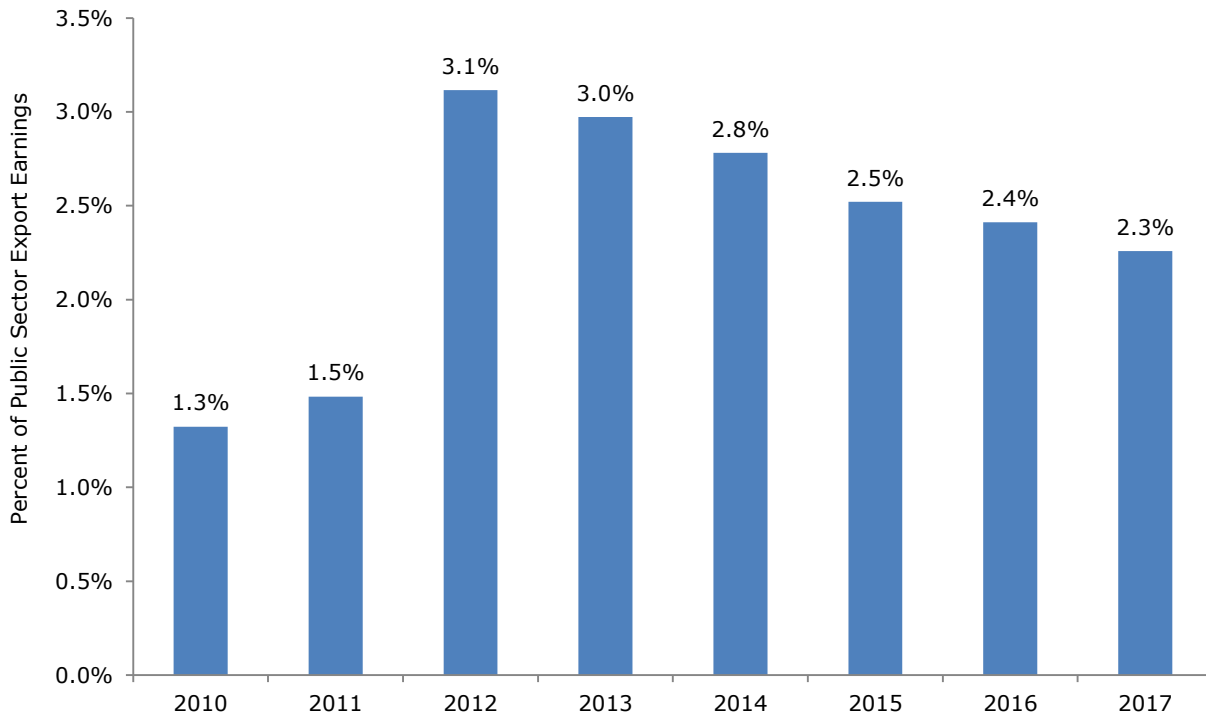
PDVSA Debt and Borrowing from China

The state oil company, PDVSA, also borrows on its own. This is separate from central government debt, and for purposes of looking at the government's debt burden it should not be simply added to the government's debt, since PDVSA pays its debt service out of its own revenue, and not government revenue. So, the main concern is whether PDVSA's debt burden will significantly reduce government revenue in future years.

PDVSA's debt for 2011 was \$34.9 billion, which is almost all foreign debt. For 2011, interest payments on the debt were approximately \$1.35 billion, or 1.5 percent of export earnings. As can be seen in **Figure 6**, under the conservative assumption that export earnings do not increase, these would be expected to peak at 3.1 percent of export earnings for 2012, then decline gradually to 2.3 percent in 2017. Even if we were to add the central government and PDVSA debt together, we get

a peak of 7.2 percent of export earnings in 2012, declining to 5.7 percent in 2017. Therefore, there is no reason to think that PDVSA debt would change the picture.

FIGURE 6
Venezuela: PDVSA Interest Payments as a Percent of Public Sector Export Earnings



Source: PDVSA, 2011a, authors' calculations.

It is worth emphasizing that all of these projections assume no increase in oil revenue. Venezuela has plans to increase production from the current level of about 3 million barrels per day to 6 million barrels per day in 2019. Even if only a fraction of this were achieved, it would of course make the country's debt burden even smaller, relative to public sector export revenue.

Since 2007, Venezuela has also borrowed from China under a set of arrangements that is somewhat complicated. Total borrowing has been \$36 billion; according to the Ministry of Petroleum and Mining, \$13.5 billion has been repaid. Of the remaining \$22.5 billion, \$20 billion has been borrowed under the Gran Volumen program. These loans pay interest rates of LIBOR plus 1-2 percent, which is far below the rate on most other Venezuelan government borrowing.¹⁴ These interest payments would take up about 0.5 to 0.7 percent of public sector export earnings for 2012. Even with another \$2 billion per year for amortization, this wouldn't add too much to Venezuela's debt service burden. But in practice, Venezuela can undoubtedly borrow more from China, in effect rolling over the principal as needed. Perhaps most importantly, the Venezuelan government's ability to borrow from China, with which it has established a strategic partnership, gives it a very important source of non-market and low-interest credit that the government might tap in an urgent situation.

¹⁴ PDVSA (2011b) and Ministry of Petroleum and Mining.

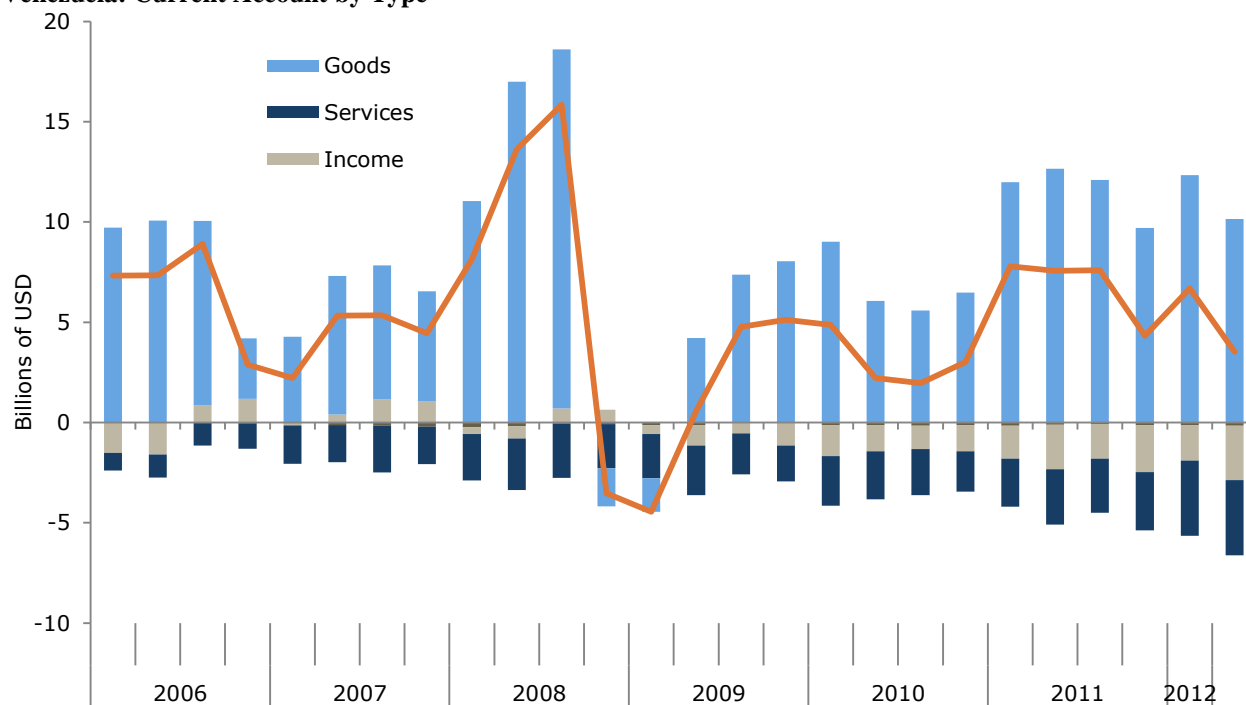
Financing, Foreign Exchange, and Balance of Payments Constraints

Venezuela's low level of debt service allows much room for the financing of increased public spending without running into any debt sustainability problems. Even if the country's central government internal debt/GDP ratio were to double, to 22 percent of GDP, this would still be a low level of internal public debt. And if it could be financed at interest rates below the current rate of inflation – as currently appears to be the case – then the low interest burden that the government currently has on internal debt (currently just 1.1 percent of GDP) would rise much more slowly than the increase in borrowing.

With regard to the government's external debt, this would not be much affected by public investment and other spending programs that are financed with domestic currency.

There is, however, a balance of payments constraint: if the economy grows faster, we would expect imports to increase. Therefore, the government must maintain sufficient reserves to allow for an increase in imports in the overall economy. However, the government is currently running a trade and current account surplus. This can be seen in **Figure 7**. As shown, Venezuela ran a trade deficit for just two quarters, when oil prices collapsed in the fourth quarter of 2008. According to the most recent data, for the year through the end of the second quarter 2012, Venezuela ran a large current account surplus of \$22.1 billion, or about 6.6 percent of GDP. Although imports have, as would be expected, picked up with the recovery, export earnings have risen faster.

FIGURE 7
Venezuela: Current Account by Type



Source: Banco Central de Venezuela (2012), Table 2.4.1

The Central Bank's international reserves are currently at about \$24.6 billion. This is enough to cover more than five months of imports; normally, reserves that cover three months of imports are considered adequate.¹⁶

Of course, given Venezuela's trade and current account surplus, the central bank's reserves should be higher and should have accumulated rapidly. However, in the past year most if not all of the current account surplus went outside of the country. Part of this loss of reserves was capital flight, although it is not possible to tell exactly how much. Capital flight does not threaten in the foreseeable future to cause a balance of payments crisis, because the country still has more than adequate reserves. However, it would be to Venezuela's advantage for a number of reasons if the government could reduce the amount of money leaving the country. This could be done partly with more effective foreign exchange controls; there are many countries that have more effective capital controls than does Venezuela.

In theory, foreign exchange controls should be easier to administer in Venezuela than in most other countries because more than 90 percent of the country's foreign exchange earnings accrue to the government. Part of this is an administrative problem: a government needs to co-ordinate among various agencies, including tax collection, the central bank, and customs, and build capacity to make sure that people who acquire foreign exchange do so for legitimate reasons such as imports, rather than to simply take money out of the country. The biggest part of the problem is political: people and institutions can take money out of the country for political reasons, and this is typical in a country where there is a polarized political climate and the people who control most of the wealth and income of the country – as well as most of the media – are mostly against the government. It is not difficult to convince people who dislike and distrust the government that they should put their money outside the country, especially when most of the media is encouraging that view. (The government has a number of TV stations but they have only about 5-8 percent of the television audience, and most likely the majority of these viewers are not upper-income groups).¹⁷ To the extent that households and businesses who have most of the national savings want, for political reasons or because of their own fears, to get out of the domestic currency and are able to do so, a lot of dollars will leave the country.

However there is no compelling economic rationale for people and businesses that accumulate most of the national savings to take money abroad, while there are profitable investment opportunities within the country. As we will see below, during the last recovery, private investment increased very rapidly. It is important to distinguish the current situation from that of a country that is running chronic trade deficits, for example, and must borrow in order to finance its imports. As noted above, Venezuela had just two quarters of a trade deficit when oil prices collapsed, and faced no balance of payments crisis even then. If not for the capital leaving the country, Venezuela would be piling up large amounts of reserves. The government will want to keep more of this money within the country, and there a number of feasible ways to do this. Of course, one way to keep more money in the country is to devalue the currency. As the currency moves toward a lower value in both the official rate and the black market rate, this is effectively placing a tax on capital flight. People who want to take their money out of the country now have to pay more to do so. However, as noted above, there are more effective ways of inducing people and businesses to keep their money in the country other than devaluation.

16 See Wijnholds and Kapteyn (2001) for a review of the literature on the adequacy of reserves.

17 Ruttenberg and Weisbrot (2010).

The important thing is that Venezuela's situation is vastly different from the situation of countries that are running trade deficits, or where people have other reasons to fear inevitable devaluation, as in Brazil or Argentina in the late 1990s – where these countries had fixed, overvalued exchange rates that could not be maintained. Venezuela exports oil, which is sold in dollars, and it does not need to devalue its currency in order to make its oil exports competitive.

So Venezuela's currency is not overvalued, in a fundamental sense. This can be seen by looking at the IMF data for Purchasing Power Parity (PPP) GDP. This is a measure of a country's GDP that adjusts for price differences between different countries. A country whose currency is overvalued, by this measure, will have a higher PPP GDP than their GDP measured in dollars, at least relative to other countries. So we can compare different countries' PPP exchange rate with their dollar exchange rate to see how much it might be overvalued or undervalued.

Figure 8 shows this measure of over/under-valuation for 183 countries in 2011.¹⁸ Although the vast majority of developing countries show up as having undervalued currencies by this measure, for technical reasons,¹⁹ we are still able to compare Venezuela to other countries. As can be seen, Venezuela does not stand out at all as having an overvalued currency relative to other countries of comparable levels of development. Note that Brazil, for example, has a currency that is much more overvalued than Venezuela's in PPP terms. And Brazil has not had any problems with capital flight; on the contrary, during the past year it has tried to limit capital inflows in order to stem further appreciation of its currency.

It is also worth emphasizing that the value of Venezuela's PPP exchange rate, because of the way that is estimated by the IMF, increases with the real price of oil. The real price of oil has increased by 180 percent since 2000; Venezuela's currency by the IMF's PPP measure has doubled. Yet, in spite of this large increase, Venezuela's currency did not appear to be terribly overvalued in 2011, relative to other currencies.²⁰

Purchasing power parity estimates are another way of seeing that Venezuela's currency is not overvalued in a fundamental sense, that is, with regard to its international purchasing power as compared to other currencies. The problem is mainly that many Venezuelans have become convinced that it will be devalued, or want to take their money out of the country for other reasons. This is different from having a fundamentally over-valued currency, or chronic current account deficits.

Of course a lower-valued currency would benefit Venezuelan producers of tradable goods, by making imports more expensive and non-oil exports cheaper. This would give Venezuelan manufacturing and industry a better chance to compete against imports, and well as to increase the country's non-oil exports. Venezuela's exports earnings are currently 95 percent from oil and oil

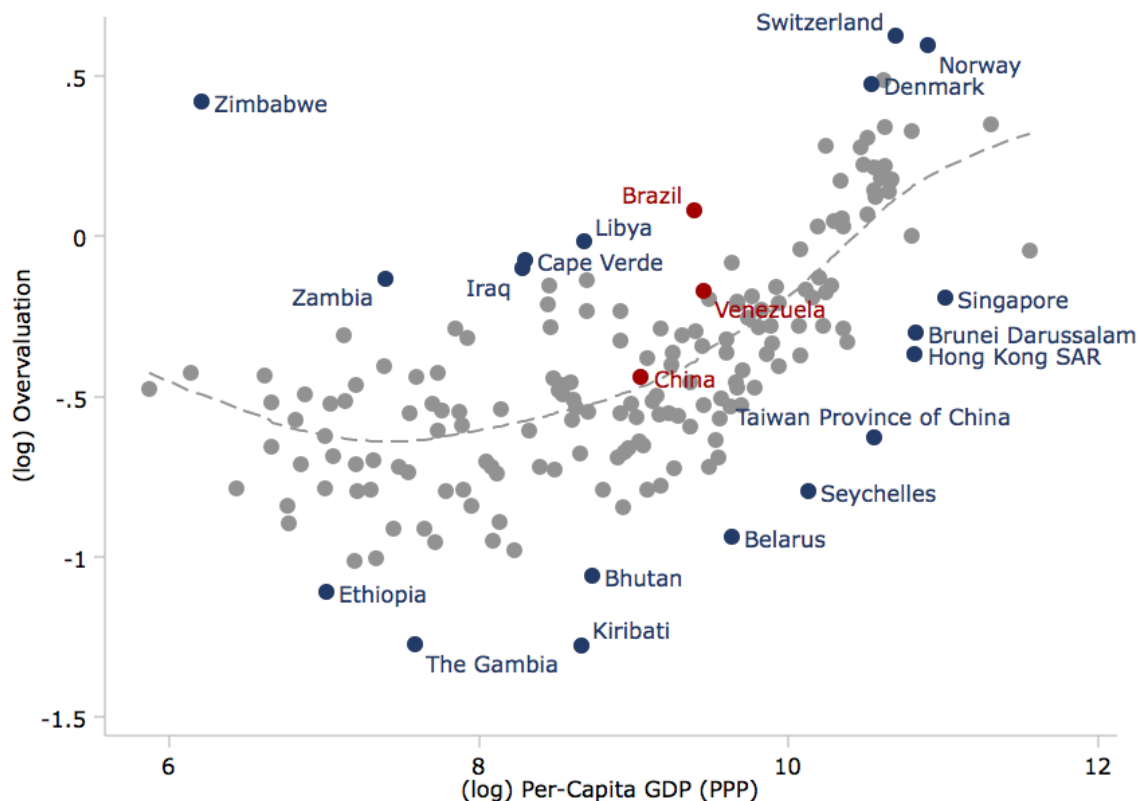
18 The year of the PPP survey. Other years are estimates based on GDP deflators.

19 This is mainly because of prices in the non-tradable goods and services sectors, which tend to be relatively lower in developing countries; and because the U.S. dollar is overvalued. In part, this *general* undervaluation of currencies represents an overvaluation of the dollar —the currency to which all the others are compared. As the dollar falls, there must be —by definition— a general appreciation of other currencies. For more on PPP measures, see Taylor and Taylor (2004).

20 The last year before the IMF assumed devaluation.

products; eight years ago this figure was 81 percent. Venezuela's manufacturing could potentially increase as a share of the economy, which has not happened over the past decade.

FIGURE 8
Relative Currency Values by Implicit PPP Exchange Rates, 2011



Source: IMF (2012), author's calculations.

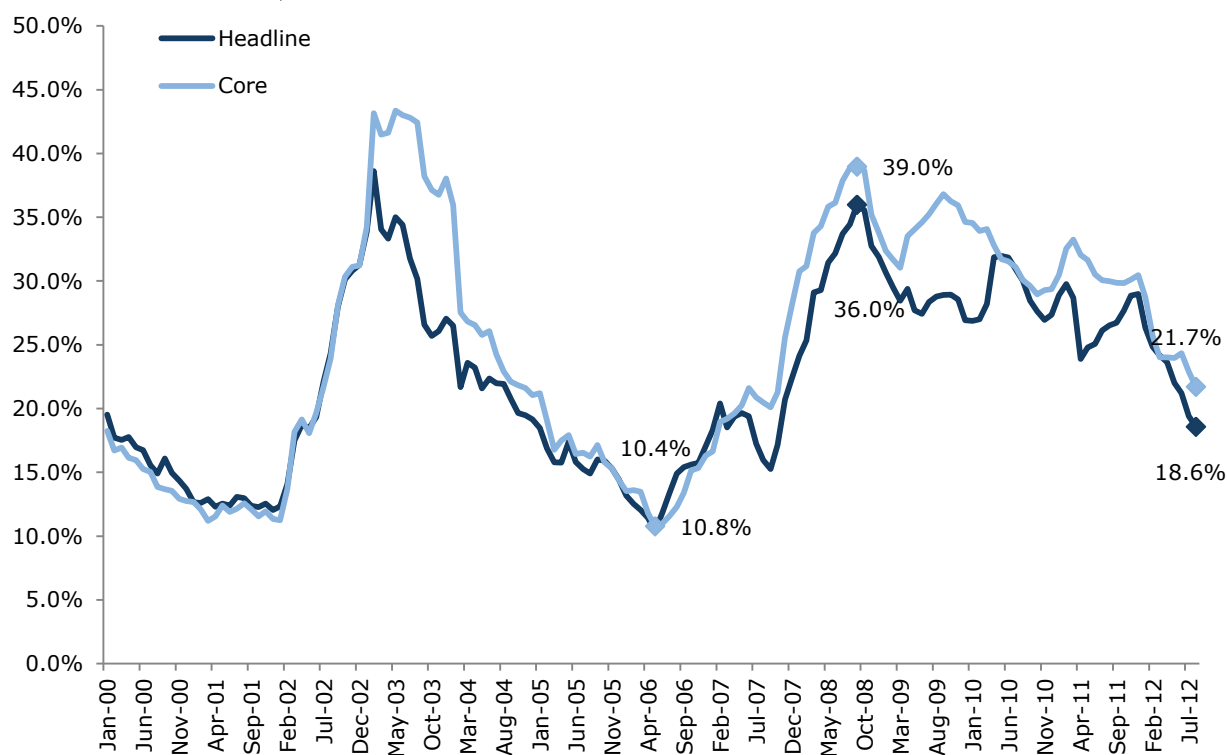
But that is a long-term policy question and is separate from the question of whether Venezuela can maintain its current exchange rate, given its export earnings. The current exchange rate could be maintained, given Venezuela's trade and current account surplus.

One problem, or at least fear, in moving to a more competitive real exchange rate – as Argentina managed successfully after its devaluation at the end of 2001– is the concern about inflation. Although inflation has been much lower over the past decade than in the pre-Chávez years, it has averaged about 22 percent annually since 2003. The consumer price index is shown in **Figure 9**. Most recently, inflation has been declining during the current recovery, even as growth has accelerated and the government has sharply increased its spending. As can be seen in Figure 9, year-over-year inflation peaked at 39 percent just as the economy was going into recession, in September 2008; it has fallen by more than half since then to its current level of 18.6 percent, with most of the decline coming in the two years since the recession ended. Over the last quarter, the Consumer Price Index (CPI) has grown at an annual rate of 13.7 percent, the lowest it has been in more than four years, as government spending has continued to increase and monetary policy has also been expansionary. Among the likely contributors to lower inflation have been the implementation of

price controls in November, 2011 and April 2012 on basic food and some other household items, and increased allocation of foreign exchange for imports (especially food).

Clearly, inflation in Venezuela is not well understood, at least not by most of the economists and analysts who write about it. We can see from the graph that the biggest decline in inflation, from February, 2003 to May, 2006 occurred when the economy was growing extremely rapidly. Inflation fell from 38.6 to 10.4 percent, while real GDP grew by 66.4 percent, or an annual rate of 17 percent. Of course, part of this growth was during a recovery from a deep recession, but the economy reached its pre-recession peak in the third quarter of 2004, and inflation continued to drop for two more years, from 22 percent to its low point of 10.4 percent. The often cited explanations that inflation in Venezuela is driven by excess demand, or by growth of the money supply, do not appear to fit the data in Venezuela. The fact that inflation can fall so quickly while the economy is growing rapidly is more evidence that inflation in Venezuela is to a large extent a supply-side phenomenon.

FIGURE 9
Venezuela: Caracas CPI, Year over Year



Source: Banco Central de Venezuela (2012), Table 4.1.6s.

The relation between inflation and the exchange rate also appears to not be well understood. When the government devalued the currency from 2.15 Bf to a dual system of 2.6 and 4.3, analysts were predicting that inflation would shoot up as high as 60 percent for the year;²¹ instead, it rose for four months (pushing year-over-year inflation from 26.9 percent in January to a peak of 32 percent in May) and then continued its decline to the present. Core inflation (excluding food and energy)

²¹ See, for example, Forero (2010) and Jaramillo (2010).

actually fell after the devaluation and continued its decline to the present. The limited effect of the devaluation may be partly due to the fact that import prices were already determined to a large extent by the black market rate at that time.

Whatever the actual underlying dynamics of inflation in Venezuela, fears of spiraling inflation in response to any foreseeable policy changes are without foundation. The current fixed exchange rate is 4.3, and the government has also established the SITME (Transaction System for Foreign Currency Denominated Securities) exchange rate of 5.3, which is the exchange rate for many importers. Even if the government were to devalue from the current 4.3 BF/dollar to 7, this would not be expected to cause a very large increase in inflation. As noted above, the last devaluation was about this size and was followed by only a brief, temporary rise in inflation, and no increase in the core rate.

As noted above, there is no need to devalue under the current exchange rate regime. Over the longer run, there are a number of policy options that the government can take in order to encourage Venezuelan firms and individuals with savings to keep their money in the country, and it is likely that the government will adopt some of them. For example, on July 19, 2012 the Venezuelan government published, in the Official Gazette, new rules that would allow some firms and individuals, for the first time in nearly ten years, to hold local bank accounts denominated in foreign currency.²²

It is often argued that the government must devalue so that it can have more Bolívares to spend, for each dollar of foreign exchange earnings. But this not true. As noted above, domestic spending can be financed through domestic borrowing; it can also be financed through credit from the central bank, so long as the country is not facing a rising inflation rate due to excess demand. But in any case domestic spending does not depend on the dollar export earnings of the public sector. The Venezuelan economy's foreign exchange constraint is that it has to have enough dollars to cover its imports, plus a reasonable amount of reserves.

Over time, it would be good if Venezuela could develop a foreign exchange regime that sharply reduced or eliminated the speculation against the currency, as well as the black market. This should not be too difficult to accomplish in a country where almost all of the foreign exchange earnings accrue to the public sector, and where the economy is almost always running current account surpluses. It is primarily a question of administrative capacity and choosing the best exchange rate regime. But even under the current exchange rate regime, there is no need to devalue; even if the current account were to temporarily fall into deficit, as it did for two quarters when oil prices collapsed in 2008-2009, the government has more than enough foreign borrowing capacity to maintain the exchange rate at its desired level.

22 Banco Central de Venezuela (2012b).

Oil Prices

A recurring pessimistic scenario has been based on a collapse of oil prices, which provide about 95 percent of Venezuela's foreign exchange earnings. This is what happened in the fourth quarter of 2008; although much of the price drop recovered within six months.

As noted above, Venezuela had the capacity to borrow in order to finance counter-cyclical spending when oil prices collapsed. Since its debt burden remains quite low, it would be able to do this if there were another temporary drop in oil prices; and it is likely that it would, in order to avoid another recession.

A long-term drop in oil prices would of course present a bigger problem, although Venezuela's borrowing capacity would enable the government to adjust over a long time to any such change. However, such a long-term price decline is very unlikely. **Table 3** shows various forecasts for future real oil prices from the U.S. Energy Information Administration's Annual Energy Outlook. Almost all of them show higher real oil prices in the years and decades ahead.

TABLE 3
Projections of Oil Prices 2015-2035 (2010 Dollars per Barrel)

	2015	2020	2025	2030	2035
AEO2012	116.91	126.68	132.56	138.49	144.98
AEO2011	95.41	109.05	118.57	124.17	126.03
EVA	82.24	84.75	89.07	94.78	102.11
IEA	106.3	118.1	127.3	134.5	140
INFORUM	91.78	105.84	113.35	117.83	116.76
IHSGI	99.16	72.89	87.19	95.65	98.08
Purvin & Gertz	98.75	103.77	106.47	107.37	107.37
SEER	94.2	101.57	107.13	111.26	121.94

Source: U.S. Energy Information Administration (2012).

Investment

Figure 10 shows gross fixed capital formation, public and private, since 1999, as a percent of GDP. Private capital formation declined during the political turmoil of 1999-2003, dropping from 16 percent of GDP to its low point of 8 percent of GDP in 2003. However, it grew very fast after the government won control over the oil industry, during the rapid recovery of 2003-2007, growing to 12.9 percent of GDP in 2007, then falling sharply with the recession. During this period, private investment grew more rapidly than public sector investment.

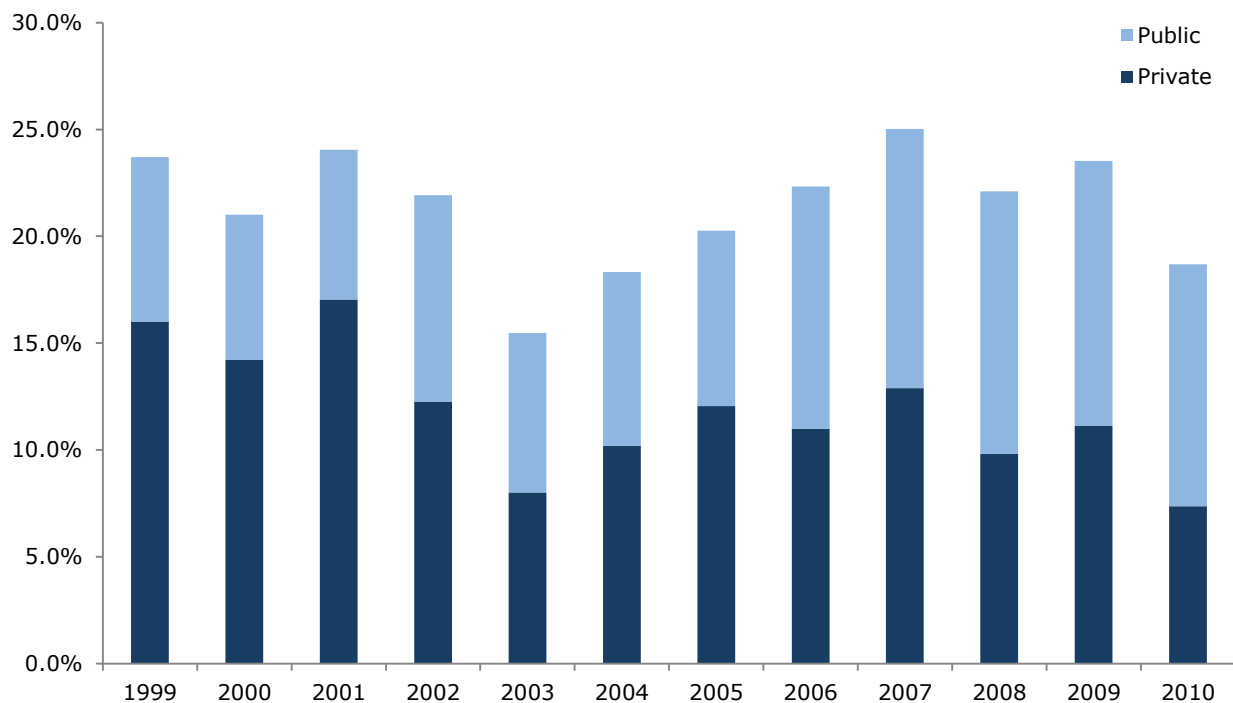
This is important because it shows that private investors will invest in Venezuela's economy when it is growing and expected to continue growing. Although much has been written about the effect of nationalizations on the investment climate, the probability of any individual company being nationalized is very small, and investors face much bigger risks with regard to uncertainty over future

prices and demand for their output. So private sector investment is likely to grow again with the current economic recovery. As can be seen in Figure 10, public sector investment also grew rapidly during the recovery, from 7.5 percent of GDP in 2003 to 12.1 percent in 2007, while GDP was soaring.

Figure 11 shows overall gross fixed capital formation, in real (inflation-adjusted) terms, through the first half of this year. (Data separating capital formation into public and private, shown in Figure 9, are only available through 2010). As can be seen, total investment dips during both recessions, but then recovers. Total gross fixed capital formation in the first half of 2012 was about 33 percent of GDP.

This is a relatively high rate of investment for the region; the corresponding figures for Brazil and Mexico are about 20 percent and 23 percent, respectively.²³ Nonetheless, there is a need for more public investment in infrastructure, including water, transportation, utilities, roads, bridges, ports, communications (including internet), hospitals, and electricity. If it takes some time for private sector investment to reach sufficient levels in this recovery, the government can compensate for this with increased public investment – as with its successful housing stimulus over the past year. This public investment is badly needed in any case, and can be a major source of growth and development in the years ahead.

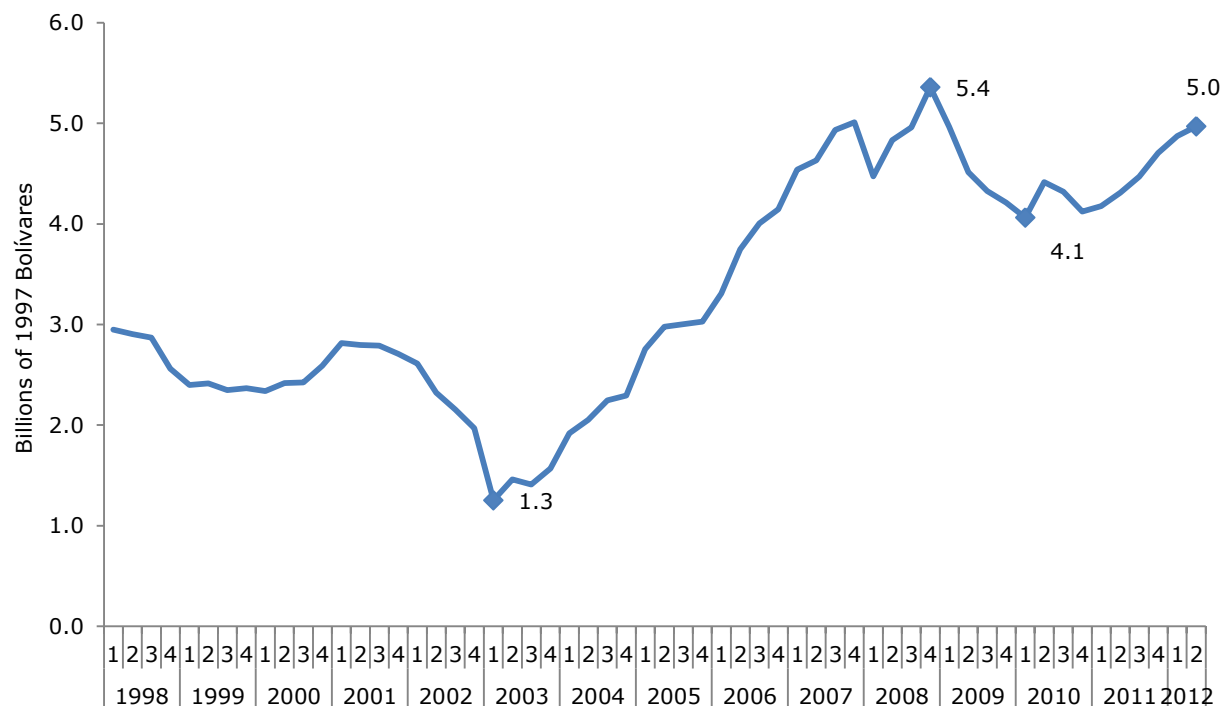
FIGURE 10
Venezuela: Gross Fixed Capital Formation, Public vs. Private



Source: Banco Central de Venezuela (2012), Table 7.1.12.

²³ Data is for the first quarter of 2012.

FIGURE 11
Venezuela: Real Gross Fixed Capital Formation (Seasonally-Adjusted)



Source: Banco Central de Venezuela (2012), authors' calculations.

Poverty

It is worth noting that both poverty and extreme poverty have seen a large decline in Venezuela over the past 13 years. This can be seen in **Table 4**. Measuring from 1999 – ignoring that the government could not do much of anything during the first four years – poverty has fallen from 42.8 percent of households to 26.7 percent, or a 37.6 percent decline in the poverty rate. Measuring from 2004, when political stability returned and the government had control over the oil industry, the decline is 49.7 percent. As can be seen in Table 4, the poverty rate inched up slightly during the 2009 recession.

Extreme poverty declined even more, from 16.6 to 7.0 percent from 1999 to 2011, or a 57.8 percent decline. Measuring from 2004, the decline is 70 percent.

However, these figures do not include the most recent program, introduced in December 2011, which pays 430 BF (\$100) per month for each child and pregnancy to families below the extreme poverty level. This is expected to lower the extreme poverty rate by half, to about 3.5 percent.²⁴

It is also important to note that these poverty rates include only cash income. They do not include the populations' increased access to education – for example, college enrollment has doubled since 2004, with free tuition for many students. It also does not include the increased access for millions of people to health care.

²⁴ Agencia Venezolana de Noticias (2012).

TABLE 4
Venezuela: Poverty and Inequality

Year	Time Period	Households (% of total declared)		Population (% of total declared)		Inequality
		Poverty	Extreme Poverty	Poverty	Extreme Poverty	Gini Index
1997	1st Half	55.6	25.5	60.9	29.5	0.487
	2nd Half	48.1	19.3	54.5	23.4	
1998	1st Half	49.0	21.0	55.4	24.7	0.486
	2nd Half	43.9	17.1	50.4	20.3	
1999	1st Half	42.8	16.6	50.0	19.9	0.469
	2nd Half	42.0	16.9	48.7	20.1	
2000	1st Half	41.6	16.7	48.3	19.5	0.477
	2nd Half	40.4	14.9	46.3	18.0	
2001	1st Half	39.1	14.2	45.5	17.4	0.457
	2nd Half	39.0	14.0	45.4	16.9	
2002	1st Half	41.5	16.6	48.1	20.1	0.494
	2nd Half	48.6	21.0	55.4	25.0	
2003	1st Half	54.0	25.1	61.0	30.2	0.481
	2nd Half	55.1	25.0	62.1	29.8	
2004	1st Half	53.1	23.5	60.1	28.1	0.456
	2nd Half	47.0	18.6	53.9	22.5	
2005	1st Half	42.4	17.0	48.8	20.3	0.475
	2nd Half	37.9	15.3	43.7	17.8	
2006	1st Half	33.1	10.2	38.9	12.5	0.442
	2nd Half	30.6	9.1	36.3	11.1	
2007	1st Half	27.5	7.6	33.1	9.4	0.424
	2nd Half	28.5	7.9	33.6	9.6	
2008	1st Half	27.7	7.5	33.1	9.2	0.410
	2nd Half	27.5	7.6	32.6	9.2	
2009	1st Half	26.4	7.3	31.7	8.9	0.418
	2nd Half	26.7	7.5	31.8	8.8	
2010	1st Half	26.8	7.1	32.5	9.0	0.390
	2nd Half	26.9	6.9	32.5	8.6	
2011	1st Half	27.4	7.3	33.2	8.9	0.390
	2nd Half	26.7	7.0	31.9	8.6	

Source: Instituto Nacional de Estadística (2012).

Conclusion

The Venezuelan economy has had two recessions in the past thirteen years. The first was brought on by an oil strike, and the second – which could probably have been avoided with sufficient counter-cyclical policies – was during the world recession of 2009. The predictions of economic collapse, balance of payments or debt crises and other gloomy prognostications, as well as many economic forecasts along the way, have repeatedly proven wrong.

The sharp fall in inflation over the past year indicates that the government has the ability to keep inflation under control while maintaining economic growth. As we have seen, Venezuela's internal debt burden is very low, and its external debt burden is modest. Even if oil prices were to crash as they did in 2008-2009, the government would have plenty of capacity to borrow in order to counter a drop in private demand. The previous economic recovery showed that private investment was forthcoming, as would be expected, when the economy grows; but the government can also replace lagging private investment with public investment, which is very much needed in order to increase the productivity of the economy.

With a sizeable trade surplus, Venezuela is unlikely to see any balance of payments crisis in the foreseeable future, and its currency does not have to be devalued. While in the long run the government may want to consider other currency regimes, there is no obvious reason that the current system could not be maintained. For all of these reasons, the current economic recovery is sustainable.

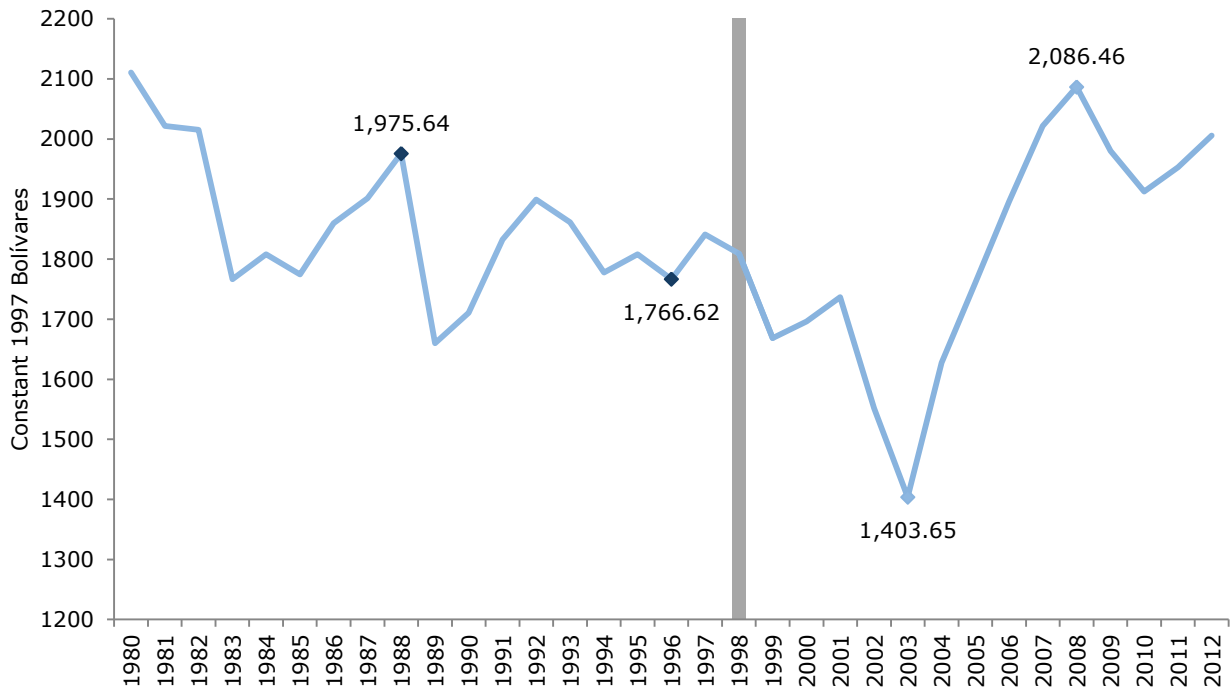
An unsustainable economic expansion is one in which there are imbalances that cannot be maintained. Examples would include the U.S. economy in 2006, or a number of other economies (e.g. Spain, U.K., Ireland) that had large real estate bubbles that would inevitably have to burst. Economies with unaffordable debt service, or large current account deficits can also face inevitable adjustment – although even in these cases there are usually feasible alternatives to recessions, or at least to severe or prolonged recession. But Venezuela does not face any such inevitable, sharp adjustment that would push the economy into recession.

As can be seen in **Figure 12**, from 1980-1998, Venezuela's per capita GDP actually declined by 14 percent. It was one of the worst economic performances in a region that, as a whole, experienced its worst long-term growth failure in a century.

Since 1998, the economy has had modest per capita GDP growth, and much higher growth since political stability was restored and the government got control over the oil industry. Measuring from 2004, when the economy reached its pre-recession peak, GDP per person has grown by an average of 2.5 percent annually. As noted above, this growth led to a large reduction in poverty and extreme poverty, as well as numerous other gains in health care and education due to increases in social spending. And as **Figure 13** also shows, as high as Venezuela's 22 percent annual rate of inflation has been (since 1998), it was much worse (34 percent) in the pre-Chávez years.

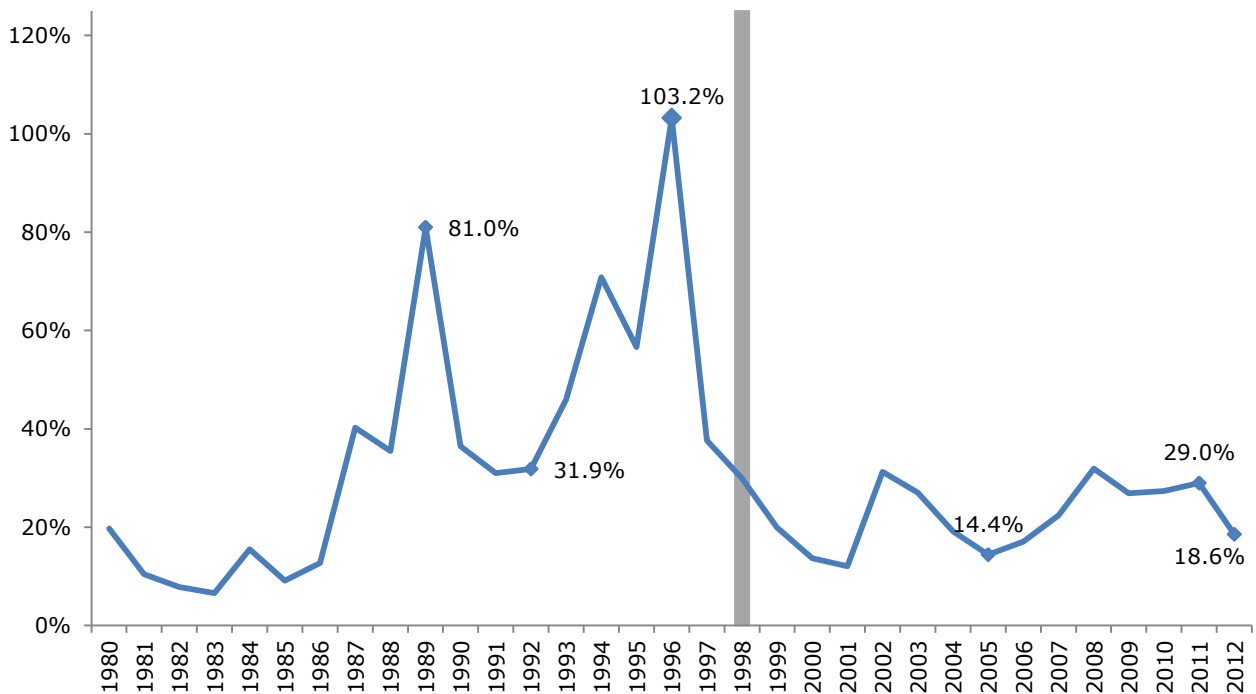
Venezuela has about 500 billion barrels of oil, according to the U.S. geological survey estimates, the largest in the world. Its proven reserves are about 300 billion barrels. The country is currently using about 1 billion barrels of those reserves per year. So long as political stability is maintained – and it has been since the government got control of the national oil industry in 2003 – Venezuela will have the ability, with reasonable macroeconomic policies, to maintain solid rates of economic growth.

Figure 12
Venezuela: Per-Capita GDP, Before and After Chávez



Source: International Monetary Fund, World Economic Outlook (2012).

Figure 13
Venezuela: Inflation, Before and After Chávez



Source: Banco Central de Venezuela (2012), Table 4.1.6s
 Notes: Data for 2012 is Year-over-Year as of August, 2012.

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