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August 7, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Venezuela - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Venezuela, which will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Fajgenbaum, ext. (5)7162.

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INTERNATIONAL MONETARY FUND

VENEZUELA

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the
1984 Consultation with Venezuela

Approved by E. Wiesner and W. Beveridge

August 6, 1984

I. Introduction

The 1984 Article IV consultation discussions 1/ with Venezuela were conducted in Caracas in the period June 1-18, 1984. Representatives of Venezuela in the discussions included the Minister of Finance, the President of the Central Bank, the Ministers of Mining and Energy, Agriculture, and of the Venezuelan Investment Fund, the Vice Ministers of Finance and Planning, the Director of the Budget, the External Debt Negotiator, and senior officials of public sector agencies and corporations. The mission also met with representatives of the Venezuelan Labor Federation, the Federation of Chambers of Commerce, and the Association of Banks. The staff representatives in the discussions were Messrs. Martin Hardy (Head), Luis Eduardo Escobar, Jose Fajgenbaum (all WHD), Alberto Pera (ETR), Parthasarathi Shome (FAD), and Mrs. Karin Sturgill (Secretary-SEC). Mr. Miguel A. Senior, Executive Director for Venezuela, participated in the policy discussions.

The previous consultation discussions with Venezuela were held in March-April 1983. The relevant documents (SM/83/119, 6/6/83 and SM/83/127, 6/15/83) were considered by the Executive Board on July 1, 1983. At that meeting, Executive Directors observed that Venezuela was facing a major task of adjustment and that remedial actions were needed on a number of fronts, including broad-based measures to correct the imbalance in the public finances and a policy of credit restraint.

Directors felt that the application of price controls threatened to create distortions and to frustrate adjustment in a situation in which there was a need for changes in cost-price relationships. They emphasized that wages should not reflect corrective price changes, and the prudent wage policy which the Government had followed thus far was noted and welcomed.

Concern was expressed that Venezuela's exchange and trade policies were not helping the country to adjust efficiently. A simplification of the multi-tier exchange rate system was very much needed, and Directors

1/ Venezuela accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Articles of Agreement on July 1, 1976.

stressed the importance of re-establishing a realistic unified exchange rate as soon as possible, and of returning to the trade liberalization process that had been interrupted in 1982.

In view of Venezuela's strong resource base, Directors said that with appropriate adjustment measures the country should be able to achieve an adequate rate of growth. The needed refinancing of the external debt would be facilitated if Venezuela were to adopt a convincing package of adjustment measures to which the Fund could lend its financial support.

II. Background

In 1982 and early 1983 Venezuela experienced a crisis in its external finances, precipitated by the downturn in the world oil market.1/ For several years domestic activity had stagnated despite efforts to stimulate growth by means of massive public investments and easy credit policies. The weakening of the oil market and difficulties in meeting debt service obligations exacerbated the lack of confidence in the domestic private sector and capital flight. Heavy reserve losses prompted the authorities to establish a multiple exchange rate system and a tightening of fiscal policies in 1983, and to seek deferral in debt repayments. Adjustment policies have been carried further in 1984.

The economic stagnation of the period after 1979 can be ascribed in large measure to distortions in relative prices that emerged after the second oil price hike of 1979-80, and especially to the overvaluation of the currency. The second oil price increase occurred when Venezuela was in the midst of a stabilization effort that included tighter demand management policies and import liberalization measures. In the expectation that the new oil price would result in a permanently higher level of income, the authorities switched policies to reflate the economy and granted a 30 percent general wage increase. This wage increase, along with the rise in the value of the U.S. dollar against other currencies, resulted in a 40 percent real effective appreciation of the Venezuelan bolivar in the 1979-82 period. In these circumstances, the reduction in protection from imports and high interest rates abroad resulted in a stagnation of output in the domestic nonpetroleum sectors, rapid increases in imports, a sharp decline in private investment, and outflows of private capital (Table 1).

1/ In Venezuela, the oil sector provides about 95 percent of merchandise exports and some two thirds of central government revenues, and contributes around 25 percent of GDP.

Table 1. Venezuela: Selected Macroeconomic Indicators

(Percentage change from preceding year)

	1980	1981	1982	Prel. 1983	Proj. 1984
Real GDP (at 1968 prices)	-1.9	0.4	0.7	-4.7	--
Petroleum	(-6.8)	(-4.3)	(-7.6)	(-3.3)	(--)
Nonpetroleum	(-1.4)	(--)	(1.4)	(-5.0)	(--)
Nominal GDP	22.4	12.2	2.1	-2.1	18.8
Petroleum	(33.0)	(4.9)	(-16.3)	(-10.4)	(45.3)
Nonpetroleum	(18.5)	(15.2)	(9.0)	(0.3)	(12.0)
Domestic expenditure (at current prices)	14.5	15.0	11.8	-9.1	3.0
Investment	(-4.3)	(4.1)	(15.1)	(-42.9)	(15.8)
Consumption	(23.4)	(19.1)	(10.6)	(2.2)	(-4.9)
GDP implicit price deflator	24.8	11.8	1.4	2.7	18.8
Petroleum	(42.7)	(9.6)	(-9.4)	(-7.3)	(45.3)
Nonpetroleum	(20.2)	(15.2)	(7.5)	(5.6)	(12.0)
Urban consumer price index (period average)	21.3	16.2	10.0	6.4	16.0
Unemployment rate 1/	5.7	6.0	6.9	9.7	13.5 2/

Sources: Central Bank of Venezuela; and Fund staff estimates.

1/ Second semester data through 1982 and first semester data for 1983.

2/ Average for February and March 1984.

Massive increases in public investment (largely financed through foreign borrowing) failed to reactivate the economy, and growing distortions in the cost-price structure and interest differentials in favor of U.S. dollar-denominated assets resulted in large capital outflows. In late 1981 policies were changed again: import restrictions were increased, price controls were tightened, and interest rates were freed, eliminating the differential in favor of rates abroad. However, the drop in oil export earnings in 1982 triggered a major deterioration in the public finances and balance of payments. The consolidated public sector 1/ overall deficit rose from 3.3 percent of GDP in 1981 to

1/ The consolidated public sector in this report covers the Central Government, central government extrabudgetary operations, the Venezuelan Investment Fund, the National Petroleum company (PDVSA), and the nonfinancial public enterprises.

11.3 percent of GDP in 1982 (Table 2), resulting in relatively large foreign and domestic borrowing, including a buildup of domestic arrears. With export earnings declining by 18 percent, the current account moved from a surplus of US$2 billion in 1981 to a deficit of US$3 billion in 1982; private capital outflows exceeded public sector external borrowing by over US$5 billion, reflecting expansionary credit policies in the second half of the year and expectations of a devaluation. As a result, the overall balance of payments registered a deficit of US$8.6 billion in 1982.

The further weakening of the international oil market in early 1983 intensified the balance of payments difficulties. In the two-year period 1982-83 Venezuela's external earnings dropped by the equivalent of 10 percent of GDP. In February 1983 the authorities introduced a set of adjustment measures, including a cutback in public investments, strict price, exchange, and import controls, and a three-tier exchange rate system which involved a depreciation of the bolivar averaging about 13 percent and which included a floating rate for tourist expenditures and capital transactions.

At the same time, the Government renewed its efforts to refinance the US$14 1/2 billion of external public and publicly guaranteed debt with commercial banks maturing in 1983 and 1984. Since then, there have been successive 90-day deferrals on all principal payments, with the most recent one extending through October 31, 1984. Discussions on a possible financial arrangement with the Fund were held during 1983, but the authorities decided against concluding an arrangement in view of the approaching presidential elections, which were held in December 1983.

The February 1983 measures produced a significant improvement in the public finances and balance of payments positions in 1983, although the economy experienced a sharp recession. Real GDP declined by almost 5 percent, unemployment jumped to 13 percent by the end of 1983 (from 7 percent one year earlier), and the rate of increase in prices slowed to less than 7 percent (from 10 percent the previous year). The public sector deficit declined from 11.3 percent of GDP in 1982 to 4.7 percent of GDP in 1983, as a result of significant reductions in capital expenditure, particularly by public enterprises, and higher revenues from improved export earnings of the public enterprises and central bank profits from exchange differentials (see Table 2). An accumulation of payments arrears on private external debt and reductions in inventories led to a sharp increase in liquidity and a deceleration in private sector credit demand; as a result there was a buildup of excess reserve holdings by commercial banks (Table 3).

The effective devaluation of the bolivar, the strict import controls, and the decline in domestic expenditures led to an improvement in the balance of payments in 1983, primarily through a 50 percent reduction in imports. The exchange rate for travel averaged Bs 13 per U.S. dollar compared with Bs 4.3 per U.S. dollar before the devaluation, and foreign

Table 2. Venezuela: Operations of the Consolidated Public Sector 1/

	1980	1981	1982	1983	Proj. 1984
	(In billions of bolivares)				
Total receipts	105.0	114.3	102.6	98.6	127.2
Petroleum sales	80.8	84.4	70.7	63.5	92.6
Nonpetroleum central government receipts	17.2	21.8	25.3	21.2	23.9
Exchange profits	--	--	--	10.1	6.9
Operating surplus of NPEs	--	--	--	--	0.8
Interest and dividend income	7.0	8.1	6.6	3.6	3.0
Fixed asset sales	--	--	--	0.2	--
Total expenditures	103.2	123.8	135.4	112.1	129.9
Current expenditures	58.5	72.1	67.4	63.5	80.4
Central Government (net of transfers to NPEs)	(39.3)	(52.7)	(48.2)	(48.0)	(62.3)
Central Government (extrabudgetary)	(0.1)	(--)	(0.1)	(--)	(--)
Petroleum sector (PDVSA)	(12.7)	(13.2)	(14.4)	(15.1)	(18.0)
Operating deficit of NPEs	(6.4)	(6.2)	(4.6)	(0.4)	(--)
Venezuelan Investment Fund (VIF)	(--)	(--)	(0.1)	(--)	(0.1)
Capital expenditure	44.7	51.7	68.0	48.6	49.5
Central government transfers (net of VIF and NPEs)	(10.1)	(10.4)	(7.2)	(7.7)	(9.1)
Central government direct investment	(3.8)	(4.4)	(6.3)	(4.0)	(4.6)
Central Government (extrabudgetary)	(0.5)	(0.9)	(6.6)	(2.3)	(2.0)
Petroleum sector investment	(9.5)	(15.6)	(21.2)	(11.5)	(15.9)
Investments of NPEs	(16.3)	(15.6)	(26.7)	(21.3)	(17.9)
Other	(4.5)	(4.8)	(--)	(1.8)	(--)
Current account surplus	25.9	42.2	35.2	35.1	46.8
Overall surplus or deficit (-)	1.8	-9.5	-32.8	-13.5	-2.7
Required adjustment	--	--	-	--	3.8
Sources of financing	-1.8	9.5	32.8	13.5	-1.1
Banking system	0.8	2.1	8.0	6.0	7.5
Central Bank	(4.4)	(-2.9)	(7.1)	(6.5)	(16.5)
Other	(-5.2)	(5.0)	(0.9)	(-0.5)	(-9.0)
Change in VIF reserves) Change in PDVSA net foreign assets)	-19.4	-6.2	4.8	2.7	0.2
Change in external debt	6.4	1.4	6.0	2.3	-5.0
Other (including domestic arrears)	10.4	12.2	6.4	3.5	-3.8
	(As percentage of GDP)2/				
Total receipts	41.3	40.1	35.2	34.6	37.5
Total expenditures	40.6	43.4	46.5	39.3	38.3
Overall surplus or deficit (-)	0.7	-3.3	-11.3	-4.7	-0.8
	(Annual rates of change)				
Total receipts	...	8.9	-10.2	-3.9	29.0
Total expenditures	...	20.0	9.4	17.2	15.9
Of which: current expenditures	(...)	(23.2)	(-6.5)	(-5.7)	(26.6)

Sources: Central Bank of Venezuela; Central Budget Office; and Fund staff estimates.

1/ Covers the Central Government, the Venezuelan Investment Fund, the National Petroleum Company, and the Nonfinancial Public Enterprises. The source of data for 1980 and 1981 is the Central Bank, while the source for 1982 onward is the Central Budget Office (OCEPRE), which includes a greater number of nonfinancial public enterprises.

2/ As receipts and expenditures of the National Petroleum Company are included on a gross basis, ratios to GDP differ from the ones in the accompanying recent economic developments paper where data up to 1983 are fully consolidated and the coverage of the public sector is broader.

Table 3. Venezuela: Summary Accounts of the Banking System

	1980	1981	1982 1/	1983 2/	Proj. 1984
	(In billions of bolivares)				
I. Central Bank					
Net international reserves	30.3	36.8	30.0	47.8	69.4
Net domestic assets	-3.5	-5.1	6.7	-1.9	6.6
Net credit to public sector	-4.1	-7.2	--	-5.0	4.5
Credit to banks	5.7	8.7	13.9	12.6	12.6
Other 3/	-5.1	-6.6	-7.2	-9.5	-10.5
Valuation and other adjustments 4/	1.6	1.5	9.2	8.0	36.2
Liabilities to banks	12.8	16.6	14.1	22.8	22.8
Liabilities to private sector	12.4	13.6	13.4	15.1	17.0
II. Banking System					
Net foreign assets 5/	32.2	37.9	29.3	50.8	72.4
Net domestic assets	106.3	125.0	157.5	165.0	183.6
Net credit to public sector	-23.1	-21.0	-13.0	-18.6	-18.1
Credit to private sector	125.1	141.9	162.0	167.4	187.6
Other 6/	4.3	4.1	8.5	16.2	14.9
Valuation and other adjustments 4/	1.6	1.4	9.2	8.0	36.2
Medium- and long-term foreign liabilities	10.2	12.0	16.2	16.7	16.7
Liabilities to private sector	126.7	149.5	161.4	191.1	202.9
	(Percentage change in relation to liabilities to private sector at the beginning of the period)				
Net domestic credit	26.4	14.7	21.8	9.6	13.4
Net credit to public sector	0.7	1.7	5.4	3.7	3.9
Credit to private sector	24.4	13.2	13.5	3.3	12.1
Liabilities to private sector	22.1	17.9	8.0	18.4	6.2
	(As percent of nonpetroleum GDP)				
Net domestic credit	58.9	60.1	69.5	72.6	72.1
Net credit to public sector	-12.8	-10.1	-5.7	-8.2	-7.1
Credit to private sector	69.3	68.3	71.5	73.7	73.7
Liabilities to private sector	70.2	71.9	71.3	84.1	79.7
Money and quasi-money	64.2	65.8	64.7	64.7	75.0
Memorandum items					
Average interest differential between domestic and LIBOR rates	-0.8	-1.7	1.6	4.2	...
Excess reserve holdings of commercial banks (in billions of bolivares) 7/	1.7	3.7	2.1	7.6	...

Sources: Central Bank of Venezuela; and Fund staff estimates.

1/ Data in this column exclude the effects of: (a) the gold revaluation of September 1982; (b) the centralization of international reserves by transfer to the Central Bank of deposits held abroad by PDVSA; and (c) the transfer of two thirds of the Securities Stabilization Fund to the Central Government.
2/ Data in this column record as credit the Bs 7 billion transfer of central bank gold revaluation profits to the Central Government.
3/ Includes official capital and surplus, net credit to the rest of the financial system, net credit to nonmonetary international organizations, medium- and long-term foreign liabilities and net unclassified assets.
4/ Includes SDR allocations and valuation changes in foreign exchange and gold holdings. In 1982 it also includes the deposits held by PDVSA at the Central Bank resulting from the centralization of international reserves. In 1983, it also includes the counterpart of the Bs 7 billion transfer of gold revaluation profits.
5/ Includes net international reserves and other foreign assets.
6/ Includes official capital and surplus, net credit to the rest of the financial system, net credit to nonmonetary international organizations, net unclassified assets, and interbank float.
7/ Excludes the National Bank of Discounts.

travel expenditures dropped drastically. Thus, despite a further fall in export earnings, the current account improved by US$7.5 billion to a surplus of US$3.3 billion (6 percent of GDP). However, the capital account continued to register large net outflows (US$4.2 billion) as foreign banks curtailed their lending to the public sector and cut trade-related lines of credit. The overall balance of payments deficit was reduced to US$1.1 billion, and, as explained more fully below, was financed through an accumulation of arrears on interest and principal of private sector external debt (Table 4).

At end-1983, net international reserves (gross of external arrears) were US$11.8 billion or about 16 months of imports at the level projected for 1984; this figure includes gold holdings of US$3.5 billion, valued at US$300 per ounce. Venezuela's external debt was estimated at about US$35-US$38 billion at end-1983, equivalent to more than 60 percent of that year's GDP. Public and publicly guaranteed debt was about US$27 1/2 billion; of this total, about US$25 billion was owed to commercial banks, of which US$14 1/2 billion was due before the end of 1984 (Table 5).

Following the introduction in February 1983 of a multiple exchange rate system with a floating rate for capital transactions, it was announced that certain private sector debts contracted before the devaluation would have access to a preferential rate, which was understood to be the existing Bs 4.30 per U.S. dollar rate, for both principal and interest payments. Because of delays in registering debt for access to preferential exchange rates, Venezuela's private sector virtually stopped servicing its external debt after the introduction of the multi-tier exchange system in early 1983: an estimated US$0.5-0.6 billion of arrears on private interest payments and an estimated US$0.9 billion of arrears on principal payments were outstanding at the end of 1983. Further arrears accumulated in the first half of 1984.

III. Economic Prospects and Policies

The Government which came into office in February 1984, following the 1983 elections, recognized that the containment of balance of payments pressures through controls was not sustainable in the medium term, and adopted a set of measures designed to adjust further the cost-price structure and to restrain domestic demand. The Government's program included a further 25 percent average devaluation of the bolivar (within a four-tier exchange system); a tightening of fiscal policy; sale, liquidation, and reorganization of public entities; and an incomes policy based on a freeze of wages for most public sector employees, and commitments by private firms to increase employment by 10 percent and by unions not to seek wage adjustments to offset the price increases stemming from devaluation. These policies aimed at permitting a restructuring of relative prices without triggering a price-wage spiral. In addition, the Government adopted selective measures aimed at reactivating the economy, including a general reduction in interest rates and subsidized lending rates to agriculture.

Table 4. Venezuela: Summary Balance of Payments

(In billions of U.S. dollars)

	1980	1981	1982	1983	Proj. 1984
Current account	2.4	2.1	-3.2	3.3	1.5
Trade balance	8.1	7.8	3.9	8.0	7.0
Exports, f.o.b.	(19.3)	(20.2)	(16.5)	(14.8)	(15.7)
Petroleum sector	/18.3/	/19.1/	/15.6/	/13.8/	/14.5/
Other	/1.0/	/1.1/	/0.9/	/1.0/	/1.2/
Imports, f.o.b.	(-11.2)	(-12.4)	(-12.6)	(-6.8)	(-8.7)
Services and transfers	-5.7	-5.7	-7.1	-4.7	-5.5
Freight and insurance	(-0.9)	(-1.0)	(-1.0)	(-0.6)	(-0.8)
Travel	(-1.6)	(-2.1)	(-2.5)	(-0.7)	(-0.7)
Investment income	(-1.1)	(-1.1)	(-1.5)	(-2.6)	(-3.2)
Credits	/2.3/	/3.6/	/2.6/	/1.3/	/1.4/
Debits	/-3.4/	/-4.7/	/-4.1/	/-3.9/	/-4.6/
Transfers	(-0.7)	(-0.4)	(-0.6)	(-0.2)	(-0.1)
Other	(-1.4)	(-1.1)	(-1.5)	(-0.6)	(-0.7)
Capital account	2.0	-0.8	-3.6	-1.8	-1.2
Long-term capital	0.8	1.3	2.3	0.2	-0.3
Public sector	0.1	0.8	2.1	0.2	-0.7
Public debt	(1.5)	(0.3)	(1.4)	(0.5)	(-0.7)
Disbursements	/2.7/	/1.2/	/3.4/	/1.4/	/0.4/
Amortization	/-1.2/	/-0.9/	/-2.0/	/-0.9/	/-1.1/
Scheduled	[-1.2]	[-0.9]	[-2.0]	[-2.0]	[-5.0]
Refinanced	[...]	[...]	[...]	[1.0]	[3.9]
In arrears	[...]	[...]	[0.4]	[-0.1]	[...]
International cooperation	(-0.3)	(-0.2)	(-0.2)	(-0.2)	(0.1)
Other 1/	(-1.1)	(0.7)	(0.9)	(-0.1)	(-0.1)
Private sector	0.7	0.6	0.2	-0.1	0.4
Direct investment	(0.1)	(0.2)	(0.2)	(0.1)	(0.1)
Other	(0.6)	(0.4)	(--)	(-0.2)	(0.3)
Short-term capital	1.2	-2.2	-6.0	-2.1	-0.9
Private nonbank sector	-1.4	-2.7	-4.9	0.7	-0.8
Public sector	2.2	-0.2	-0.8	-1.1	-0.2
Commercial banks	--	--	0.9	-0.4	...
National petroleum company	0.2	0.3	-0.2	0.3	-0.1
Import financing	0.2	0.3	-1.1	-1.6	0.2
Net errors and omissions	-1.0	-0.9	-1.8	-2.2	--
SDR allocation	0.1	0.1	--	--	--
Overall balance	3.5	0.5	-8.6	-0.9	0.3
Valuation changes in reserves 2/	0.3	--	3.0	-0.2	--
Change in net international reserves (increase -)	-3.8	-0.5	5.6	1.1	-0.3
Central Bank	0.5	-1.6	-1.5	-1.1	1.9
Venezuelan Investment Fund	-0.5	-0.9	0.9	0.8	--
National Petroleum Company	-3.8	2.0	5.8	...	...
Change in arrears	--	--	0.4	1.4	-2.2
Memorandum items					
Net international reserves	16.3	16.8	11.6	11.8	9.9
Stock of arrears	0.4	0.4	0.8	2.2	--

Source: Central Bank of Venezuela; and Fund staff estimates.

1/ Includes subscription to IMF.
2/ Data for 1982 reflect a revaluation of gold holdings from US$42.20 per ounce to US$300 per ounce (US$3.0 billion).

Table 5. Venezuela: External Public Debt

(In millions of U.S. dollars)

	1980	1981	1982	Prel. 1983	Proj. 1984
Debt outstanding 1/	23.9	26.0	28.0	27.5	26.3
Medium- and long-term debt	10.4	10.5	12.3	12.9	22.2 2/
External liabilities of the financial sector, and short-term debt of the non-financial public sector	13.5	15.5	15.7	14.6	4.1
Debt service	4.2	5.2	4.9	3.9 3/	4.7 3/
Amortization on medium- and long-term debt	1.7	1.5	1.9	9.5 3/	1.1 3/
Authorized debt	(1.2)	(9.4)	(1.6)	(9.5)	(...)
Official banks	(2.4)	(2.7)	(3.0)	(--)	(...)
Other debt	(2.7)	(2.6)	(--)	(--)	(...)
Interest payments	2.5	3.7	3.0	3.0	3.6
Authorized medium- and long-term debt	(9.6)	(1.3)	(1.3)	(1.8)	(...)
Short-term debt	(1.6)	(2.4)	(1.7)	(1.2)	(...)
Exports of goods and nonfactor services	20.0	20.9	17.6	15.9	16.9
Public debt service ratio 4/	20.9	24.7	27.8	24.6 3/	27.6 3/

Sources: Central Bank of Venezuela; Ministry of Finance; and Fund staff estimates.

1/ Data for 1980-82 are staff estimates based on data provided by the Ministry of Finance. Differences with the amounts implicit in Venezuela's published balance of payments arise from the fact that most short-term public debt transactions until 1982 were not recorded.
2/ Assumes the consolidation of short- into medium-term debt by the end of 1984.
3/ Excludes the deferral of US$1.0 billion in 1983 and US$3.9 billion in 1984. Including these amounts, public debt service ratio would have amounted to 31.1 percent in 1983 and 50.5 percent in 1984.
4/ Ratios of principal and interest payments to exports of goods and services.

The authorities expect that the adjustment of the economy will be completed during 1984 and 1985, and they therefore foresee a gradual reduction in the recourse to transitory mechanisms, such as multiple exchange rates and import and price controls, during the next 18 months. By implementing this program, they hope to lay the basis for a diversification of the economy and a renewal of economic growth, and to secure agreement with foreign banks on a multiyear rescheduling of Venezuela's external debt.

1. External sector prospects and policies

In the discussion of the outlook for Venezuela's balance of payments, the authorities indicated that they expected petroleum export earnings to reach US$14.5 billion in 1984, some 5.5 percent above the 1983 level, reflecting a favorable change in the composition of oil exports and a modest strengthening of prices of oil derivatives that had already taken place. Imports are projected at US$8.7 billion, some 28 percent above the abnormally low level of 1983, and the current account surplus is expected to narrow to about US$1.5 billion from US$3.3 billion in 1983. Assuming a rescheduling of US$3.9 billion of public debt maturities in 1984 and net public debt amortization of just over US$1 billion, a small overall balance of payments surplus is projected for the year. The staff estimates that official reserves will decline by some US$1.9 billion in 1984, reflecting the payment of accumulated external arrears of principal and interest. During the first five months of 1984 official reserves rose by about US$0.5 billion, but there was a further accumulation of arrears on private debt service of a similar magnitude.

According to staff estimates, the level of imports projected for 1984, although 30 percent lower in absolute terms than that recorded in 1981-82, would nevertheless be approximately in line with long-term trends given the developments in real economic activity, the evolution of import prices and changes in the real effective exchange rate. The projected level of imports for 1984 would be some 13 percent below the 1979 import level in nominal terms, but export prices of industrial countries are at the same level as in 1979, real GDP is projected to be some 6 1/2 percent below the 1979 level and, following the two devaluations of the bolivar, the average real effective exchange rate in 1984 would be slightly depreciated compared with that of 1979.

The February 1984 devaluation involved a change of the three-tier multiple exchange system that had been introduced one year earlier to a four-tier exchange rate regime, consisting of (a) a preferential rate of Bs 4.30 per U.S. dollar, applicable to certain public and rescheduled private amortization and 1983 interest payments and, during a transitional period, to imports of food and medicines and student expenses abroad (this rate presently covers about 15 percent of imports of goods and services); (b) a rate of Bs 6 per U.S. dollar applicable to transactions of the petroleum and iron ore sectors (this rate covers 95 percent of exports and some 15 percent of imports of goods and services, and is mainly an accounting device to tax these public entities at a higher rate than under the existing tax laws); (c) a rate of Bs 7.50 per U.S. dollar applicable to the remaining foreign exchange sales by the Central Bank under the exchange and import control system (this rate covers some 60 percent of imports of goods and services); and (d) a free market rate applicable to all other current and capital transactions, covering an estimated 10 percent of imports of goods and services and all exports of goods and services except iron ore and petroleum.

The Central Bank intervenes in the free market selling foreign exchange to the commercial banks at a rate determined daily; the commercial banks sell the foreign exchange bought from the Central Bank at the intervention rate plus a small commission. From mid-1983 to February 1984 the Central Bank kept the intervention rate at Bs 9.90 per U.S. dollar, but from February to early June 1984, the intervention rate was gradually raised to Bs 14.10 per U.S. dollar. Recently, the intervention rate has been changed in steps to Bs 12 per U.S. dollar. Because these rates were generally below the free market rate, central bank intervention has effectively given rise to an additional exchange market. The rate in the free market in mid-July was Bs 12-13 per U.S. dollar, but it had been as high as Bs 16 per U.S. dollar at times in both 1983 and 1984. The pressures on the free market rate in 1983 and 1984 probably reflected purchases of foreign exchange for debt servicing in that market pending registration of the private debt and thus access to the preferential exchange rates. Additional pressures began to develop in March 1984 when interest rates were lowered, and were sustained by nervousness following the closure in early June of a major Venezuelan bank. The mission noted that this market would probably continue under pressure as long as the private debt problem remained unresolved.

The weighted average exchange rate as of mid-1984 was about Bs 7.3 per U.S. dollar, bringing the cumulative devaluation since early 1983 to about 40 percent (70 percent in terms of local currency per U.S. dollar). As price and wage pressures have remained low, this has resulted in a major shift in relative prices, and by March 1984 the real effective exchange rate had been reduced to below the 1979 level (Chart 1).

In keeping with their aim of gradually reducing distortions in the economy, the authorities have stated that they will unify all fixed rates by the end of 1985, except for the rate of Bs 4.30 per U.S. dollar for the amortization of approved private external debt contracted before February 18, 1983 and rescheduled over seven years, and the amortization of debts of public enterprises. They hoped that it would be possible to unify the fixed rates at Bs 7.50 per U.S. dollar, and they planned to unify the free market and the fixed market rates some time after 1986. The authorities stated that foodstuffs and pharmaceutical products would be shifted in stages from the Bs 4.30 rate to the Bs 7.50 rate from time to time; in particular, the shifting of major agricultural commodities would be linked to projected increases in domestic agricultural production. About 200 pharmaceutical items had been shifted in June and a further 15 percent of the list of food items (accounting for some 8-10 percent of the value of imports effected at the Bs 4.30 per U.S. dollar rate) would be transferred in the coming weeks. However, they noted that a significant amount of foodstuffs and pharmaceutical products might not be moved to the Bs 7.50 rate before the end of 1985, and might be given direct subsidies through the budget in subsequent years. The mission encouraged the authorities to establish a timetable for shifting foodstuffs and pharmaceuticals from the Bs 4.30 rate to the Bs 7.50 rate and to keep subsidies to a minimum. It also suggested that if price pressures turned out to be somewhat below expectations the timetable could be speeded up.

The mission took the position that a simplification and liberalization of the trade system was needed to enhance the growth capacity of the Venezuelan economy. At present imports are subject to a dual system of controls, first in the ministries in charge of issuing licenses and subsequently in the exchange control office (RECADI), which again evaluates the requests in light of balance of payments considerations and issues exchange sale authorizations. It was suggested that the second stage of licensing be eliminated immediately and exchange control authority be vested in the Central Bank, which could delegate it to commercial banks that would exercise controls over capital transfers and be authorized to sell foreign exchange freely for permitted current transactions. The mission argued that, in light of the adjustments made in demand management and exchange rate policies and since projected imports seemed about at normal levels, there was little balance of payments justification for maintaining quantitative import restrictions, with its associated distortions. Therefore it would be desirable to start the process of decontrol in the near future.

The mission also suggested that Venezuela's growth prospects would be enhanced by a restructuring of the restrictive system through the substitution of tariff protection at a reasonable level for quantitative import restrictions and prohibitive duties. The new tariff structure could be based on a few uniform tariff levels. Furthermore, the prohibitions on imports of luxury goods that have been introduced in order to conserve foreign exchange could be relaxed as the external position strengthened. Similarly, as progress is made toward unification of the exchange rates and as rates in the free and official markets converge, it should be possible to eliminate the present system of export licensing which is designed to maintain domestic supplies and to prevent arbitrage operations between exchange markets.

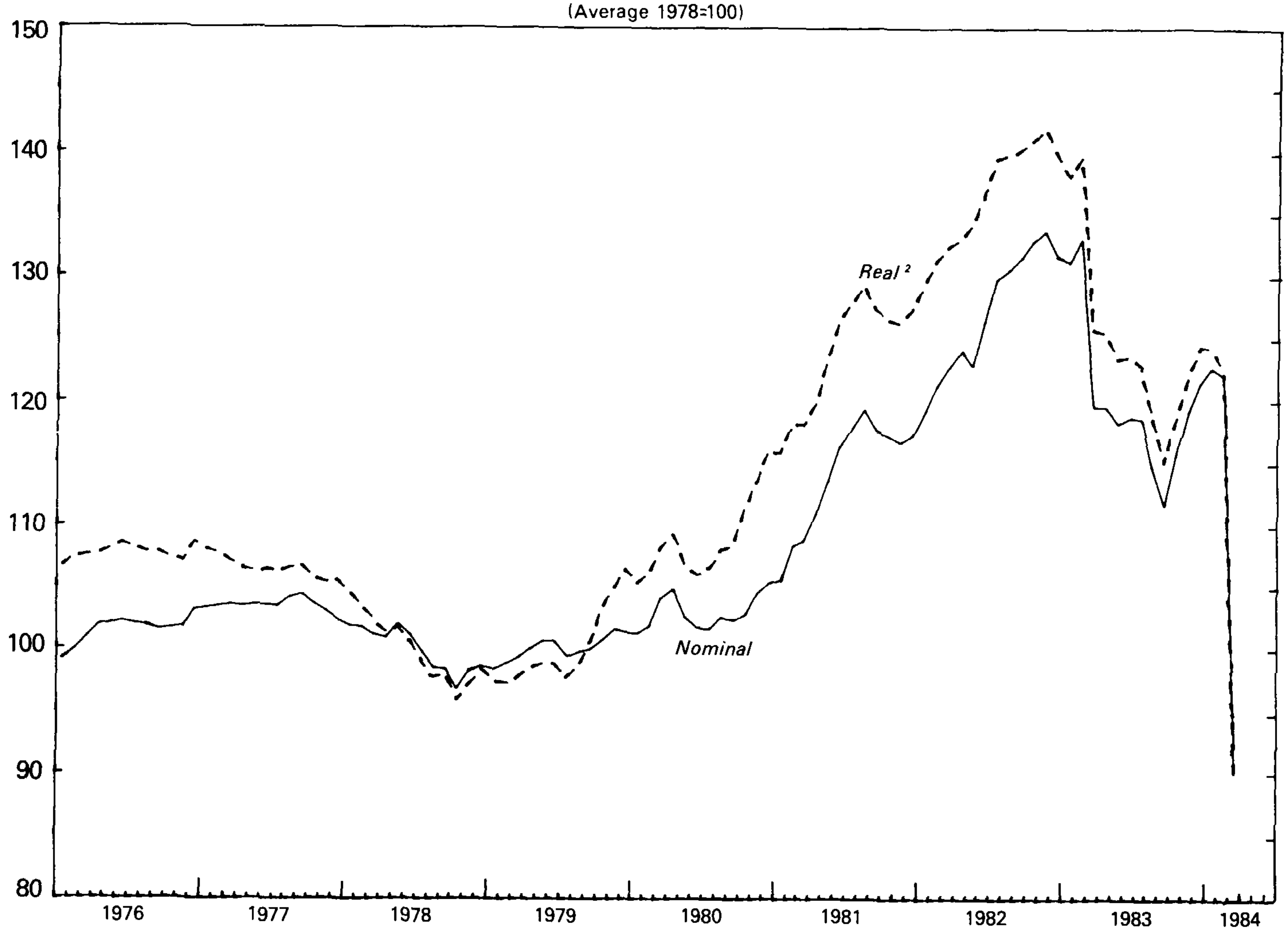
The authorities noted that import licenses were being issued substantially in excess of the 1983 level. They planned to maintain import controls in 1984 and 1985, but by 1986, with the unification of the official exchange rates and given that the industrial sector would have had time to adjust to the new cost-price structure, the restrictions would be eased and more reliance placed on tariff protection. They were giving thought to the possibility of cutting back the duplication of restrictions that now exist and a commission was being set up to propose a restructuring of the tariff system.

CHART 1

VENEZUELA

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES[1]

(Average 1978=100)



Source: IMF.

[1]Weighted by import shares of principal trading partners in 1978. A decrease in the indices represents a depreciation of the exchange rate.

[2]Adjusted by the urban consumer price index for Venezuela and consumer price indices of trading partners.

2. Domestic financial policies

In addition to measures designed to change the cost-price structure (such as devaluation), the new Administration adopted cautious fiscal and monetary policies for 1984.

a. Fiscal policy

In the public finances the aim of the authorities is to achieve an overall public sector surplus of around 1 percent of GDP in 1984, compared with a deficit of 4.7 percent of GDP in 1983. This improvement is to be achieved through increases in domestic fuel prices (from an average equivalent to US$5 per barrel to US$12 per barrel, based on the Bs 6 per U.S. dollar rate) that have been adopted and that are expected to yield revenues equivalent to almost 2 percent of GDP; additional oil revenues arising from the devaluation of the bolivar, which were expected to be equivalent to over 3 percent of GDP; and the exercise of restraint on public spending. The plan to restrain public spending included a 10 percent reduction in operating and maintenance expenditures of the Central Government and public enterprises; a freeze on salary increases and a 10 percent reduction of salaries in the highest brackets;1/ and savings that would result from a reorganization of the decentralized public sector through mergers, divestment, and the liquidation of certain agencies. Capital outlays of the consolidated public sector are projected to be about the same as in 1983 in nominal terms. Public sector foreign interest payments, however, are expected virtually to double in 1984 and to rise by 2.4 percent of GDP, mainly as a result of the devaluation of the bolivar.

The mission's projections for 1984 point to an overall public sector deficit of about Bs 3 billion, the equivalent of 1 percent of GDP, in contrast to the surplus of 1 percent of GDP projected by the authorities--the principal discrepancies with the official estimates being the calculation of Central Bank exchange profits due to different assumptions on balance of payments transactions by market, and in the assumed reductions in operating and maintenance outlays. Although the overall public sector deficit would have been reduced by over 10 percentage points of GDP in a two-year period according to the mission's estimates, the public sector deficit of Bs 3 billion that would remain in 1984 and the planned net external amortization of Bs 5-8 billion could not be financed without crowding out the private sector, or creating inflationary pressures that would result in some combination of reserve losses and a higher rate of price increase. The mission therefore recommended that additional fiscal measures be implemented equivalent to Bs 4 billion in the balance of the year; such measures might involve tigher cuts in planned public investment (for example,

1/ Wages of laborers are governed by a three-year agreement signed in 1983 which provides for increases of about 5 percent a year in 1984 and 1985. Salaried government employees received no wage adjustments in 1982 and 1983.

in the petroleum sector),1/ reductions in subsidies, and adjustments in prices of electricity and domestic petroleum products. The mission also urged implementation of a tax reform program along the lines recommended by a 1983 tax reform commission (reform of the corporate income tax to a flat rate tax, rationalization of the individual income tax, improvements in the administration of customs, and introduction of a value-added tax).

The authorities noted that a number of additional fiscal measures were contemplated in a law under Congressional consideration which entitled the Executive to implement a substantial part of its economic program (Ley Habilitante). Congress has now approved this law, including increases in the tax on liquor and the stamp tax which would generate about Bs 1.2 billion on an annual basis. In addition, the Government was planning to raise electricity tariffs. Other revenue measures included improvements in the collection of income taxes and public utility charges, and customs duties. As regards expenditure, the Government plans to eliminate the consumer subsidy on milk products (about Bs 0.6 billion on an annual basis), and has adopted programs to sell or liquidate a number of public entities, starting with the Agricultural Marketing Corporation (CMA) and the Venezuelan Development Corporation (CVF), and to restructure others, including the state airline (VIASA). They felt that these various measures would go some way toward closing the financing gap estimated by the mission for 1984. The authorities added that later in the year, or in early 1985, the legal framework for a change in the corporate and personal income tax systems and for a generalized sales tax would be presented to Congress.

Looking somewhat further ahead, the mission noted that expenditure commitments arising from new social programs (such as family allowances) that are contemplated for 1985, the rising domestic interest burden from internal debt consolidation,2/ the need to provide for the cost of exchange rate guarantees on private external debt and the prospect of adjustments in salaries all indicated that further revenue measures would be needed in 1985 and 1986. Also, the public finances could be bolstered by strengthening the management and control systems of the public sector (particularly of decentralized entities), along the lines that had been indicated by the authorities. For these purposes, the mission added that it would be useful to draw up quantitative financial targets for all parts of the public sector.

1/ In recent years, Venezuela has raised its oil production potential to 2.5 million barrels per day, almost 50 percent above its OPEC quota of 1.7 million barrels per day, has proven reserves equivalent to 41 years of production at current levels, and completed large-scale upgrading of its refineries.

2/ Legislation has been approved for the issue of long-term domestic bonds to consolidate the large domestic arrears that have accumulated in recent years.

b. Monetary policies

Monetary policies, the authorities explained, would be designed to support the adjustment effort and to limit inflationary pressures. In this context, the authorities had acted to increase the legal reserve requirement so as to sterilize some of the existing excess liquidity in the banking system. In addition, a temporary 100 percent marginal reserve requirement was placed on commercial banks' holdings of foreign assets and on loans granted with collateral foreign assets held overseas from February through early June 1984.

The new Administration also sought to provide a stimulus to the economy through a general lowering of interest rates in March 1984; the agricultural sector, in particular, was to be favored by a preferential interest rate and a requirement that banks increase the share of loans to agriculture to 17 percent and agro-industry to 5.5 percent of their total loan portfolio. These loans are to be made at an interest rate of 8 1/2 percent, whereas the maximum lending rate for the banks was set at 14 1/2 percent, down about 2 percentage points from previously prevailing levels. Mortgage rates were lowered to 12-16 percent, depending on the type of housing. The minimum savings rate was reduced from 10 percent to 8 percent. The rediscount rate was kept at 11 percent but the special rediscount rate on agricultural loans was lowered to 6 1/2 percent provided the loan carries an interest rate of 8 1/2 percent.

The authorities explained that interest rate policy would be managed flexibly to prevent the emergence of a negative differential with rates abroad and to stimulate domestic savings; during the mission's stay, maximum lending rates were raised by 1 1/2 percentage points to 16 percent and the interest rate on time deposits was fixed at 11 percent and the rate for certificates of deposit at 12 1/2 percent (Chart 2).

The mission stressed that a cautious monetary policy would be critical during 1984-85 to assure that inflation was contained. This would facilitate the stabilization of the exchange rate, and of the external position. The mission therefore recommended that the existing excess liquidity of the commercial banks be sterilized immediately by a further adjustment in the reserve requirement, possibly differentiating between large and small banks (reflecting the distribution of the excess holdings). The mission cautioned against increases in rediscounts by the Central Bank. Noting the recent closure of a major bank in Venezuela, the mission suggested that if the Central Bank felt compelled to inject resources into the system in order to support banks in difficulties, a marginal reserve requirement on increases in deposits of the other banks might be implemented to offset the effects of such assistance. Finally, a flexible interest rate policy should be pursued with the aim of stimulating savings and discouraging private capital outflows.

The mission commented that the preferential interest rate given to agricultural loans was not an efficient way of stimulating the sector since the resources may easily be channeled to other purposes. It suggested that subsidized interest rates to agriculture be eliminated progressively with the increase in profitability of the agricultural sector that was expected to result from the shift of food imports to the Bs 7.50 exchange rate and the planned increases in agricultural minimum prices.

The authorities said that they intend to follow a cautious credit policy, but observed that it might be counterproductive to implement a marginal reserve requirement as it could jeopardize the consolidation of the domestic financial system that was in progress. They agreed that the primary focus of interest rate policy under present circumstances should be to protect the balance of payments position. For this reason they intended to review interest rates on a monthly basis. With regard to preferential rates for agricultural loans, they explained that the aim of the policy had been to provide a major stimulus to the sector, but they agreed that the subsidy could be gradually eliminated as the sector's financial position improved.

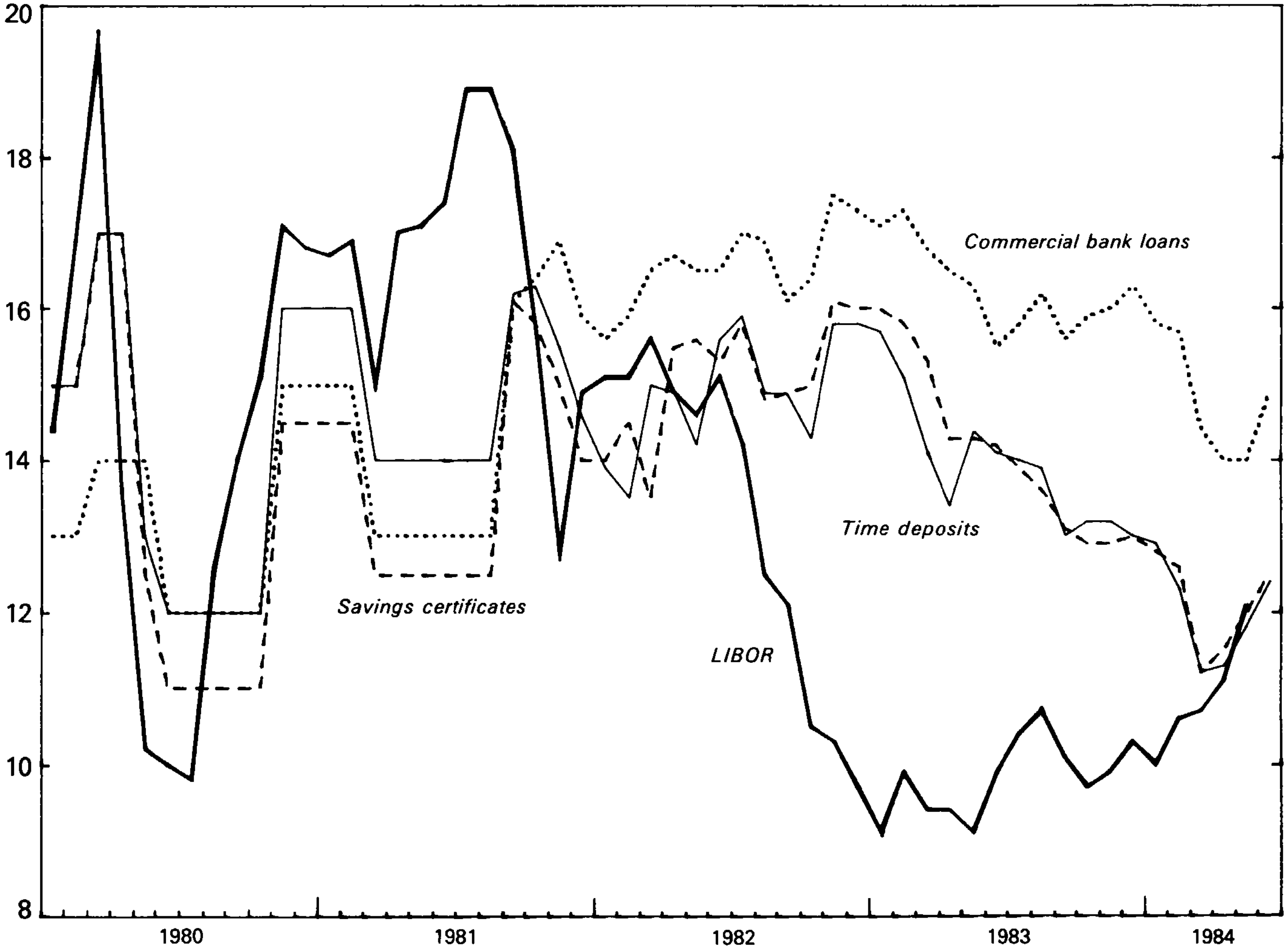
3. Price and wage policies

Venezuela's export earnings have dropped substantially over the past two years, and the authorities recognize that in these circumstances real incomes throughout the economy needed to contract. Thus, in order to restore Venezuela's traditional price and exchange rate stability, wages need to be set without regard to the effects of corrective price adjustments. Indeed, real wage rates in Venezuela declined by some 10 percent during 1982 and 1983, and they are expected to decline further as prices are projected to rise by 15-20 percent during 1984 and no general wage adjustments are contemplated. However, to help low income groups cope with the increases in domestic fuel prices, a two-year "transportation bonus" of Bs 100 per month is to be paid in 1984 and 1985 to employees earning less than Bs 3,000 per month, and enterprises are being required to install cafeterias for their employees.

The authorities viewed wage restraint, together with cautious demand management policies, as essential to permit a realignment of relative prices in the domestic economy without provoking a price-wage spiral. The new structure of relative prices was needed to encourage economic diversification and provide the basis for growth.

Labor unions have shown that they are aware of the adverse effects a general wage increase would have on employment, and have thus subordinated their wage demands to the objective of reducing unemployment. In fact, a major element of the policy strategy of the Administration is a "social pact," whereby union restraint on wages is linked to an undertaking by private enterprises to pay the transportation bonus and to increase employment by 10 percent over the January 31, 1984 levels. Enterprises are also being required to reduce profit distributions. The

CHART 2
VENEZUELA
INTEREST RATES
(In percent per annum)



Sources: Central Bank of Venezuela; and IMF, *International Financial Statistics.*

system of collective bargaining will continue to apply in the private sector. The mission thought that it would be advisable to allow some flexibility to enterprises in the fulfillment of their commitment to increase employment so as to curb cost increases and avoid distortions in the labor market.

The authorities explained that the system of universal price controls should be viewed in the context of the social pact, in order to assure workers that they would not be subjected to speculative price hikes. In this sense, it was a counterpart to wage stability. The system would be administered flexibly and increases in costs would be passed through to prices. Prices for some domestic agricultural products have been raised to stimulate production--for example beef prices were increased by 40 percent in April 1984--and a new minimum price structure for agricultural crops was being considered at the time of the discussions. Private sector representatives interviewed by the mission confirmed that the price control system was being administered flexibly. The mission noted that, even so, the price control system might give rise to distortions. A simplification and reduction in scope of price controls could thus be expected to strengthen the prospects for private investment and growth over the medium term.

4. Medium-term outlook

The Venezuelan authorities have drawn up a set of medium-term macroeconomic projections, in the context of their negotiations with the commercial banks for rescheduling the country's public and private external debt. These projections show small overall surpluses in the public finances over the remainder of the decade, small current account surpluses in the balance of payments, net amortization of external debt on commercial terms, and stabilization of the reserve position at around US$9 billion (or some 9-10 months of imports).

The mission's medium-term projections (Table 6) suggest that current account surpluses over the rest of the decade can be compatible with levels of imports consistent with sustained real economic growth. The projections are subject to a large degree of uncertainty, however, as export earnings will be heavily influenced by developments in the world oil market. Each US$1/bbl change in the price of oil is equivalent to US$0.5 billion in Venezuela's export receipts.1/ For this reason, both the authorities and the mission believe that it is appropriate for Venezuela to maintain a high level of net international reserves. The achievement of current account surpluses and net amortization of external debt will require the pursuit of cautious fiscal and monetary policies.

The authorities indicated that in order to achieve the projected equilibrium in the consolidated public sector accounts, current outlays in real terms would be reduced in 1984, and maintained at that level

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1/ It may be noted that the mission's projections are in line with the assumptions of the latest World Economic Outlook.

Table 6. Venezuela: External Sector Medium-Term Projections (1985-90) 1/

	1985	1986	1987	1988	1989	1990
	(In millions of U.S. dollars)					
	I. Balance of payments					
Current account	1,110	1,606	1,685	1,778	1,680	1,591
Trade balance	6,980	7,109	7,329	7,439	7,615	7,866
Exports, f.o.b.	(16,480)	(17,704)	(18,837)	(20,045)	(21,333)	(22,705)
Petroleum	/15,160/	/16,252/	/17,240/	/18,288/	/19,400/	/20,580/
Other	/1,320/	/1,452/	/1,597/	/1,757/	/1,933/	/2,126/
Imports, f.o.b.	(-9,500)	(-10,595)	(-11,508)	(-12,606)	(-13,718)	(-14,839)
Nonfactor services	-2,635	-2,936	-3,247	-3,613	-4,012	-4,447
Factor services	-3,085	-2,387	-2,181	-1,769	-1,611	-1,455
Transfers	-150	-180	-216	-279	-311	-373
Capital account	-1,642	-1,606	-1,685	-1,778	-1,680	-1,592
Direct investment	90	150	200	210	250	280
Long-term capital	-2,347	-2,007	-1,371	-1,436	-1,434	-1,351
Public sector	(-2,147)	(-1,167)	(-531)	(-596)	(-594)	(-511)
Public debt	/-2,097/	/-1,107/	/-459/	/-509/	/-490/	/-386/
International cooperation	/-50/	/-60/	/-72/	/-86/	/-104/	/-124/
Private sector	(-200)	(-840)	(-840)	(-840)	(-840)	(-840)
Short-term capital	615	250	-514	-552	-496	-521
Overall balance	-531	--	--	--	--	--
	II. External Public and Private Debt and Debt Service					
Total service payments	7,792	7,451	7,159	5,704	8,066	7,634
Interest payments	4,245	3,500	3,280	2,854	2,681	2,507
Amortization payments 2/	3,547	3,952	3,879	2,849	5,385	5,126
Gross new disbursements	700	2,005	2,520	1,500	4,055	3,900
Outstanding debt	31,628	29,681	28,321	26,972	25,642	24,416
	(In percent)					
Debt service ratio	43.8	39.0	35.2	26.3	34.9	31.0
Debt/GDP 3/	62.0	54.0	47.5	41.5	36.1	31.5
Memorandum items						
Oil exports						
Volume (millions of barrels)	564	581	593	604	616	629
Price (US$ per barrel)	27	28	29	30	31	33
	(In millions of U.S. dollars)					
Imports of the oil sector	1,330	1,580	1,570	1,550	1,530	1,530
Other imports	8,170	9,015	9,938	11,056	12,188	13,309
Volume (percentage changes)	3.2	6.0	6.0	7.0	6.0	5.0
Prices (percentage changes)	4.0	4.0	4.0	4.0	4.0	4.0

Source: Fund staff estimates.

1/ International interest rates are assumed to be 12 percent in 1985, 10 percent, on average, in 1986-87, and 9 percent in 1988-90. Spreads are assumed to be 1.5 percent for public sector debt and 2.5 percent for private sector debt.

2/ Assumes rescheduling of US$14 1/2 billion of 1983 and 1984 maturities over ten years, with five years of grace.

3/ Assumes a constant real exchange rate and the following rates of growth of GDP in real terms: 2 percent in 1985, 4 percent in 1986 and 1987, and 5 percent in 1988-90.

in subsequent years. Capital outlays would increase by about 4 percent a year in real terms in the 1985-89 period. Revenues would be boosted by improved tax administration, tax reform, and tariff adjustments in the enterprises.

The mission said that it would be prudent to aim for overall surplus or at least equilibrium in the consolidated public sector. Given the limited scope for noninflationary internal borrowing, the size of the surplus to be targeted would largely depend on the magnitude of the net amortization of external debt. One way to strengthen the overall fiscal position would be to keep public sector investment below the ratio prevailing in the early 1980s. It seemed that it would be possible to limit investment outlays to about 14 percent of GDP in the next several years without a serious impact on growth and employment because major infrastructure works in transportation, electric power, petroleum exploration and refining, and basic industry, have been mostly completed. Moreover, the mission felt that adverse effects on growth and employment could be avoided if the criteria of investment selection adopted were to favor export industries and small-scale infrastructure.

5. External debt and debt rescheduling

As noted above, since 1981 Venezuela has been negotiating with foreign commercial banks the consolidation of large amounts of short-term public debt. Following the balance of payments crisis of 1982/83, Venezuela initiated a comprehensive effort to refinance short- and medium-term public sector maturities with commercial banks falling due in 1983 and 1984, an effort that is still in progress. In the meantime, since early 1983 there have been successive 90-day deferrals of principal on such debt.

The policy of granting foreign exchange at preferential rates for the servicing of certain private sector debts contracted before the 1983 devaluation has been reconfirmed by the new Administration: eligible private debt will have access to the Bs 4.30 public sector rate for payments of principal and for interest payments corresponding to 1983; interest payments corresponding to 1984 onward will have access to the Bs 7.50 rate. This scheme implies a large subsidy equivalent to 1-2 percent of GDP a year in coming years, depending on the amount of debt involved and the exchange rate prevailing at the time of the amortization payments. In response to the staff's concern at the magnitude of these subsidies, the authorities stated that the policy was needed to ensure the financial stability of private enterprises which would have been severely jeopardized by the large adjustment of the exchange rate, and that the policy also served as an inducement to foreign banks to agree to a rescheduling.

Approval of private external debt payment and the allocation of foreign exchange for debt servicing is subject to the debt being (a) registered with the exchange control office (RECADI); (b) certified that it was contracted in the "national interest"; and (c) rescheduled over seven years with two years of grace. The third requirement does not apply to direct commercial credit nor to approved debt of less than US$100,000. The foreign exchange allocation for amortization will be limited to the face value of registered debt, net of any foreign assets held by the debtor.

At the time of the mission, the process of registration and authorization of private debt servicing was still largely incomplete. There were about 8,000 requests for registration, covering about US$11 billion of debt. However, RECADI estimated that on the basis of the registration criteria, authorizations would be in the range of US$5.7-US$7.5 billion. This would consist of about US$2.1 billion debt of financial institutions; about US$3-US$3.5 billion of medium-term debt, and US$0.6-US$1.9 billion of short-term debt. The remaining (nonapproved) debt (US$2-5 billion) will have to be serviced through the free market.

The authorities explained that they were fully aware of the urgency of expediting the process of registration and authorization of debt service. In March 1984 a commission was created to authorize delivery of foreign exchange at the preferential rate for payment of interest on debt which still has not been approved by RECADI, subject to the presentation of a bank guarantee that provides for payment of any difference in the exchange rate in case the debt subsequently does not qualify for the preferential rate. This was expected to permit the immediate resumption of debt servicing. The new commission began its activity in late May, had authorized interest payments of about US$110 million at the time of the discussions, and was authorizing payments at a rate of US$40 million a week. The authorities added that they were instructing RECADI to accelerate the examination of the applications of the largest debtors, and expected that RECADI would finish the examination of the bulk of the private debt by end-September 1984.

The mission noted that the outstanding arrears were extremely damaging to the country's creditworthiness and were a major obstacle to a refinancing of both public and private debt. It suggested that the authorities approve automatically applications for foreign exchange to service foreign debts of financial institutions, subject to ex-post verification, as this would expedite the flow of other credits to the country; clarify and publicize the criteria applied for determining if the debt was contracted in the national interest; and approach urgently the official guarantee agencies to solve any problems concerning officially guaranteed credits.

Subsequently, the staff has been informed that by mid-July RECADI has processed US$3.5 billion of applications; net of assets abroad, the amount registered was US$2.5 billion of which US$1.7 billion was approved for preferential exchange rate treatment and US$0.8 million would be serviced through the free market.

6. International cooperation

The Venezuelan representatives informed the mission that the Program of Cooperation with Central America and the Caribbean had been renewed for another year in August 1983 and is expected to be renewed for an additional year in August 1984. This program covered the fourth year of the joint oil facility with Mexico, whereby both countries finance a part of crude oil imports of about 160,000 barrels a day by ten countries in the region. Given the balance of payments difficulties faced by Mexico and Venezuela, the portion being financed was reduced from 30 percent in previous years to 20 percent in 1983. The financing consists of five-year loans, denominated in U.S. dollars, carrying an annual interest rate of 8 percent; these credits can be converted into 20-year development loans that carry a 4 percent interest rate if the proceeds are used for mutually agreed development projects. The annual net disbursements under this program has been about US$150-200 million. The mission acknowledged the important assistance Venezuela has provided to other countries at a time when the country itself was under serious balance of payments pressures.

IV. Staff Appraisal

During the 1979-82 period the Venezuelan economy stagnated, as the real exchange rate appreciated by 40 percent and expansionary financial and wage policies led to sharp increases in imports of goods and services, a rapid buildup of external debt and increasing capital flight. The decline in petroleum export earnings in 1982-83 precipitated a balance of payments crisis, revealing the extent of the misalignment of relative prices in the domestic economy and the need to undertake a major adjustment of domestic expenditure to a lower level of foreign earnings.

Since early 1983 Venezuela has taken significant steps in adjusting its economy. The nominal effective exchange rate of the bolivar has been depreciated by close to 40 percent (70 percent in terms of local currency per U.S. dollar), reducing the real effective exchange rate to approximately the level that existed prior to the second oil price hike of 1979-80. Moreover, the public sector deficit was reduced from 11.3 percent of GDP in 1982 to 4.7 percent in 1983, and is expected to be close to equilibrium in 1984. In 1983, real GDP experienced a substantial decline, unemployment rose sharply, price increases were quite limited, and the balance of payments situation improved as imports and travel expenditures fell dramatically. Following a current account surplus of US$3.3 billion in 1983, a surplus of US$1.5 billion is projected for 1984. The overall balance of payments is expected to show a small surplus; however, as external arrears are eliminated, reserves are likely to decline by some US$2-2 1/2 billion from their current relatively comfortable level of over US$12 billion.

Policies in the past 18 months have been based to a significant extent on transitional mechanisms such as multiple exchange rates, exchange and import restrictions, and price controls, which have created distortions in the economy. Thus, notwithstanding the adjustments in relative prices, real wages, and demand policies that have taken place and the relatively sound underlying balance of payments situation, confidence has not been fully restored. This situation has been further exacerbated by the experience of five years of stagnation, and the unsettled treatment of private sector external debt.

The Government which took office in February 1984 recognizes the need to adjust the economy to the lower level of income that has resulted from the softening of the world oil market, and to restructure relative prices so as to stimulate economic growth. In addition to a further substantial average devaluation of the bolivar, its economic program includes fiscal restraint; divestment, liquidation, and reorganization of public entities; and an incomes policy that envisages no general wage increase and is based on a freeze of wages for most public sector employees. At the same time, the program calls for a commitment by enterprises to increase employment by 10 percent, and envisages the use of price controls to permit the pass-through only of cost increases. The Government also has adopted selective measures aimed at reactivating the economy, including a general reduction of about 2 percentage points in lending interest rates, and heavily subsidized lending rates to agriculture; more recently, however, the maximum lending rate was adjusted upward.

The staff agrees with the authorities on the importance of wage restraint in assuring the re-establishment of Venezuela's traditional price and exchange rate stability. The staff has reservations, however, about the arrangements to seek an increase in employment. While a recovery of private sector employment is an important objective, it is even more important that such an improvement be lasting, and thus emphasis should be given to keeping cost increases to a minimum. In this respect, the staff would advise the authorities to permit enterprises flexibility in the fulfillment of their commitment to increase employment by 10 percent. Moreover, even if cost increases are being passed through, the present price control system is not free from inefficiencies. A simplification of price controls and a reduction of their scope would help create a climate of confidence in the domestic private sector and would be beneficial from the viewpoint of private investment and growth.

Wage restraint needs to be accompanied by tight fiscal and monetary policies to ensure that the realignment in relative prices is completed without triggering inflationary pressures. This combination of policies would enhance the prospects for sustained growth in subsequent years. Pressures to increase spending in order to reactivate the economy should be resisted, although there may be some room for shifting public investments toward labor-intensive projects.

In regard to fiscal policy, the overall public sector deficit is expected to decline to less than 1 percent of GDP in 1984 owing to higher petroleum revenues, adjustments in domestic petroleum prices, and a further reduction in investment and noninterest current outlays in real terms. Such an outturn would represent a major improvement in the public finances, as the deficit will have been reduced by about 10 percent of GDP over a two-year period. Even so, in the view of the staff, the projected deficit in 1984 and the expected large net external amortization cannot be financed without crowding out the private sector in the context of a monetary program that seeks to avoid a large loss of international reserves. Thus, additional deficit-reducing measures would seem to be in order. Such measures could encompass further reductions in certain public investments; restraint on current outlays and cutbacks in subsidies; adjustments of certain public prices (e.g., for petroleum products and electricity); and an acceleration of the process of rationalizing the public enterprise sector. The staff would also urge the authorities to consider reform of the tax system, based on the various studies that have been completed in this area.

A cautious fiscal stance will need to be buttressed by tight credit policies and flexible interest rates. In order to sterilize the existing excess liquidity of the banks, it would be appropriate to raise the effective bank reserve requirement further. In addition, it will be important not to inject net resources into the banking system through rediscounts or special aid to financial institutions in difficulty. Interest rate policy should be flexible and oriented primarily to assuring that domestic interest rates are not out of line with foreign rates. In this context, the staff welcomes the recent increase in controlled interest rates. Subsidized interest rates for agricultural loans are an inefficient means of stimulating the sector; it would be advisable to phase out subsidized lending rates over the next year or so as profitability of this sector increases with the transfer of imported agricultural goods to the Bs 7.50 rate.

The existing four-tier exchange rate system, with rates varying from Bs 4.30 per U.S. dollar to Bs 12-13 per U.S. dollar in the free market, is causing significant distortions. The authorities have stated that their aim is to unify the fixed rates by the end of 1985. However, it might prove difficult to achieve this objective if the shift of food and pharmaceutical imports to the Bs 7.50 rate were delayed. The staff would, therefore, urge adoption of a timetable for these shifts to take place at regular intervals. Provided economic policies keep the underlying rate of inflation in Venezuela (net of relative price adjustments) at the level of its main trading partners, unification of the official rates at Bs 7.50 per U.S. dollar by the end of 1985 would restore the parity in real effective terms to the level which existed prior to the 1979 oil price hike. It would seem that such an exchange rate could well be compatible with a sustainable balance of payments position, including a certain net amortization of external debt. The staff considers that fiscal and monetary policies should be geared to achieving unification at this rate. However, the appropriate level at which full unification can be achieved will need to be judged in the context of developments in the domestic and international economies over the next year or two.

Quantitative import restrictions are an inefficient substitute for approaches that rely on the price mechanism assisted by appropriate exchange rate policy and demand policies. The overvaluation of the bolivar has been corrected and demand management policies have been significantly tightened; thus, the staff considers that it would be advisable to begin to eliminate the quantitative import restrictions and prohibitions that have been introduced, and to return to the trade liberalization policies that were interrupted in 1981. In particular, the exchange control by RECADI (the exchange control office) does not fulfill any useful function and could be eliminated without delay. Protection of domestic activity can be made more efficient through a reformulation and simplification of the tariff structure, rather than through quantitative import restrictions and prohibitive duties.

A rescheduling of Venezuela's external debt is needed in order to facilitate economic management and re-establish confidence. For this to be feasible, the process of registration of private debt and authorization of debt service payments must be completed with maximum urgency. Provided the foreign debt is restructured and the country follows cautious monetary and fiscal policies, Venezuela should be able to service its external debts and make net amortization payments in the next few years. As to the exchange guarantee schemes for private debt, the cost is expected to be substantial in future years (perhaps 1-2 percent of GDP a year) and will require the adoption of equivalent measures of fiscal adjustment if the inflation and balance of payments objectives are to be achieved.

The staff would urge the authorities to proceed a step further in the formulation and clarification of economic policies by drawing up a quantified financial program and a timetable for the elimination of the transitional mechanisms that have been introduced to protect the balance of payments, i.e., the multiple exchange rate system, quantitative import restrictions and price controls. The formulation of such a program, and its subsequent implementation, would be most useful in assuring the necessary coordination of policies, and in re-establishing confidence.

The changes in the exchange arrangements that have been made by the Venezuelan authorities in the past 18 months have included the introduction of a multi-tiered exchange market that, as such, gives rise to exchange restrictions and multiple currency practices subject to the Fund's approval under Article VIII, Sections 2(a) and 3. Moreover, foreign exchange applications for current international transactions to be settled at the fixed rates continue to be subject to approval and undue delays. The exchange restrictions that are evidenced by payment arrears, together with the restrictions and prohibitions on imports that are being maintained only for balance of payments reasons, have made the exchange and trade system highly restrictive, and the staff urges the authorities to reduce reliance on such measures. Until a firm timetable for the liberalization of the exchange system is developed, the staff would not propose approval under Article VIII of Venezuela's exchange measures.

It is recommended that the next Article IV consultation with Venezuela be held on the standard 12-month cycle.

Venezuela - Fund Relations
(As of June 30, 1984)

I. Membership Status

(a) Date of membership:	December 30, 1946
(b) Status:	Article VIII

A. Financial Relations

II. General Department (General Resources Accounts)

(a) Quota:	SDR 1,371.5 million
(b) Total Fund holdings of bolivares:	SDR 867.6 or 63.3 percent of quota.
(c) Reserve tranche positon:	SDR 503.9 million

	Limit	Outstanding	Uncalled
(d) Lending to the Fund supplementary financing facility (in millions of SDRs)	500.0	349.3	130.6

III. SDR Department

(a) Net cumulative allocation	SDR 316.9 million
(b) Holdings	SDR 362.4 million or 114.4 percent of net cumulative allocation
(c) Current designation plan:	None.

IV. Administered Accounts

(a) Trust Fund	
(i) Donation	US$52.4 million
(b) Oil subsidy account	
(i) Donation	SDR 6 million.

V. Country has not used Fund resources to date.

B. Nonfinancial Relations

VI. Effective February 24, 1984, a four-tier exchange system was established, comprising an exchange rate of Bs 4.30 per U.S. dollar applicable to priority transactions; a rate of Bs 6.00 per U.S. dollar for petroleum and iron ore transactions; a rate of Bs 7.50 per U.S. dollar for all other transactions approved under the exchange control system; and a free rate applicable to the remaining transactions.

VII. Last Article IV consultation was concluded on July 1, 1983 (SM/83/119 and SM/83/127) and the Executive Board did not approve Venezuela's exchange measures. The consultation is under the normal 12-month cycle.

Venezuela--Basic Data

Area and population	
Area	912,000 sq. kilometers
Population (1983)	14.7 million
Annual rate of population increase (1979-83)	2.9 percent
GNP per capita (1983)	SDR 3,623

Origin of nominal GDP (1983)	(percent)
Agriculture	6.8
Petroleum (crude and refining) and mining	20.3
Manufacturing, construction and utilities	19.9
Commerce	9.5
Transport, storage, and communications	11.2
Government	12.1
Other services	19.8

Ratios to GDP (1983) 1/	
Exports of goods and nonfactor services	24.5
Imports of goods and nonfactor services	17.5
Net factor receipts from abroad	-4.5
Central government revenues	25.2
Central government expenditures	26.1
External public debt (end of year)	48.0
External total debt (end of year)	61.2
Savings	22.0
Investment	15.0
Money and quasi-money (end of year)	63.7

Annual changes in selected economic indicators	1981	1982	Prel. 1983
		(percent)	
Real GDP	0.4	0.7	-4.7
Real GDP per capita	-2.4	-2.2	-7.7
GDP at current prices	12.2	2.1	-2.1
GDP deflator (excluding petroleum)	15.2	7.5	5.6
Wholesale prices (annual averages)	13.8	8.1	7.0
Consumer prices (annual averages)	16.2	10.0	6.4
Central government revenues	47.8	-19.5	-3.7
Central government expenditures	54.0	-5.8	-16.2
Money and quasi-money	18.0	7.2	16.4
Money	(9.6)	(-8.2)	(25.8)
Quasi-money	(23.9)	(16.7)	(11.8)
Net domestic bank assets 2/	14.7	21.8	7.9
Credit to public sector (net)	(1.7)	(5.4)	(1.7)
Credit to private sector	(13.2)	(13.5)	(3.3)
Merchandise exports (f.o.b., in U.S. dollars)	4.7	-18.0	-10.1
Merchandise imports (f.o.b., in U.S. dollars)	11.5	1.7	-46.1

Public sector finances 3/	1981	1982	Prel. 1983
	(billions of bolivares)		
Revenues	114.3	102.6	98.6
Of which: petroleum revenues	(84.4)	(70.7)	(63.5)
Expenditures	123.8	135.4	112.1
Current account surplus or deficit (-)	42.2	35.2	35.1
Overall surplus or deficit (-)	-9.5	-32.8	-13.5
External financing (net)	...	10.8	5.0
Internal financing (net)	...	22.0	8.5
Balance of payments	(millions of U.S. dollars)		
Merchandise exports, f.o.b.	20,181	16,516	14,842
Merchandise imports, f.o.b.	-12,373	-12,584	-6,778
Investment income (net)	-1,116	-1,530	-2,575
Other services and transfers (net)	-4,583	-5,648	-2,131
Balance on current and transfer accounts	2,109	-3,246	3,358
Official long-term capital (net)	760	2,100	172
Private long-term capital (net)	603	215	-71
Short-term capital and errors and omissions	-3,105	-7,681	-4,558
SDR allocations	90	--	--
Change in net international reserves (increase -)	-457	8,612	1,099
International reserve position	(millions of SDRs)		
Central Bank (gross)	7,356	8,988	10,615
Central Bank (net)4/	6,994	8,235	8,509
Venezuelan Investment Fund	2,106	1,496	695
National Petroleum Company	4,980	--	--

1/ Petroleum exports are valued at realized prices rather than fiscal export values.

2/ Change in net domestic assets in relation to the private sector claims on the banking system outstanding at the beginning of the period.

3/ Includes the consolidated operations of the Central Government, the Venezuelan Investment Fund, the National Petroleum Company, and the nonfinancial public enterprises.

4/ Net of external arrears and other liabilities.

Venezuela - Statistical Issues

1. Coverage, Currentness, and Reporting of Data in IFS

		Latest Data in August 1984 IFS
Real Sector	- National Accounts	1982
	- Prices	April 1984
	- Production	April 1984
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	Febraury 1984
	- Financing	February 1984
	- Debt	January 1984
Monetary Accounts	- Central Bank	April 1984
	- Deposit Money Banks	February 1984
	- Other Financial Institutions	February 1984
External Sector	- Merchandise Trade: Values	March 1984
	- Merchandise Trade: Prices	May 1984
	- Balance of Payments	1982
	- International Reserves	June 1984
	- Exchange Rates	June 1984

During the past year, the reporting of data for inclusions in IFS has been timely.

2. Outstanding Statistical Issues

Real Sector--National Accounts

As a result of some methodological revisions made recently, the Central Bank has sent to the Bureau, revised figures for national accounts for the period 1972-1982. The mission received from the authorities a description of the new methodology adopted.

Government Finance

The 1983 GFS Yearbook includes data through 1982. Recently, the GFS correspondent provided revised data for the period 1972-82 in reply to the 1984 questionnnaire.

Monetary Accounts

A major financial institution not covered in IFS is the Venezuelan Investment Fund (VIF). However, the fact that the VIF is a major source of credit to public enterprises, finances development projects in neighboring countries, lends to foreign central banks, and maintains substantial short-term foreign investments implies that it should be included as a part of the financial sector. This matter is under discussion with the Venezuelan authorities.

External Sector--Merchandise Trade

Trade by partner data were last reported for 1981 and are reported only on an annual basis. The authorities have encountered a number of problems in data collection and processing. It would be useful if the authorities were able to overcome these problems, and were able to report their data at least quarterly.