

GENERAL

E/CN.12/166/Add.9
18 April 1950

ORIGINAL: ENGLISH

ECONOMIC COMMISSION FOR LATIN AMERICA
Third session
Montevideo, Uruguay
5 June 1950

LEGAL AND ECONOMIC STATUS OF FOREIGN INVESTMENTS
IN SELECTED COUNTRIES OF LATIN AMERICA

Prepared by the Secretariat

POLICIES AFFECTING FOREIGN INVESTMENTS IN VENEZUELA

Table of Contents

	<u>Page</u>
Introduction	2
I. General controls	4
A. Nationality of ownership	4
B. Taxation	6
C. Transfer of earnings and capital	10
D. Personnel	12
E. Commercial policy	12
II. Control of the petroleum industry	14
III. Government participation in industry	16

1/ This document has been reproduced in New York from the original issued at Montevideo.

INTRODUCTION

As the result of foreign interest in the extraction of petroleum, Venezuela has probably received a larger amount of foreign capital for direct investment in the post-war period than any other country. The net inflow of such capital from the United States during the years 1945-1948 inclusive was \$489 million, of which 90 to 95 per cent was invested in the petroleum industry.^{1/} During this period Venezuela absorbed over half of the addition to United States investments in Latin America and about a third of those in the world as a whole.

Since 1943, the year of the last official United States census of foreign assets, the value of United States investments in Venezuela has more than doubled. The predominance of foreign investments in petroleum is shown in table 1, which relates to 1943. In the post-war period substantial additions have also been made to previous investments in petroleum by British and Dutch

^{1/} This figure includes the reinvested earnings of branches but excludes the reinvested earnings of subsidiaries which represented more than 60 per cent of the value of United States direct investments in Venezuela in 1943. In 1945 and 1946 inclusive the reinvested earnings of subsidiaries amounted to \$29 million.

interests. The assets in Venezuela of the Royal Dutch-Shell group increased by some \$50 million in 1947 and by \$80 to \$100 million in 1948.^{2/}

Table 1

Value of United States direct investments in Venezuela,
by industrial groups, 31 May 1943

(In millions of United States dollars)

Manufacturing	1.3
Petroleum	341.1
Public utilities and transportation	7.9
Trade	1.6
Finance	16.3
Miscellaneous	4.7
Total	372.9

Source: United States Treasury Department, Census of American-Owned Assets in Foreign Countries, (1947), page 70.

Venezuela is one of the few countries in Latin America the Government of which did not raise any foreign loans during the 1920's in the United States. In fact, the external public debt, which amounted to 113 million bolivares in 1914, steadily declined to 357 bolivares in 1929 (\$7 million at the prevailing rate of exchange).^{2/} In recent years Venezuela has borrowed to a small extent from foreign governmental agencies, particularly the

^{1/} Figures based on data from annual reports of Venezuela Oil Concessions, Limited, which accounts for two-thirds of the Royal Dutch-Shell group's output in Venezuela (see United Nations, World Economic Report, 1948, page 244).

^{2/} United Nations, Public Debt, 1914-1946, (1948), page 157

United States Export-Import Bank. Including a credit of \$5.2 million for the purchase of electrical equipment authorized in November 1949, credits authorized by the Export-Import Bank during the period 1941-1949 totalled \$12.4 million.

I. GENERAL CONTROLS

A. Nationality of ownership

Foreigners may engage in practically all significant types of economic activity on the same basis as Venezuelan nationals, including industries requiring government concessions, such as mining and petroleum extraction. ^{1/} The limitations on this right are relatively unimportant. For security reasons the Federal Executive may prohibit the transfer to foreign companies or individuals of lands or buildings located within 25 kilometres of the frontier. ^{2/} Banking activities may be engaged in by foreign enterprises only if they are legally domiciled in the country. While domestic air transport activities are reserved to domestically-owned airlines, the Government may permit foreign airlines to engage in such service temporarily for reasons of "general interest or special advantages to the country". ^{3/} Foreign companies are free to

^{1/} These concession industries, in fact the most important in the Venezuelan economy, have been developed almost exclusively by foreign capital.

^{2/} Article 17 of the law of Expropriation of 4 November 1947. The power may be enforced by expropriation of such holdings.

^{3/} Article 6 of the Civil Aviation Law of 13 June 1944.

/to engage in

engage in the insurance business but must make higher initial deposits of funds or securities than domestic companies as guarantee of financial responsibility.

Foreign enterprises may generally carry on business operations in Venezuela either by forming a local company or by establishing agencies or branches of foreign parent companies. As of 31 May 1943, some 62 per cent of the total assets of United States-owned enterprises were represented by local corporations and 38 per cent by branches ^{1/}

A provision in the Venezuelan Constitution relating to procedure in the event of a dispute arising from a contract with the Government or a public authority has a bearing on foreign investments in the petroleum and mining industries, since such investments are regulated by concession contracts with the government. Pursuant to this provision all such contracts are subject to the following clause: "Disputes and controversies of any nature which may arise with respect to this contract, and which cannot be amicably settled by the contracting parties, shall be decided by the competent courts of Venezuela". ^{2/}

^{1/} United States Treasury Department, op cit., page 72.

^{2/} According to Article 50 of the Constitution of 1936, as amended by the regulations of 5 May 1945.

In connexion with the expropriation of foreign investments, it may be observed that Venezuela expressed a formal reservation with respect to a clause contained in the Economic Agreement of Bogotá, signed at the Ninth International Conference of American States on 2 May 1948. The position of Venezuela was that "it in no case will (Venezuela) admit the preeminence of international treaties or agreements over the text of its Constitution, nor will it accept any jurisdiction for foreign investments other than that of its own courts." Under the Constitution, however, the property of both domestic and foreign nationals is subject to expropriation only for reasons of "public or social utility" and prior indemnification is required.

B. Taxation

Venezuelan taxes are administered without discrimination as to the nationality of the taxpayer. However, higher rates of taxation apply in the mining and petroleum industries which are almost exclusively foreign-owned. The imposition of a graduated surtax on incomes also results in effect in heavier taxation on foreign-owned than on national enterprises since foreign-owned enterprises, being comparatively large, generally earn higher incomes than domestic concerns. Furthermore, personal income tax rates are higher for non-residents than for residents.

Net profits of industrial, commercial and mining enterprises are subject to a basic tax rate of 2.5 per cent.^{1/} A graduated

^{1/} Income Tax Law of 12 November 1948, superceding the law of 7 July 1942, and its amendments of 27 July 1944, and 30 December 1946. /surtax

surtax is levied on all taxable income in excess of 9,000 bolivares per annum. ^{1/} Rates (Draft not legible) per cent on incomes between 9,000 and 10,000 bolivares to 26 per cent on incomes over 28 million bolivares. Certain reductions in the rates are granted to enterprises with taxable incomes exceeding 14 million bolivares, depending on the extent to which they reinvest their earnings. In the case of income in excess of 28 million bolivares, to which the maximum rate of 26 per cent is applicable, the rate is reduced to 22 per cent on the amount reinvested.

Legislation also provides for compulsory profit-sharing with employees by all business enterprises to the extent of 10 per cent of annual profits. The employees' shares are proportionate to their regular wages but in no case are to exceed two months' wages.

Petroleum companies are subject to a so-called exploitation tax or royalty of $16 \frac{2}{3}$ per cent on all oil produced, payable in cash or in kind. Other taxes on petroleum operations are minor and include an initial exploration tax and a so-called initial exploitation tax. The taxes paid by the twelve major petroleum companies in relation to their net income are shown in table 2.

^{1/} One bolivar = \$0.2985 in United States currency.

Table 2

Taxes paid by petroleum companies^{a/}

(In millions of dollars)

	<u>1948</u>	<u>1943-1948 inclusive</u>
Taxes paid:		
Exploitation tax (royalties)	204	538
Income taxes	151	368
Import duties	15	47
Concession-carrying taxes	10	56
Initial exploration and exploitation taxes	13	51
Annual exploration taxes	1	12
Services	6	25
Miscellaneous	11	34
	<hr/>	<hr/>
Total	411	1,131
Net income (before taxes)	788	2,102
Taxes as percentage of net income	52	54

a/ Adapted from J. E. Pogue, Oil in Venezuela, (New York: Chase National Bank, 1949), page 26. Figures relate to the twelve major petroleum companies operating in Venezuela.

It will be observed that in 1948 taxes paid were 52 per cent of the companies' net income before taxes. In 1948 the income tax law was revised to ensure that total taxes paid by petroleum and mining companies should equal 50 per cent of their net income.

This was accomplished by a provision that such companies should pay, in addition to the taxes referred to, a special tax determined according to the so-called "50-50" formula. The minor exploration and initial exploitation taxes are not counted for this purpose. The rate of 50 per cent applies, regardless of the

/size

size of income, to incomes in excess of 15 per cent of invested capital ("patrimony"). Enterprises whose net income after normal tax and surtax is less than 10 per cent of invested capital are exempt from the additional tax, and enterprises earning net incomes between 10 and 15 per cent of invested capital are subject to only half the additional tax. The Government is also authorized to accord complete or partial tax exemption for a specified period to new mining enterprises. The importance of the petroleum industry in the country's fiscal system is indicated by the fact that revenue collected from the industry constituted 50 per cent of Government revenue in 1943 and 72 per cent in 1948, averaging 64 per cent during the period 1943-1948.

At the levels of earnings prevailing in 1948 the new tax law does not involve a substantial change in the tax liabilities of the major petroleum companies. The net income of the major companies increased from \$32 million in 1943 to \$377 million in 1948, representing 27.7 per cent of invested capital ("net worth") in the latter year.^{1/} The profits of the industry are highly sensitive to the price of petroleum in world markets however, and petroleum prices have recently declined. It has been reported that a provision in the concession agreements between the Minister of Public Works and the petroleum companies relating to the payment of certain taxes was denounced by the companies on 1 October 1949 following the decline in petroleum prices and that there has been a resulting delay in the payment of taxes due, pending the conclusion of new

^{1/} J.E. Pogue, *op. cit.*, page 13

arrangements. This situation resulted in greatly reduced receipts of dollar exchange by the central Bank in January 1950.^{1/}

C. Transfer of earnings and capital

The exchange transactions of foreign-owned enterprises are not subject to official limitation in Venezuela except that the foreign exchange proceeds of petroleum sales that are utilized by the companies to meet local expenditure must be surrendered at the official buying rate of exchange.

Petroleum companies buy local currency from the Central Bank for their expenses in Venezuela at the rates of 3.09 and 3.03 bolivares to the dollar. The rate of 3.09 applies to the bulk of the sales of foreign exchange by the companies, the balance being bought at the rate of 3.03. The general buying rate for foreign exchange is 3.32 bolivares to the dollar. The basic selling rate is 3.35 bolivares to the dollar for all transactions except some government operations to which the rate of 3.09 applies. The difference between the rates at which exchange is bought from the petroleum companies and sold to importers constitutes a source of revenue for the Government.

The favourable balance of payments situation of Venezuela during the war and post-war years is reflected in the substantial increase in official and commercial bank holdings of gold and foreign exchange, largely dollars. These holding increased steadily

^{1/} Based on information appearing in El Nacional, (Caracas), 10 and 12 March 1950, as reported by the International Monetary Fund, International News Survey, (24 March 1950).

from \$59 million at the end of 1939 to \$406 million at the end of 1948, and were \$410 million at the end of September 1949. The last-mentioned figure equalled about 80 per cent of the average annual value of imports during the years 1946-1948.

In 1948 96 per cent of the country's exports consisted of petroleum. In that year the foreign petroleum companies (and their employees) surrendered to Venezuela foreign exchange amounting to \$687 million (net). This represents chiefly the expenditure of the companies for current operations and investment outlays (including reinvested earnings) and payments to the Government on account of taxes and royalties. Imports by the petroleum companies for their own account were \$201 million and the net inward capital movement represented by these enterprises was \$324 million. A large part of the new investment represented reinvestment of earnings. Total earnings (distributed and reinvested) amounted to \$430 million.^{1/}

Excluding the transactions of the petroleum companies, there was a deficit on current account in Venezuela's balance of payments of \$528 millions in 1948. The difference between this deficit and the \$687 million surrendered by the petroleum companies is reflected in the increase of gold and dollar balances of \$129 million. Inward capital movements for investments in industries other than petroleum were small; in fact, there was recorded a net outflow of private capital of \$5.5 million.

^{1/} According to J. E. Pogue, *op cit.*, in 1948 reinvested earnings of the twelve major companies were 70 per cent of net income after taxes.

D. Personnel

Venezuelan law requires that 75 per cent of all manual and clerical workers of an enterprise must be domestic nationals, but this proportion may be reduced temporarily if it is necessary to use foreign personnel with specialized technical knowledge.^{1/}

Similarly, foremen and other supervisory personnel must be Venezuelans, but exception is made for technical specialists and higher supervisory personnel, such as office chiefs, department heads and managers. No wage differentials are permitted on the basis of nationality.

In practice foreign-owned enterprises in Venezuela employ substantially more domestic personnel than the legal minimum of 75 per cent. It is reported that 93 per cent of the employees in the petroleum industry are Venezuelans.^{2/}

E. Commercial policy

The establishment of manufacturing industries to supply the domestic market has been encouraged by high import duties on manufactures, import quotas on selected products, and reductions in or exemptions from duties for the equipment and materials needed by local industries.

The Venezuelan tariff has long been considered one of the highest in the world. Some reductions have been made in recent years, largely on machinery and raw materials for industry. The

^{1/} Labour law of 16 July 1936, as amended 4 May 1945 and 3 November 1947.

^{2/} J.E. Pogue, op. cit., page 14.

scope of import quotas, originally established before the Second World War to aid the cotton textile industry, has been extended in recent years to other consumers' goods.

New industries and existing enterprises being expanded are eligible for reductions in or exemptions from import duties on machinery, tools, equipment, raw materials and other articles necessary for their operation or maintenance, except to the extent that these products are available locally.^{1/} Until 1943 the petroleum industry was accorded duty-free entry of all equipment and materials necessary for operation. This general exemption was abolished by the Petroleum law of 1943; but exemption may be granted in particular cases.^{2/} Exemption from import duties on machinery and equipment is provided to mining enterprises and railways by general legislation.

Foreign capital has not responded to any appreciable extent to the official policy of promoting manufacturing industries. The value of United States direct investments in Venezuelan manufacturing industries was \$0.5 million at the end of 1940

^{1/} Organic Law of National Finance, 15 July 1938, and Resolution No. 95, 6 June 1939.

^{2/} Import duties paid by the petroleum industry increased from \$3 million in 1943 to \$15 million in 1948.

and \$1.3 million as of 31 May 1943.^{1/} An inflow of United States capital into manufacturing, amounting to \$2 million, did, however, occur during the years 1945-1947.^{2/}

II. CONTROL OF THE PETROLEUM INDUSTRY

The impact of fiscal and exchange controls on the petroleum industry has already been indicated: the policy of taxation is based on the principle of equal participation by the Government and the private companies in the net profits realized; the foreign exchange proceeds from sales of petroleum may be retained or freely transferred, the portions returned to the country for local expenditure being converted at a rate of exchange slightly less favourable than is applied to other transactions.

The Hydrocarbon Law of 17 March 1943 provides for special controls on the industry.

Petroleum deposits may be exploited either directly by the Government or by private persons under concessions granted by the Government.^{3/} No such concessions may be acquired by a foreign government. Concessions for exploration are granted for

^{1/} United States Department of Commerce, American Direct Investments in Foreign Countries - 1940 (1942), page 13; United States Treasury Department, op. cit. page 70.

^{2/} United States Department of Commerce, Survey of Current Business (November 1949), page 22.

^{3/} It was reported in mid-1949 that no new petroleum concessions had been granted by the Government since 1945.

a period of three years and for exploitation for forty years, subject to renewal for an additional period of forty years. Upon the termination of a concession, the Government re-acquires without cost the land as well as all the permanent installations that have been constructed. The law repeats the principle embodied in the Constitution that disputes relating to concessions that cannot be settled amicably shall be decided by Venezuelan courts and under no circumstances may give rise to foreign governmental claims.

The law also authorizes the Government to take appropriate measures to develop petroleum refining. Pursuant to this provision, it has become obligatory for holders of new concessions granted after adoption of the Law in 1943 to refine within the country one-tenth of their production, with the auxiliary requirement that none of the remaining nine-tenths be refined in the Caribbean area outside of Venezuela. This requirement has not been applied, however, to holdings of concessions under previous laws or to old concessions modified in accordance with the 1943 statute.^{1/} About 9 per cent of the crude petroleum produced in 1948 was refined in the country.^{2/}

1/ Virtually all the companies operating in Venezuela have replaced their existing concessions with forty-year concessions under the new law.

2/ Banco Central de Venezuela, Memoria Correspondiente al Ejercicio Annual 1948, (Caracas) page 22.

III. GOVERNMENT PARTICIPATION IN INDUSTRY

Direct participation in industry by the Venezuelan Government is on a limited scale. The Agricultural and Livestock Bank, the principal function of which is to supply credit, operates slaughterhouses, rice, coffee and flour mills, and grain storage facilities. It also holds shares in the Great Colombian Merchant Fleet, a shipping company owned jointly by the Governments of Venezuela, Colombia and Ecuador. Another Government-owned shipping company, primarily engaged in coastwise and inland river shipping, has recently expanded into overseas operation. A Government-owned airline engages in both domestic and international operations. The important railroads are owned or operated by the Government through a State Railways Institute.

The importation and sale of matches and cigarette paper are government monopolies. The Government also participates in a limited number of other activities and industries through various agencies and corporations. The National Supply Commission is empowered to buy and sell articles of "prime necessity" in order to carry out the objective of controlling the prices of such commodities. Certain salt beds are directly exploited by the State.

The Venezuelan Development Corporation, (Corporación Venezolana de Fomento) a governmental agency, was established in 1946. Modelled after similar agencies previously established in Chile, Colombia and Mexico, the Development Corporation is intended to stimulate investment in the production of basic commodities and in enterprises

/providing

providing various public services that are of such a size or nature that they are not attractive to private enterprise. It may operate its own enterprises or participate in enterprises jointly with private capital and also guarantee in whole or in part the securities issued by private enterprises and the interest thereon.^{1/} The resources of the Corporation are provided from an initial fund of 90 million bolivares (\$27 million) augmented by annual appropriations of not more than 10 per cent of the Federal budget. Thus far the bulk of its resources has been devoted to food production, but smaller investments have been made in a cement plant and in a plant for the generation of electric energy. The total loans and investments of the Corporation were 110 million bolivares (\$33 million) in 1948 and 75 million bolivares (\$22 million) in the first half of 1949.^{2/}

Part of the Development Corporation's operations have been undertaken in co-operation with the Venezuelan subsidiary of the International Basic Economy Corporation (IBEC), a private enterprise organized in the United States in 1947 with an initial capital of \$7 million. The IBEC has advanced \$2 million to its Venezuelan subsidiary; in addition the subsidiary has issued \$14.5 million of non-voting preferred shares, of which \$10 million have been subscribed by the foreign petroleum companies and \$ 4.5 million by the Development Corporation. The enterprises thus far established

^{1/} For a full account of the Corporation's organization and powers see United Nations, Economic Development in Selected Countries, (1947), pages 134-143.

^{2/} See Ministerio de Hacienda, Boletín Informativo, (Caracas, July 1949), page 84.

through these arrangements are engaged in farming, fishing, dairy production and the wholesale distribution of food. The fishing venture has provided motorized fishing vessels and established a refrigeration plant. The farming enterprise is engaged mainly in the production of improved crops, chiefly corn, and the raising of livestock. The operations in food distribution are reported to account for about 10 per cent of the distribution of foodstuffs in Venezuela at the wholesale level. It is the stated policy of the parent company to offer half of the voting stock in the Venezuelan subsidiary for sale to local investors after five years and to offer majority ownership of the enterprise for sale to Venezuelan investors after the end of ten years.