

**IDB COUNTRY STRATEGY WITH THE
BOLIVARIAN REPUBLIC OF VENEZUELA**

(2011-2014)

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ELECTRONIC LINKS

Electricity	Electricity sector note
Water and sanitation	Water and sanitation sector note
Natural disasters	Natural disaster risk management sector note
Social protection	Social protection sector note
Fiduciary	Fiduciary technical note
Macro	Macroeconomic and debt sustainability analysis
Infrastructure	Infrastructure, growth, and poverty: Why are infrastructure interventions key in Venezuela?
Sector priorities	Diagnostic assessment: Sector priorities. Venezuela 2011-2014
Consultation process	Consultation process with social actors

ABBREVIATIONS

CAF	Andean Development Corporation
CNG	Centro Nacional de Gestión del Sistema Eléctrico [National Management Center for the Electricity System]
ConSOC	Civil Society Consulting Group
CORPOELEC	Corporación Eléctrica Nacional
GDP	Gross domestic product
FESNOJIV	Fundación del Estado para el Sistema Nacional de Orquestas Juveniles e Infantiles de Venezuela [State Foundation for the National System of Youth and Children's Orchestras of Venezuela]
HIDROVEN	C.A. Hidrológica Venezolana
IIES	Instituto de Investigaciones Económicas y Sociales [Economic and Social Research Institute]
LOPNA	Ley Orgánica para la Protección de los Niños, Niñas y Adolescentes [Child and Teen Protection Act]
LOPSAPS	Ley Orgánica para la Prestación de Servicios de Agua y Saneamiento [Water and Sanitation Service Delivery Act]
OMJ	Opportunities for the Majority
ORP	Office of Outreach and Partnerships
PNDSB	Plan Nacional de Desarrollo Simón Bolívar (2007-2013) [Simón Bolívar National Development Plan (2007-2013)]
PDVSA	Petróleos de Venezuela, S.A.
SIGECOF	Sistema Integrado de Gestión y Control de las Finanzas Públicas [Integrated Public Finance Management and Control System]
STGIR	Secretaría Técnica de Gestión Integral de Riesgos [Technical Secretariat of Integrated Risk Management]

EXECUTIVE SUMMARY

- The Bank in Venezuela:** Given the size of the Venezuelan economy and the financing strategy pursued by the country, the Bank has played a relatively small role in public finance in the Bolivarian Republic of Venezuela (hereinafter “Venezuela”). However, in those sectors where it has provided support, the Bank has been an important source of technical assistance and has put its support at the country’s service.
- Priority sectors:** Within the framework of the [Simón Bolívar National Development Plan \(PNDSB\)](#), the Venezuelan authorities and the Bank have identified four strategic areas of cooperation for the period 2011-2014:¹ (i) electric power; (ii) water and sanitation; (iii) natural disaster risk management; and (iv) social protection,² mainly through sovereign-guaranteed interventions, as well as nonreimbursable resources.
- Financing needs:** The maturity profile of public debt is appropriate, and Venezuela is not expected to have any debt sustainability problems. Multilateral lending is expected to be a relatively small source of public investment in the coming years, but strategic for developing key sectors of the economy. The national government is expected to have annual average financing requirements equivalent to 4.7% of GDP.
- Bank financing:** The lending scenario assumes an average of US\$900 million in annual approvals for sovereign-guaranteed operations and US\$3 million in nonreimbursable contributions and knowledge products. In this scenario, the Bank’s share of the country’s multilateral debt would remain below 50% throughout the strategy period. Assuming an average of US\$540.6 million in annual disbursements, the country’s net flows would remain positive throughout the period in question.

¹ The country strategy period will be from May 2011 to December 2014.

² The selection of these areas reflects the targeting criteria recommended by the Office of Evaluation and Oversight (OVE) in the document, “[Country Program Evaluation: Venezuela 1999-2007](#),” dated April 2009.

Utilization of country systems:

Country systems are not expected to be used as a management tool for Bank-financed programs during the strategy period with regard to financial and accounting management, external auditing, and procurement. Consequently, information systems consistent with Bank policy will continue to be needed for financial and accounting management, reporting, and accountability on Bank projects, as well as for procurement planning and execution. Projects will also continue to use the services of firms for financial audits. Meanwhile, the Bank will gear its efforts toward fiduciary efficiency in operations with the country by improving project management tools.

Coordination with other multilateral and bilateral cooperation agencies:

The Bank and the Andean Development Corporation (CAF) are in close communication and exchange information frequently. In recent years, under the guidance of the national authorities, a certain degree of specialization has emerged. As an exception to that, both entities have worked together on projects of a large financial or technical scale to ensure appropriate levels of financing. Although in recent years Venezuela has signed a number of cooperation agreements with other countries, the central government's bilateral debt at the end of 2010 was relatively small.

I. COUNTRY CONTEXT

- 1.1 Between 2003 and 2008, the Venezuelan economy experienced a growth phase during which its GDP grew 62.5%. The economy is currently experiencing a contraction of real activity: GDP shrank 3.3% in 2009, and economic activity will continue to contract in 2010 with a reduction of 1.4% in GDP.
- 1.2 The aforementioned expansion over the past decade reduced the idle capacity of the economy's capital stock and, in particular, exerted significant pressure on the country's infrastructure. Maintaining economic growth in the long term will require the promotion of investment, especially in infrastructure.

II. THE IDB IN VENEZUELA

- 2.1 Given the size of the Venezuelan economy, and because national authorities pursued a strategy of reducing the country's multilateral debt until 2007,³ the Bank's program has been relatively limited. As of 31 December 2010, Venezuela's debt with the Bank was just 5.05% of its external public debt. The Bank has maintained its support for the country at all times, serving as a source of technical assistance and financing in strategic areas, including development of hydroelectric generation capacity, improvement of water and sanitation services, and support for social safety net programs. Since 2008, dialogue with the national authorities has intensified, resulting in the approval of new operations and the reversal of negative flows of resources to the country.
- 2.2 The active portfolio as of 30 September 2010 comprises 11 operations for a total of US\$2.2492 billion, with 54.4% undisbursed (US\$1.224 billion). Most of the undisbursed portfolio is concentrated in the electric power sector (67.3%), followed by water and sanitation (16.5%) and social protection (11.4%). The technical-cooperation portfolio includes nine operations for US\$2.6 million, with US\$2 million in undisbursed resources. The technical assistance program supports projects in the areas of intercultural education, microenterprise training, sustainable tourism, and entrepreneurship in social production; and supplements the Bank's work in areas with sovereign guaranteed operations already in execution, such as modernization of the State and solid waste management.

III. PRIORITY SECTORS

- 3.1 Within the framework of the [Simón Bolívar National Development Plan 2007-2013](#), the Venezuelan authorities and the Bank have identified four shared priority areas of cooperation for the period from April 2011 to December 2014: (i) electric power; (ii) water and sanitation; (iii) natural disaster risk management; and (iv) social protection. The Bank will work with other donors to build partnerships to

³ Between 2002 and 2007, Venezuela's multilateral debt fell 29.1% in the context of a strategy to reduce external public debt as a percentage of GDP (Economic Report of the Central Bank of Venezuela, 2007).

support the Bank's country strategy with the Bolivarian Republic of Venezuela (2011-2014), with emphasis on cofinancing and transfer of best practices and knowledge. In addition, nonreimbursable resources from the Bank and the Multilateral Investment Fund (MIF), as well as possible operations under the Opportunities for the Majority (OMJ) initiative, will be used to support public and private business sector initiatives.⁴ With the exception of OMJ operations, no non-sovereign guaranteed operations in priority sectors are anticipated during the strategy period.

- 3.2 In addition, dialogue between the Government and the Bank will be deepened in the transportation sector, where needs have been tentatively identified in relation to: (i) rehabilitation and maintenance of the road system, including points vulnerable to natural disaster emergencies; (ii) improvement of urban transportation systems, including public transit systems and support for the formulation of transportation planning and traffic management measures; and (iii) consolidation and strengthening of the sector institutional framework, including support for the planning, prioritization, management, and evaluation systems for transportation programs and projects. Once the Bank has finalized its sector diagnostic assessment, and priorities for its involvement have been identified by mutual agreement, an update to this country strategy will be presented, setting out the framework for the Bank's work in the sector.
- 3.3 The selection of sectors reflects the country's needs as they pertain to government plans and strategies, as well as the Bank's experience, knowledge, and institutional priorities. It also takes into consideration the targeting criteria recommended by the Bank's Office of Evaluation and Oversight in the document, "[Country Program Evaluation: Venezuela 1999-2007](#)," dated April 2009. The operations to be programmed in each of the country strategy sectors can contribute to the lending targets of the report on the Ninth General Increase in the Resources of the Inter-American Development Bank (GCI-9). Specifically, actions in social protection and in water and sanitation can contribute to the targets for poverty reduction and equity enhancement, while actions in the energy, water and sanitation, and natural disaster risk management sectors can support the target for sustainable energy and environmental sustainability.

A. Electric power

- 3.4 Venezuela has a high rate of electricity service coverage, with more than 95% of its population served (2009). The growth in economic activity, along with a relative decline in rates, caused electricity consumption to increase from 79,000 GWh/year in 1998 to an estimated 123,000 GWh/year in 2010, equivalent to year-on-year growth of 4%. The electricity generation, transmission, and distribution infrastructure has been responding to this growing demand, albeit with certain liabilities related to the technical sustainability of the system, as explained below.

⁴ Interventions in the four priority areas are expected to be supplemented by MIF and OMJ activities to support small productive enterprises, facilitating access to finance, encouraging the adoption of new technologies, and promoting training for workers in sectors that can generate positive externalities for the rest of the economy.

- 3.5 Installed generation capacity increased from 19,000 MW in 1998 to 23,000 MW in 2010. Some 60% of current installed capacity is in hydroelectric sources, with the remainder in thermoelectric units. The country's transmission network is 12,106 km long, carrying power from the generation units and the country's major population centers. This system faces limitations in its ability to meet future needs in terms of interconnection and quality, and this is exacerbated by the fact that 70% of all electricity is generated in the Guayana region (southeastern Venezuela), while some 72% is consumed in the Capital, Central, Centro Occidental, Andina, and Zuliana regions (northwestern Venezuela). On the business side, only 71% of raw generated power (2007) is billed; this figure has decreased slightly from 77% in 1998. Unaccounted-for power is associated primarily with losses at low voltage (82.2% of unaccounted-for power) and, to a lesser extent, with losses at high voltage.
- 3.6 The main liabilities affecting the system's technical sustainability relate to: (i) the age of hydroelectric generation plants, with more than 50% of installed capacity being 25 to 40 years old, and thermoelectric plants more than 25 years old; (ii) the transmission system, which must be strengthened to meet interconnection needs because of the distance between the regions that generate and consume power; and (iii) distribution equipment, which has limitations with regard to business management and monitoring of medium- and high-voltage networks, such as a lack of power metering and control equipment and a lack of modern, standardized billing systems.
- 3.7 To improve service quality, maximize efficiency in the use of primary energy sources, and optimize operations in the electricity sector, the national government transferred responsibility for sector planning, supervision, regulation, and enforcement to the People's Ministry for Electric Power. In 2007 the Government of Venezuela began to restructure the sector through a process whereby the enterprises of the National Electricity System would be merged into a single legal entity, Corporación Eléctrica Nacional (CORPOELEC). The agreements to integrate and consolidate the sector companies into CORPOELEC were signed in November 2010. Under them, CORPOELEC takes over the management, human resources, and operation of the assets of the different sector companies. This process should be complete by late 2011.
- 3.8 Along with the need to meet growing demand and resolve the aforementioned liabilities, the Government of Venezuela faces the challenge of institutional development of CORPOELEC. The current level of remuneration for electricity service does not ensure, by itself, the ability to finance the necessary investments and operations, so regular transfers of funds from the national treasury are required. Therefore, the sector's sustainability depends not only on strengthening of the legal and institutional framework with sufficient management capacity in system operation and economic remuneration for electricity service, but also on timely investment to keep generation, transmission, and distribution capacity operational and to reduce system losses. The Government of Venezuela had undertaken initiatives and shown progress in this area, including: (i) the new Electric Power System and Service Act, passed in December 2010, which calls for a Development

- Plan for the National Electric Power System; (ii) formulation of a pricing system for electricity service based on criteria of economic and financial sustainability; and (iii) measures to increase revenue intake by reducing energy losses.
- 3.9 For the 2011-2013 period, the country expects demand for investment in the sector to total approximately US\$5 billion, broken down as follows: US\$2.343 billion for thermoelectric and hydroelectric generation, US\$870 million transmission, and US\$1.494 billion for distribution. Of that total, 78.3% is still unfinanced, and part of this investment is expected to be financed by multilateral agencies.
- 3.10 The Bank will provide technical assistance to the Government of Venezuela to put in place a framework conducive to the financing of investment projects in the sector. Accordingly, the government and the Bank will establish a series of milestones reflecting progress toward sector sustainability, taking into account especially the activities and outputs of operation VE-L1021 (CORPOELEC), including: (i) preparation of the sector strategy plan, to guide sector consolidation from multiple companies to a single company structure; (ii) review and adjustment of the service pricing structure and explicit, targeted subsidy mechanisms conducive to sector financial sustainability; (iii) tracking of service quality indicators such as outage frequency and duration; (iv) implementation of new corporate management oversight by process, business segment, or organizational unit; (v) movements in business metrics such as percentage of receivables and distribution loss levels; and (vi) regular publication of CORPOELEC's financial statements, annual report, and management's report on operations. As these milestones are met and progress is made toward sector sustainability, an update of this country strategy will be presented, detailing such progress and identifying priorities for Bank investment actions in the sector.
- 3.11 The risks of Bank involvement in the electric power sector are associated with: (i) difficulties in strengthening the sector's economic sustainability; (ii) delays in achieving the necessary operational and management capacity at CORPOELEC to implement programs and projects, as well in implementing the new regulatory framework resulting from the new Electric Power System and Service Act; (iii) tensions associated with the current economic environment, such as difficulties in meeting energy demand, which draw the attention of sector operators away from medium- and long-term issues.
- 3.12 At the end of the strategy period, electrical service should be better able to satisfy the country's needs, with strategies to reduce vulnerability to natural disasters, reduce business losses, and achieve greater reliability and more power generated through enhanced energy efficiency.

B. Water and sanitation

- 3.13 Venezuela has extensive water resources. The geographic distribution of these resources, however, does not coincide with that of the population. This gap has been widening over time as the urbanization process unfolds. As a result, water services entails logistical problems that increase costs and require constant investment to ensure coverage, service quality, and sustainability. Thus,

rationalizing consumption is a primary objective. In addition, water quality is subject to pressures associated with the pollution of bodies of water. Solid waste management in Venezuela has weaknesses in service organization and final disposal. Both sector legislation and national government policy give the State, acting through the People's Ministry for the Environment, the authority to establish policies, plans, and programs to ensure financing for necessary sector investments. In view of these factors, the strategic focus of the Bank's relationship with the country is on meeting objectives in three subareas: (i) protection of water resources; (ii) potable water service and wastewater treatment; and (iii) solid waste management.

1. Protection of water resources

- 3.14 Venezuela has a relatively high population growth rate (1.6% year-on-year), so the number of users of public utilities can be expected to increase significantly in the medium term. Despite abundant water resources to satisfy future demand, Venezuela's large watersheds are subject to pressures that could diminish their productive capacity and water quality.⁵ One of the objectives of the sector's governing law, the Water Act,⁶ is comprehensive water management to ensure conservation. It emphasizes protection, sustainable use, and recovery of surface and ground water to satisfy the demand generated by the country's human, environmental, and productive needs. This legal framework sets the right sector-policy conditions for financing investment in the sector by establishing the levels of administrative jurisdiction of the various government agencies, identifying water management instruments and usage rights, and proposing financing mechanisms to ensure the sustainability of water resources.
- 3.15 Based on the current legal framework, the government plans to develop and implement the National Comprehensive Water Management Plan, which would include actions to protect and conserve the country's main watersheds, from planning to execution of specific activities for each basin. Within this framework, the objective of the Bank's involvement is to support efforts to ensure that water resources are available to supply drinking water in the medium and long term by: (i) supporting the preparation of investment projects based on strategic planning in the sector; (ii) conducting projects to protect and conserve springs; (iii) designing and implementing management plans for the most vulnerable and strategically important watersheds; and (iv) executing projects to decontaminate bodies of water. At the end of the strategy period, the quality of water sources is expected to improve in watersheds subject to the impact of nearby urban populations.

2. Water service and wastewater treatment

- 3.16 In 2008, Venezuela's water service coverage rate was 96% for the urban population and 80% for the rural population. In the same year, the coverage rate of wastewater collection was 86% for the urban population and 72% for the rural population. The

⁵ These pressures could also adversely affect hydroelectric generation capacity and exposure to natural disasters.

⁶ The Water Act went into effect upon its publication in issue 38595 of the *Gaceta Oficial*, 2 January 2007.

wastewater treatment coverage rate currently stands at 36% for the population overall. Gaps have been identified in: (i) supply of clean drinking water in rural areas; (ii) wastewater collection, especially in rural and periurban areas; and (iii) wastewater treatment in rural and urban areas.

- 3.17 Water, sewer, and wastewater treatment services are governed by a legal framework that was updated with the Water and Sanitation Service Delivery Act (known by its Spanish-language acronym, LOPSAPS), separating the functions of planning, regulation, and service delivery. These functions are being performed together temporarily by C.A. Hidrológica Venezolana (HIDROVEN), which is authorized by legislation to do so through 2013.
- 3.18 The legal framework provides that pricing must be set with the objective of sustainability and reflect all costs of the service provider. Although this objective has not been fully achieved, the recent rate adjustment for water service has improved the financial position of service providers (HIDROVEN, its regional subsidiaries, and local autonomous entities). In addition, the overall collection rate for water service rose from 64% in 1998 to about 94% in 2007, and the percentage of operating expenses covered through revenue collection has increased from 56% to 88% in the past decade. However, the absence of an inflation adjustment mechanism adversely affects operating revenues in real terms. Additionally, the absence of updated property records makes it difficult to collect from customers able to pay.
- 3.19 One objective of the Bank's support in this area is to narrow gaps in service delivery, while another is to improve efficiency in service delivery (property record updates and other activities). The Bank's involvement in initiatives to narrow gaps in service delivery should go hand in hand with initiatives to use resources more efficiently and rationally, and to make the enterprises more financially sustainable.
- 3.20 The Bank's financial support for narrowing gaps in service delivery will focus on the following initiatives: (i) universalization of access to clean drinking water service by expanding coverage among rural populations; and (ii) wastewater collection and treatment projects in vulnerable watersheds. The objective of improved efficiency will be met by: (i) reducing the amount of unaccounted-for water; and (ii) rationalizing water consumption. At the end of the strategy period, rural areas are expected to see increased coverage rates for water service and wastewater treatment, and service quality and the technical, institutional, and financial sustainability of the sector should be enhanced by rationalizing the use of clean drinking water.

3. Solid waste management

- 3.21 The amount of municipal solid waste generated per person has doubled in the past decade. This has forced municipal governments, whose infrastructure for final disposal was already limited, to manage an estimated 8.9 tons of solid waste per year. The main gap in service delivery lies in uncontrolled final disposal in open-air

dumps by a significant portion of the country's 335 municipios.⁷ In general, although municipios are authorized to charge fees to users, revenue flows for service delivery are not enough to cover operating, maintenance, and capital costs. Closing the gap entails high upfront costs associated with establishing necessary infrastructure. In most cases, these costs are beyond the financial means of the municipios and require transfers from the central government.

- 3.22 The current legal framework, as well as the one now pending under the bill for the Integrated Solid Waste Management Law, has the objective of making service delivery sustainable and efficient. This modern policy framework seeks to promote best practices in solid waste management, adapted to local conditions in Venezuela. Among other things, it fosters an efficient cost recovery system that ensures the service's financial sustainability and the construction of infrastructure for integrated solid waste management and, especially, to solve the problem of open-air dumps once and for all by building sanitary landfills that ensure environmental sustainability. It also seeks to involve informal workers in waste sorting and separation.
- 3.23 The Bank's work will focus on helping to narrow the initial investment gap in a number of municipios through the following integrated, parallel initiatives: (i) institutional strengthening and technical assistance for solid waste management institutions; and (ii) infrastructure development and operational improvements in the solid waste treatment system, including: (a) support for national executive branch initiatives to build sanitary landfills; (b) cleanup, conversion, and closure of open-air dumps; (c) construction of transfer stations; and (d) procurement of plants for salvage processing and basic equipment to support the formalization of informal waste separators. In parallel with these actions, the Bank will also promote the use of efficient rate and collection mechanisms to help municipios, at least, to operate the new infrastructure in a sustainable manner. At the end of the strategy period, several of the country's municipios are expected to be effectively managing the collection and final disposal of urban solid waste.
- 3.24 The risks of the Bank's involvement in the water and sanitation sector include: (i) limited management capacity of certain enterprises in the sector; and (ii) a lack of coordination between various political and administrative entities with jurisdiction in the sector (ministry, departmental governments, service providers, municipal governments, and community councils). Mitigating these risks are the following factors: (a) identification of counterparts with greater technical expertise and management capacity among service providers; and (b) selection of investment projects where incentives for the agencies in question are aligned.

C. Natural disaster risk management

- 3.25 Given its geographic location and physical features, Venezuela is exposed to a variety of natural disasters, including earthquakes, floods, tropical storms, and

⁷ According to the Pan-American Health Organization (2005), 60% of all final disposal in Venezuela is in open-air dumps or watercourses; this figure is 80% for midsized cities, and 100% for small cities.

droughts. The country's major urban centers are located in the very areas where such phenomena are highly likely to occur.

- 3.26 In the past 40 years, disasters caused by natural phenomena have left more than 30,000 people dead and affected 800,000, and caused more than US\$3.3 billion in losses. In 2009 and 2010, a lengthy drought associated with the El Niño phenomenon had serious consequences for the country, such as decreased hydroelectric generation potential, lower reservoir volume for water service delivery, and forest fires. Floods and mudslides during the 2010 rainy season caused the declaration of a state of emergency in large parts of the country. Climate change—especially as it pertains to changes in the frequency and intensity of rains and low water periods—may increase the frequency, magnitude, and effects of natural disasters in the future. Gaps exist in the development of the contingency plans to help the country deal with such events.
- 3.27 The section of the Simón Bolívar National Development Plan 2007-2013 that establishes the new national geopolitics makes clear reference to reducing vulnerability to climate and geological risks. The approval and entry into force of the new Integrated Risk Management Act is an essential step toward reducing the country's vulnerability to natural disasters by taking a modern approach that views disaster risk as a poor planning problem whose solution requires the participation of all development actors. This new legal framework takes an integrated approach to risk, encompassing not only traditional types of action such as response and preparation, but prevention and mitigation as well. Indeed, the new law's modern, ex ante approach, focused on better development planning to prevent a disaster from occurring, rather than on the humanitarian response after the fact, means that the Bank could not be better positioned to support the Government of Venezuela in integrated disaster risk management. The Bank and country share the view that poor development decisions, combined with the occurrence of adverse natural phenomena, can result in disasters that erode development advances achieved by countries at great cost through social and economic programs. In this regard, the Bank can offer the country solid experience with similar processes of institutional strengthening and investment in integrated disaster risk management.
- 3.28 The Bank's involvement in this area will help improve the country's performance in integrated risk management through the following forms of support, inter alia: (i) implementation of the disaster risk and risk management indicators developed by the Bank (RMI, DDI, PVI, and LDI) to measure the country's performance in various aspects of risk management and identify areas to be strengthened; (ii) development of a country risk profile, in order to identify highly vulnerable areas/sectors for prioritization of future interventions in risk management; (iii) development and implementation of a national integrated risk management plan that includes activities to reduce current and future risks, such as mitigation works, strengthening of the legal framework, institutional strengthening, and development of risk management plans in the most vulnerable municipios and communities; and (iv) development of a national plan for adaptation to climate change that encompasses risk management as it pertains to changes in the

frequency and intensity of rains and low water periods, and their consequences. The Bank has a risk identification and analysis methodology tested and applied in several different countries of the region, and has supported multiple institutional strengthening and public investment plans and a regional policy dialogue on the integration of disaster risk management and climate change adaptation. Additionally, the Bank is working to develop information technology methods and tools that build climate change scenarios into risk analysis.

- 3.29 The Bank's financing interventions aimed at reducing risks (prevention works and actions and mitigation works), preparations (installation of an early warning system, training and equipping of emergency brigades, etc.), and financial protection from possible disasters (reserve funds, contingent credit lines, insurance, etc.) should be preceded by the development and implementation of programs and actions related to risk identification and institutional strengthening for risk management. Bank-financed actions should result in greater institutional capacity to reduce the vulnerability of the population, their livelihoods, and infrastructure to natural disasters. This ex ante approach, which focuses more on forward-looking and corrective action than the conventional reactive approach of disaster response, is in line with the new Integrated Social/Natural and Technological Risk Management Act, passed by the National Assembly of the Bolivarian Republic of Venezuela in 2009.⁸
- 3.30 The risks associated with the Bank's involvement in this sector relate to: (i) the uncertainty associated with probabilistic risk and disasters, which makes long-term decision-making difficult; (ii) a possible nonalignment of the interests of various groups involved in national natural disaster risk management policy; and (iii) a lack of mechanisms for these groups to participate. Initiating Bank support for risk identification and institutional strengthening activities is the best strategy to mitigate these risk factors.

D. Social protection

- 3.31 Although in transition, Venezuela's demographic structure is still characterized by a broad base of children and young people. In 2010, 29.5% of the population were under age 15, and 18.7% were between the ages of 15 and 24.
- 3.32 Given this youthful population structure, one key concern is the high incidence of risky behaviors in this age group, particularly among low-income youth. This could affect human capital accumulation and distribution, lessening the economy's development potential and the ability to overcome poverty. The risky behaviors identified include teen pregnancy, dropping out of school, and crime.
- 3.33 Teen pregnancy is one of the most alarming risky behaviors for Venezuela, where 50% of teens become sexually active before age 19, and 10% before age 15. There is a marked difference between rural and urban areas. The aggregate adolescent fertility rate is 97 births per 1,000 women ages 15 to 19, versus the global average

⁸ Additionally, the Bank will place at the country's disposal its instruments to support disaster response during the emergency and immediate response phases.

- of 56, and regional average of 73. Twenty-one percent (21%) of registered live births are associated with the phenomenon of teen pregnancy. The maternal death rate is high and largely attributable to preventable causes. Although no precise data is available on the maternal death rate for teens, this population segment is acknowledged to be at greater risk.
- 3.34 Despite the high net enrollment rate (92.3% in primary education, and 71.7% in secondary education), there is a school dropout problem among young people. Just 48.24% of the total population over age 15 is enrolled in the formal educational system. Far from affecting society equally, this phenomenon is more pronounced in low-income groups. Average schooling among the three poorest deciles is 7.2 years, whereas for the wealthiest decile it is 11.7 years.
- 3.35 Crime has become a leading problem throughout the region. According to estimates by Soares and Naritomi (2010), the excessive rates of violence in Latin America depress GDP by an average of 13%, including direct costs to health and mortality as well as costs to the business climate. In Venezuela, the problem is particularly acute. The murder rate is an estimated 64.2 per 100,000, one of the region's highest. As commonly occurs in the rest of the region, both victims and perpetrators are concentrated among the young, particularly low-income population.
- 3.36 The risk factors described above call for specific, targeted actions and preventive interventions to address the multiple facets of the problem. A new strategy to reduce risk factors is the promotion of music training as a behavior modification and risk prevention mechanism. The involvement of vulnerable groups in music training programs reduces the amount time young people are unsupervised, and therefore their exposure to risky activities, helps them to develop valuable cognitive skills for their future life, and stimulates change in their preferences. In terms of skills development, the music programs appear to enhance executive function and self-regulation in young people (impulse control, concentration, and ability to formulate a plan of action/reaction in a new situation). Independent goal-setting (e.g., getting to class on time) seems to indicate the potential for skills development and long-term success, as well as qualities critical for work as part of a group. Likewise, contact with peers and instructors can help to adjust expectations and therefore change preferences, as well as improve decision-making.
- 3.37 Venezuela has a long record of implementing programs of this kind. The National System of Youth and Children's Orchestras of Venezuela (SNOJIV) was founded in 1975 to utilize music training as a means of prevention and social protection. It places great emphasis on sensory, physical, cognitive, and noncognitive stimulation through recreational support, and specifically music training as the main emphasis. Along with these efforts, the SNOJIV program supports, via interagency coordination, the inclusion of participating children and youth in formal health and education services and citizenship development. This intervention model based on Venezuela's experience has been favorably received, and is being tested in other countries of the region, including Ecuador, Colombia, and Chile.

- 3.38 SNOJIV consists of a network of 232 academic facilities associated with hundreds of orchestras, programs, choirs, and music ensembles. Enrollment now stands at 297,000 students, some 70% of them poor. This is despite the fact that SNOJIV is a universal program with no explicit mechanisms for beneficiary selection.
- 3.39 The number of beneficiaries is projected to reach 500,000 by 2014; a 68% increase with respect to the current enrollment. The Bank's work in this area will focus on financing: (i) teacher training programs; (ii) construction of regional centers and improvements to academic facilities; (iii) purchase of instruments; and (iv) strengthening of the evaluation framework for the system's impact.
- 3.40 Working with the government, moreover, contributions are expected to be made through the generation and dissemination of rigorous knowledge to stimulate policy dialogue with the national authorities around the issue of teen and early age pregnancy, and reduce the age-specific fertility rate for teens. With this knowledge, an intervention model and framework of action can be established for prevention and care.
- 3.41 The main risks associated with the proposed interventions relate to unforeseeable institutional changes that reassign programs within the government's organizational structure, or changes in the authorities responsible for them, which could delay decision-making and jeopardize meeting objectives.

IV. LENDING PROGRAM

A. Financing requirements

- 4.1 In the coming years, the national government is expected to need around US\$14.5 billion annually in financing (4.7% of GDP). This is a result of its efforts to revitalize the economy, the cost of addressing the emergency in the electricity sector, and increased expenditures on transfer systems within the framework of social policy. This all translates into greater primary expenditure and, hence, greater financing requirements.
- 4.2 However, under the current system for exchange rate control and setting interest rates, the national government has enough flexibility to meet a large part of its financing requirements on the domestic market. In particular, multilateral financing is expected to play a relatively small role, though a greater one than in recent years, in closing the financing gap (accounting for about 10% of requirements). Multilateral financing is being given a more strategic role related to its contribution of knowledge and experience and its favorable effect on the number and quality of participants in bidding processes, by promoting competition and thereby yielding contracts that are more technically and financially favorable to the country.
- 4.3 The country's relatively low public debt at the beginning of the strategy period, combined with the perception that negative real rates will be maintained in the domestic public debt market during the strategy period, reinforces the conclusion that public debt will remain within comfortable limits during this period.

B. IDB financing

- 4.4 The scenario assumes average annual approvals of US\$900 million for sovereign-guaranteed operations, and US\$3 million⁹ for nonreimbursable contributions and knowledge products. In this scenario, the proportion of the Bank's average annual lending allocated to Venezuela will vary between 6.4% and 10%, above the average for the last five years (4.6%) and the historical average (4%). The scenario is consistent with the greater financing requirements of the Government of Venezuela during the period. In this scenario, the Bank's share of the country's total multilateral debt will remain below 50% (41.6% for the last year of the strategy period).
- 4.5 The country's net cash flow would remain positive during the strategy period under this scenario (US\$322.2 million per year on average). The table below depicts this scenario, including the impact on the country's debt and the Bank's exposure indicators.

Lending scenario

IBD-Venezuela cash flow (US\$ million)				
	2011	2012	2013	2014
(1) Approvals	500.0	950.0	1,050.0	1,100.0
(2) Disbursements	371.2	500.5	618.1	672.5
(3) Repayments	148.4	144.1	138.9	59.8
(4) Credit flow (2)–(3)	222.8	356.4	479.2	612.7
(5) Capital contributions	22.9	22.9	22.9	22.9
(6) Capital flow (4)–(5)	199.9	333.5	456.3	589.8
(7) Interest	76.6	74.4	71.4	68.5
(8) Cash flow (6)–(7)	123.3	259.1	384.9	521.3
Debt balance	1,927.9	2,284.3	2,763.5	3,376.2
IDB debt/Multilateral debt	40.9%	40.0%	39.8%	41.6%
Multilateral debt/External public debt	12.1%	13.7%	15.5%	17.0%
IDB debt/GDP	0.9%	0.8%	0.9%	1.1%

C. Risks

- 4.6 **Macroeconomic risk.** The national budget in general, and public capital spending in particular, are highly sensitive to fluctuation in the price of oil, which has tended to be highly volatile in the past four decades. The national executive branch realizes this vulnerability and intends to reduce the proportion of fiscal revenues from oil to 42% in the 2011 Budget Act, approved in December 2010. Nevertheless, significant changes in fiscal oil revenues may affect the lending scenario. A substantial rise in oil prices may lead the country to forego Bank financing, as has occurred at various times in the past decade. A sharp decline in oil prices may jeopardize local counterparts' ability to pay. This risk is partly mitigated by the targeting of the

⁹ This amount of US\$3 million is subject to change during the programming process.

Bank's interventions to sectors where the country clearly perceives the value-added of lending (electricity, water and sanitation, natural disaster risk management, and social protection). Additionally, the requirements associated with the macroeconomic sustainability analysis of the borrowing member countries shall be substituted into all country strategies, replacing the present macroeconomic risk analysis, once the macroeconomic sustainability analysis framework is finalized.

- 4.7 **Institutional risks.** Venezuela's current constitution was drafted at a constitutional convention and ratified in 1999. Adaptation by institutions to the new constitutional framework has been a gradual, and still ongoing, process. Successful implementation of this strategy may be compromised by changes in the organizational structure of the State, which generally is accompanied by turnover of the Bank's local counterpart teams. Such a scenario in priority sectors may have an adverse effect on the ability to implement the strategy.
- 4.8 **Regulatory risks.** Also in the context of adjusting to legislation and implementing the 1999 constitution and the objectives of the Simón Bolívar National Development Plan 2007-2013, Venezuela has moved toward rethinking its regulatory framework for domestic economic activity. Unforeseen changes in regulations governing activity in priority areas and multilateral cooperation in Venezuela may have an adverse effect on the ability to design and execute new projects.
- 4.9 The identified risks, both general and sector-specific, will be monitored during the strategy implementation period with periodic and/or ad hoc instruments, as deemed suitable in each case.¹⁰ In particular, the macroeconomic sustainability risks will be subject to annual formal review pursuant to the GCI-9, once the macroeconomic sustainability analysis framework is finalized.

V. UTILIZATION OF COUNTRY SYSTEMS

- 5.1 Country systems are not expected to be used as a management tool for Bank-financed programs during the country strategy period. The Bank will gear its efforts toward efficiency in the fiduciary management of operations with the country by improving project management tools.
- 5.2 Thus far, the government has evaluated and improved its public management systems without the need for technical or financial support from the Bank or other international cooperation agencies. The government's financial management occurs through the Integrated Public Finance Management and Control System (known by its Spanish-language acronym, SIGECOF), which currently operates with separate modules for budgeting, cash management, accounting, and public credit. The Program for Modernization of the Financial Administration of the State (PROMAFE) aims to integrate these systems by implementing the Administrative

¹⁰ The mitigants for the main institutional and regulatory risks are described in paragraphs 3.10, 3.24, and 3.30.

Management System (SIGA) as a system related to SIGECOF. This process is expected to be self-financed and is slated to be fully operational in 2012.

- 5.3 As for the government's internal control system, the law grants the same powers to the National Internal Audit Administration (SUNAI) and the Office of the Comptroller General (CGR), and internal control policies are not fully implemented. The national authorities have seen fit to seek the Bank's cooperation in this area, promoting workshops. Support for the internal control system for Bank operations will depend on the fiduciary institutional quality and strength of the executing agency. External audits of projects are expected to be performed by independent audit firms.
- 5.4 Bank-financed projects currently use the Bank's procurement policies and procedures established in the loan contracts. Procurement planning and execution systems will continue to be needed in the priority sectors identified in this strategy.

VI. COORDINATION WITH OTHER MULTILATERAL AND BILATERAL COOPERATION AGENCIES

- 6.1 In recent years, four multilateral agencies have pursued active cooperation in Venezuela: the International Fund for Agricultural Development (IFAD), the United Nations (acting through UNDP, FAO, UNICEF, and others), the IDB, and the Andean Development Corporation (CAF). The latter two account for the majority of activity in terms of amounts approved, which facilitates donor coordination. The Bank and the CAF are in close communication with one another and exchange information frequently. In recent years, under the guidance of the national authorities, a certain degree of specialization has emerged. While the CAF has been more involved in transportation and thermoelectric generation operations, the Bank has been more active in hydroelectric generation, institution-strengthening, water and sanitation, and social protection. As an exception, the two institutions can work together on projects of a large technical or financial scale to ensure sufficient levels of financing.
- 6.2 Venezuela has entered into a number of bilateral agreements that entail opportunities to finance projects in the country. These include the China-Venezuela Joint Fund aimed at infrastructure development, social development, energy development, and industrial integration projects. The country has also gained access to financing tied to the execution of specific projects as part of bilateral agreements, such as support from Brazil's National Economic and Social Development Bank (BNDES) in financing infrastructure works commissioned to Brazilian enterprises (roads and mass transportation). However, Venezuela's bilateral debt is relatively small: US\$879 million at the end of 2010. The Bank has not participated in coordination efforts with bilateral cooperation agencies.

More active involvement by the Bank, acting through the Office of Outreach and Partnerships (ORP), is expected in identifying cofinancing resources and partnerships for the transfer of knowledge and best practices to priority sectors, with special emphasis on South-South cooperation.

ANNEX I. COUNTRY STRATEGY RESULTS MATRIX

Electric power

Simón Bolívar National Development Plan	IDB	IDB strategic objectives	Expected outcomes of strategy	Monitoring indicators				
				Indicator	Baseline (2008)	Indicative targets for country strategy period	Frequency of measurement	Source
Venezuela: World Energy Power	Electric power ¹	Improved management capacity of the electricity sector	Modernized business management tools	Collection rate (amounts collected over amounts billed)	74%	80%	Annual	CORPOELEC
			Updated technical resources for measurement and control	Electricity loss rate (electricity generated over electricity billed)	29%	26%	Annual	CORPOELEC
		Modernization of generation capacity	Increased hydroelectric generation capacity (renewable)	Installed capacity (nominal installed power in megawatts)	14,622	16,782	Annual	CNG
		Sustainability of hydroelectric generation	Expanded environmental management with incorporation of technical tools and knowledge	Identification and assessment of the impact of climate change on water resources in the Caroní River watershed (studies and modeling completed on variables such as flow volume, frequency, and trends)	-	100%	Annual	CORPOELEC

¹ New investment operations in this target area will be subject to contingent upon progress on the agreed milestones, in the terms described in paragraph 3.10 of the document.

Natural disaster risk management

Simón Bolívar National Development Plan	IDB	IDB strategic objectives	Expected outcomes of strategy	Monitoring indicators				
				Indicator	Baseline (2010)	Indicative targets for country strategy period	Frequency of measurement	Source
Supreme social happiness/New national geopolity	Natural disaster risk management and climate change	Improvement of the country's performance in integrated disaster risk management	Improved risk management index (RMI)	RMI ¹		Improvement over baseline	Beginning and end of strategy period	STGIR

¹ RMI: Risk management index. Measures a country's performance in the four main components of risk management: risk identification, risk reduction, disaster management, and financial protection.

Social protection

Simón Bolívar National Development Plan	IDB	IDB strategic objectives	Expected outcomes of strategy	Monitoring indicators				
				Indicator	Baseline (2008)	Indicative targets for country strategy period	Frequency of measurement	Source
Supreme social happiness	Social protection	Reduce exposure and risks of socially vulnerable groups to guarantee the rights of children and teens	Development of an intervention model and protocols to prevent and address teen pregnancy	Implementation of intervention model and protocols by relevant agencies	None	100%	Beginning and end of strategy period	People's Ministry for Municipalities and Social Protection
			Expansion of social inclusion through the National System of Youth and Children's Orchestras of Venezuela	Enrollment of children and young people in the National System of Youth and Children's Orchestras of Venezuela	250,000	500,000	Beginning and end of strategy period	FESNOJIV

Water and sanitation

Simón Bolívar National Development Plan	IDB	IDB strategic objectives	Expected outcomes of strategy	Monitoring indicators				
				Indicator	Baseline (2008)	Indicative targets for country strategy period	Frequency of measurement	Source
Supreme social happiness	Protection of water resources	Improved quality of water sources through treatment of urban wastewater	Increased treatment of wastewater in cities with over 100,000 people	% of urban wastewater treated	26%	28%	Annual	Ministry of the Environment and HIDROVEN
	Potable water and wastewater treatment	Rationalization of consumption	Decreased consumption of potable water in 70,000 housing units in cities served by subsidiaries of HIDROVEN	Consumption per capita in areas included in the program (lhd)	450 lhd	400 lhd	Annual	HIDROVEN
		Universal access to water and sanitation services	Increased coverage in rural areas	% of dwellings in rural areas with access to potable water with 12 hours of service per day	80%	82%	Annual	Ministry of the Environment and HIDROVEN
			Increased coverage of sanitation services in rural areas	% of dwellings in rural areas with individual solutions or a wastewater disposal system	72%	74%	Annual	Ministry of the Environment and HIDROVEN
			Potable water service coverage in urban areas holds steady	% of dwellings in urban areas with access to potable water with 18 hours of service per day	96%	96%	Annual	Ministry of the Environment and HIDROVEN
			Sanitation service coverage in urban areas holds steady	% of wastewater treated in urban areas	36%	40%	Annual	Ministry of the Environment and HIDROVEN
			Reduction of solid waste deposited in open-air dumps	Increased rate of sanitarily appropriate final disposal in landfills (*)	% of daily tons of solid waste diverted from an open-air dump to landfills	43%	65%	Biannual
	Solid waste	Institutional strengthening at the central, regional, and municipal levels	National Strategy for Integrated Solid Waste Management or a set of long-term sector policies	A national strategy that addresses such key issues as: (i) expected reduction of open-air dumps; (ii) policies to increase the waste treatment rate; (iii) temporary framework of activities; and (iv) identification of economic resources for activities	TBD subject to approval of legal framework	National strategy or set of long-term sector policies that address the aforementioned issues	Biannual	MPPA

(*) "Appropriate" is understood to mean compliance with construction and operation standards in accordance with international economically viable best practices.

Note: "Supreme social happiness" is defined in the National Development Plan as the objective of the Government's social actions.

ANNEX 2. DEVELOPMENT EFFECTIVENESS MATRIX

COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX

In August 2008, the Board of Directors approved the Development Effectiveness Framework (GN-2489) to increase the evaluability of all Bank development products. The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the “Good Practice Standards for Country Strategy and Program Evaluation.”

COUNTRY STRATEGY: VENEZUELA 2011-2014

Strategic alignment (measures two dimensions: (i) the degree of consistency between the strategy objectives and the country’s development challenges and the government’s priorities and plans; and (ii) utilization of a mix of products (financial, knowledge, technical assistance) to meet the objectives set, and identification of other cooperation agencies and their areas of action. The results are presented by dimension analyzed):

Consistency with strategy objectives: The strategy identifies four areas for Bank action: (i) electric power; (ii) water and sanitation; (iii) natural disaster risk management; (iv) social protection. All of the selected areas (100%) address the development challenges identified in the diagnostic assessment of Venezuela’s sector priorities (see Note on Sector Priorities) and agreed upon via country/Bank dialogue, which are consistent with the government’s plans.

Product mix and participation of other donors: The strategy specifies the products to be utilized, in particular sovereign guaranteed loans and technical cooperation operation; it does not call for the utilization of non-sovereign guaranteed operations. The strategy takes into account the interventions of other multilateral cooperation agencies such as the Andean Development Corporation (CAF), which is active in the financing of transportation and thermoelectric generation projects.

Effectiveness (measures the expectation that the country strategy will meet its objectives, based on four dimensions: (i) the quality of the diagnostics supporting the Bank’s work in each area; (ii) the quality of the strategy results matrix; (iii) the use and strengthening of country systems; and (iv) analysis of the lending framework):

Effectiveness dimensions	%
I. Sector diagnostic assessments	100
II. Results matrix	
Expected outcomes	80
SMART outcome indicators	70
Baselines	70
III. Country fiduciary systems (financial management and procurement)	
Diagnostic	100
Strengthening	0
Use	0

Sector diagnostics: The strategy relies on four sector diagnostics. All of the diagnostics (100%) clearly identify the main problems affecting development in each sector; they are based on empirical evidence, although there are some gaps in the information; and they establish that the Bank’s actions will address priority sector issues.

Results matrix: The results matrix contains 10 strategy objectives for the Bank’s action, and 15 indicators to measure

progress toward the proposed objectives.

- *80% of the strategy objectives have clearly defined expected outcomes; in the remaining 20%, the expected outcome is inconsistent with the stated objective or is not specific.*
- *70% of the indicators used are outcome indicators and SMART indicators; the remaining 30% are insufficient to measure the expected outcome or require greater specificity.*
- *70% of the indicators have baselines.*

Country systems: *In terms of country systems (financial management and procurement), there are diagnostics for all subsectors under each system (100%), but no provision is made for their strengthening (0%) or use (0%).*

Lending framework: *The strategy contains an analysis of lending needs and provides an estimate of the amount required from the Bank, based on a base-case scenario. The analysis establishes that the multilateral lending contribution will be relatively small in relation to the existing financing gap.*

Risks *(measures three dimensions: (i) identification of the factors that affect or could affect meeting the proposed objectives; (ii) definition of mitigation measures; and (iii) monitoring mechanisms):*

The strategy states risks associated with the Bank's involvement in each of the strategic sectors, and mitigation measures are identified. More general risks are also stated (macroeconomic, institutional, and regulatory risk) that will be monitored in the strategy period.

ANNEX III. LESSONS LEARNED: INCORPORATION OF RECOMMENDATIONS OF THE COUNTRY PROGRAM EVALUATION: VENEZUELA 1999-2007

The most important lessons learned by the Bank in implementing strategies with Venezuela include:

1. Technical cooperation:

Increase technical-cooperation activities and studies, with particular emphasis on the evaluation of alternative ways of addressing social problems and on the promotion of mechanisms to ensure the effectiveness of public spending: Given Venezuela's uniqueness and the Bank's deficit of knowledge on the country, consider the possibility of creating forums for dialogue that allow for technical analyses and pilot tests of alternative methodologies, particularly methodologies for social missions, with a view to identifying best practices and possibly influencing the better future use of resources aimed at these initiatives. Similarly, develop opportunities to help the country optimize the effectiveness of public spending.

For the 2011-2014 country strategy with Venezuela, the Bank has sought to expand its portfolio of technical-cooperation operations in line with investment projects that are under way, in preparation, or in areas where future financing opportunities have been identified (see recommendation 2). Technical-cooperation initiatives are in the process of preparation or identification in Water and Sanitation and in Electric Power.

2. The Bank's positioning:

Develop an active niche strategy in the Bank's areas of technical expertise: Actively cultivate a relationship with technical executing agencies within the country's public administration, civil society, and private sector. In this way, position the Bank as a multilateral partner valued by the country that is suited to carrying out innovative and highly complex and technical initiatives requiring ongoing support and independence from short-term budget decisions.

In conjunction with the national authorities, the following have been identified as strategic sectors for the 2011-2014 period: (i) electric power; (ii) water and sanitation; (iii) natural disaster risk management; and (iv) social protection. The selection of these four sectors is based on a joint diagnostic assessment by the Bank and national authorities, which principally identified gaps in infrastructure as an obstacle to improved living conditions for the country's residents. Cooperation between the Bank and the country in the electricity sector has a long track record, and the Bank's role in financing projects in the sector is highly valued by the national authorities. The Bank's relationship with local executing agencies has been thoroughly satisfactory as well. The very nature of projects in this sector has promoted the development of a long-term relationship completely independent of more immediate budgetary concerns. In the water and sanitation sector, the relationship between the Bank and executing agencies has been strengthened, and this has opened up opportunities for participation in projects where the Bank can contribute its experience and technical capacity, as well as its financial support. The Bank also maintains a dialogue with certain social actors through the Civil Society Consulting Group (ConSOC) and the MIF.

3. Evaluation:

Increase the evaluability of the program and operations, seeking to strengthen and utilize national management systems: Given the difficulties of establishing programmatic relationships with the country, the Bank should create avenues for dialogue that are geared toward gaining a better understanding of national monitoring and evaluation systems, so that they can serve as a basis for results-based management and integrated programming of the Bank's future financial and nonfinancial operations in the country.

In the fiduciary context, the Bank has promoted the preparation of a Fiduciary Technical Note, to assess the performance of country systems and the degree to which they are aligned with Bank practices. Based on this effort, which allowed the Bank to approach those responsible for national fiduciary systems, progress has been made in a plan for joint work in areas where national authorities have seen fit to seek the Bank's cooperation. The concentration of future operations in sectors or niches where executing agencies have a proven capacity to manage fiduciary processes will tend to improve the Bank's overall performance in the country. In addition, the Bank's Country Office in Venezuela, as part of the modernization process, has begun to migrate toward performance-based management, and this methodology is expected to be fully implemented during the programming cycle for the 2011-2014 country strategy. Discussions are under way with the national authorities to establish multiyear programming for future financial operations within the context of the 2011-2014 country strategy, as a way of making the Bank's interventions more relevant.

4. Promotion of tools and instruments:

Unleash the potential of the Bank's new organizational structure and instruments in order to adapt them to the needs of the country: Maximize the applicability of tools available under the new organizational structure and lending framework, seeking to increase the flexibility of the products offered by the Bank. For example, the challenges presented by the need for legislative approval of each loan could be mitigated by the Bank's offering more flexible arrangements, including global investment operations with funds allocated to multiyear execution of works to be selected based on pre-established criteria. Additionally, to implement tools such as programmatic schemes or conditional credit lines for investment projects (CCLIPs), the Bank will need to interact and become more familiar with national procurement, monitoring, and evaluation systems and strengthen its Country Office in Venezuela.

Within the context of the revitalized policy dialogue between the Bank and national authorities as part of the design of this strategy, the Bank's Country Office in Venezuela has actively disseminated information on the lending tools available under the Bank's new organizational structure and lending framework to technical officials at the People's Ministry for Planning and Development and the People's Ministry for Economy and Finance (now combined into the People's Ministry for Planning and Finance), and to staff at executing agencies. In the current political context, however, the possibility of delays in legislative approval is not identified as a risk in the execution of new operations because of the low degree of political fragmentation in the National Assembly.

5. Optimization of social impacts and knowledge transfer:

Generate activities in the infrastructure and productive sectors, emphasizing optimization of social impacts: The Bank has highly relevant experience in balancing the dual objectives of financial returns and social impact. The Bank should explore mechanisms for transferring this know-how to the Venezuelan productive sector, which is facing growing requirements for investment and measurement of social impacts. The Bank could also emphasize the search for alternative mechanisms for generating social welfare investments, such as through cooperative forms of business management, particularly in areas related to local infrastructure development.

One purpose of the 2011-2014 country strategy with Venezuela is to cooperate with the national authorities to close the existing infrastructure gap in accordance with the parties' joint diagnostic assessment. As a result, Bank-supported projects during the programming cycle are expected to be highly economically profitable and to generate a positive impact on economic activity in the country. Meanwhile, the selected sectors have significant capacity for social impact, so the Bank's cooperation will contribute to the objectives of improving people's living standards, including the majority in the enjoyment of quality public services, and reducing the vulnerability of the most disadvantaged groups to the effects of natural disasters.

ANNEX IV. MACROECONOMIC RISK ANALYSIS

After nearly three decades marked by unfavorable macroeconomic performance, during which GDP per capita fell by approximately 40%, the Venezuelan economy entered an expansionary phase in 2003 as a result of higher oil prices on international markets and the impetus of macroeconomic policy. Between 2003 and 2008, GDP rose 62.5% and consumption nearly doubled (+96.1%). This consumption-friendly expansionary phase led to a sharp drop in the poverty rate,¹¹ from 55.4% in 2003 to 28.5% in 2009.¹²

The growth phase has been accompanied by a significant increase in public investment and in public-sector social spending, including the contribution of the Venezuelan state oil company PDVSA to social programs and the National Development Fund, created as part of the new institutional framework with the dual purpose of using surplus oil revenues to finance public investment and saving part of the surplus resources for stabilization purposes.

The worldwide crisis has adversely affected the Venezuelan economy, partly as a result of the drop in oil prices in 2009 from the highs of 2008, as well as the increased cost of gaining access to international financing. This recent experience shows the risks involved in the country's macroeconomic performance, which could partially reverse the gains achieved in recent years. Below are the main risks that have been identified:

- i. **The Venezuelan economy has increased its degree of exposure to volatility in oil prices.** Historically, the Venezuelan economy has been highly dependent on oil revenues. In recent years, however, oil exports as a percentage of total exports have increased, as have oil revenues as a share of total fiscal revenues. The increased share of oil in both of these variables makes the Venezuelan economy more vulnerable to volatility in oil prices, especially since access to financing in foreign currency is procyclical vis-à-vis changes in oil prices. The national executive branch recognizes this vulnerability and intends to reduce the proportion of fiscal revenues from oil to 42% in the 2011 Budget Act.
- ii. **Appreciation of the real exchange rate poses a challenge to the growth capacity of the tradable goods sector of the economy.** Though implementation of a dual exchange-rate system last January represented a significant correction of the real exchange rate, the appreciation trend that Venezuela shares with some other countries in the region continues, regardless of what exchange-rate system is used. Real appreciation has had an adverse effect on the growth of tradable goods sectors, especially the manufacturing sector, whose role in the economy has been declining throughout the decade. Meanwhile, nonoil exports began to decline in 2006 and have dropped by nearly 60%, largely as a result of real appreciation. Appreciation could have long-term effects on the export tradable goods sector,

¹¹ According to the poverty line method (income).

¹² The extreme poverty rate fell to 29.8% in 2003, and 7.2% in 2009. This means that the Millennium Development Goal for this indicator was achieved nine years before the deadline.

as the recovery of international markets may be costly in terms of resources and time. In the absence of a nonoil export sector, macroeconomic vulnerability to changes in oil prices will be higher.

- iii. **Future production capacity of the oil industry depends heavily on high investment levels.** The production potential of the oil industry is tied not only to mature oilfields, whose production naturally declines at high rates and which therefore require high investment levels to keep production steady, but also to projects to develop heavy-crude and extra-heavy-crude oilfields, which require a large up-front investment and have high transformation and refining costs. The tax contribution by PDVSA (including extrabudgetary funds) has increased in recent years. This could limit its ability to generate the cash flow needed to finance its own investments. PDVSA has recently resorted to international financial markets to finance its expansion plan, but given international market conditions, conditions in Venezuela, and PDVSA's growing debt, future access to international markets may be more limited.
- iv. **The perception of growing risk may have an adverse effect on private investment and tax revenue.** This perception is seen in widening spreads on sovereign bonds and a drop in foreign direct investment, inter alia. The higher cost of financing could have an adverse effect on future investment decisions by private economic operators, which would reduce economic activity and nonoil tax receipts.
- v. **Access to private international financing could be adversely affected.** A drop in export oil prices, changes in investor outlook regarding the perceived profitability of their investments, and legal measures in response to political decisions could have an adverse effect on Venezuela's access to private international capital markets. This would be costly if the public sector were to need financing via external debt.
- vi. **The interconnected electricity system is vulnerable to changes in precipitation volume.** This risk will be greater to the extent that rain conditions are less favorable and the new thermoelectric generation capacity is incorporated into the system more slowly than expected. Such a contingency would have an adverse effect on economic activity over the medium term, in addition to the fiscal outcome (due to lower tax revenues and higher one-time expenditures to address the contingency).

ANNEX V. TABLE OF MACROECONOMIC AND SOCIAL INDICATORS

	2006	2007	2008	2009	2010
<i>Real-sector indicators</i>					
Nominal GDP (BsF million)	393,926	486,376	667,997	700,208	1,011,774
Real GDP (growth rate)	9.9%	8.2%	4.8%	-3.3%	-1.4%
Unemployment rate (end of period)	8.4%	6.2%	6.1%	6.6%	6.5%
Price of oil (US\$/barrel)	56.4	64.6	86.7	57.0	72.4
Inflation rate (cumulative annual)	17.0%	22.4%	31.9%	26.9%	26.9%
<i>Central government (as percentage of GDP)</i>					
Total revenues	29.6%	28.9%	24.0%	21.4%	19.7%
Total expenditures	29.6%	25.8%	26.2%	26.8%	24.1%
Primary result	2.1%	4.5%	-0.9%	-4.0%	-2.8%
Overall outcome	0.0%	3.0%	-2.2%	-5.4%	-4.4%
<i>Public-debt indicators</i>					
Total public debt/GDP	23.9%	19.3%	14.1%	13.2%	18.3%
External public debt/GDP	14.8%	12.0%	9.5%	7.5%	11.8%
Domestic public debt/GDP	9.1%	7.3%	4.5%	5.7%	6.5%
<i>Balance of payments and country risk</i>					
Current account (% of GDP)	14.4%	7.9%	11.9%	2.1%	5.6%
Current account (US\$ million)	26,462	18,098	37,392	8,561	14,378
Exports	65,578	69,010	95,138	57,595	65,786
Imports	-33,583	-46,031	-49,482	-38,442	-38,613
International reserves (end of period) (US\$ mill)	35,408	34,309	32,712	35,830	30,332
International reserves (months of imports)	12.7	8.9	7.9	11.2	9.4
EMBI+ index (end of period)	183	523	1864	1041	1090
Effective real rate of exchange	76.5	70.7	63.0	57.2	75.9
<i>Financial indicators</i>					
Lending to private sector/GDP (%)	15.3%	20.8%	19.1%	18.8%	17.2%
Lending interest rate	15.4%	17.3%	23.2%	20.1%	18.3%
Borrowing interest rate	10.0%	11.2%	15.7%	16.0%	14.7%
<i>Social indicators</i>					
Poverty UBN (%)	23.4%	23.3%	23.4%	23.5%	23.6%
Extreme poverty UBN (%)	9.0%	8.4%	8.5%	7.9%	7.7%
Gini	0.4422	0.4237	0.4099	0.4183	0.3893
Public social expenditure (% of GDP)	21.7%	21.2%	19.3%	14.3%	
Average real wages (% change)	10.4%	0.8%	-3.9%	-4.1%	-5.3%
Access to potable water	91.0%	92.0%	94.0%	95.0%	
Infant mortality (per 1,000 live births)	14.2	14.1	13.9		
Retirees (% of population of retirement age)	53.7%	63.5%	67.0%	68.0%	70.1%
<i>Sources: Central Bank of Venezuela, People's Ministry for Planning and Finance, INE, People's Ministry for the Environment, People's Ministry for Labor, People's Ministry for Health, Onapre.</i>					