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June 7, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Venezuela - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Venezuela. Owing to the exigencies of staff travel, it is hoped to bring this subject to the agenda of the Board meeting scheduled for Friday, July 1, 1983.

If Executive Directors have technical or factual questions relating to this subject prior to the Board discussion, they should contact Mr. Fajgenbaum, ext. 75986.

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INTERNATIONAL MONETARY FUND

VENEZUELA

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the
1983 Consultation with Venezuela

Approved by E. Wiesner and S. Kanesa-Thasan

June 6, 1983

I. *Introduction*

The 1983 Article IV consultation discussions 1/ with Venezuela were conducted in two stages in Caracas during the periods of March 7-24 and April 5-8, 1983. At the time of the first mission, the authorities were in the process of revising the budget for 1983 in the light of the March 14 decision of the members of OPEC to reduce oil prices and to establish production quotas in accordance with the new pricing policy. Since the task of revising the budget was expected to take some time, and because new policy guidelines for the National Petroleum Company (PDVSA) still had to be formulated, the Venezuelan authorities suggested that the discussions be interrupted for a brief period. The mission returned to Caracas in the first week of April for the final round of policy discussions.

Representatives of Venezuela in the consultation discussions included the Minister and Vice Minister of Finance, the Minister and Vice Minister of Planning, the President and Vice President of the Central Bank, the Director of the Budget, the Director of External Debt, the Director of Planning of the National Petroleum Company, and senior officials of various ministries, the Central Bank, the National Petroleum Company, and other public sector agencies and corporations. The staff representatives who participated in some or all of the dicussions were S. T. Beza, Julio Gonzalez, Joris Buyse, and Jose Fajgenbaum (all WHD), Mario Blejer (FAD), Henri Ghesquiere (ETR), and as secretaries Miss Carmen Diaz Zelaya (STAT) and Mrs. Anamaria Handford (INST). Mr. Miguel A. Senior, Executive Director for Venezuela, participated in the policy discussions.

The previous consultation discussions with Venezuela were held in April 1982. The relevant documents (SM/82/111, 6/10/82 and SM/82/120, 6/25/82) were considered by the Executive Board on July 12, 1982.

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

II. Background to the Discussions

In recent years the Venezuelan economy has stagnated, with real GDP showing no growth in the four years since 1978; over this period real GDP in the nonpetroleum sector increased at an average rate of less than 1/4 per cent a year while output of the petroleum sector declined. (In Venezuela the oil sector provides about 95 per cent of merchandise exports, is the basis of some two thirds of central government revenue, and is the origin of around 25 per cent of GDP.) The rate of inflation rose sharply during 1979 and continued at around 20 per cent during 1980, reflecting internal price liberalization measures, the increase in aggregate demand that followed the 1979-80 rise in international oil prices, and the upturn in inflation abroad. The inflation rate fell considerably during 1981 and 1982, along with the decline in inflation abroad (Table 1).

The balance of payments strengthened markedly from 1978 to 1980 with the rise in the price of petroleum exports, and the balance on current account moved to a surplus that exceeded 5 per cent of GDP. The balance of payments continued to show substantial strength in 1981 as the value of exports rose further, but weakness developed in the capital account and there was some loss of official net international reserves. In 1982 the value of exports dropped sharply because of declines in both the price and volume of petroleum exports, and the capital account continued in deficit. Venezuela experienced a major overall balance of payments deficit in 1982.

Receipts of the public sector as covered in Table 2 1/ increased substantially in 1979-80, and continued to rise in 1981, on the basis of the new rise in international petroleum prices. However, as had occurred after the surge of petroleum prices in 1974, expenditure moved up rapidly (with large increases in public employment) and virtually caught up with the increased revenue flow. Thus, the surpluses which were recorded in 1979-80 were replaced by a deficit in 1981. With the weakening of the international oil market in 1982, receipts fell substantially and the deficit widened markedly, notwithstanding a slowing in the rate of growth of expenditure.

In the monetary area, Venezuela maintained controls over interest rates until the second half of 1981, and there were some delays in the adjustment of rates to changes in domestic and international conditions. This policy resulted in domestic interest rates being relatively unattractive during periods of 1980 and 1981, when rates in international money

1/ The consolidated operations of the Central Government, the National Petroleum Company (PDVSA), and the Venezuelan Investment Fund (VIF) represent more than three quarters of the operations of the overall public sector. The data for the rest of the public sector become available only with a considerable lag.

Table 1. Venezuela: Selected Macroeconomic Indicators

	1978	1979	1980	1981	Prel. 1982
	(Percentage change from preceding year)				
Real GDP (at 1968 prices)	3.2	0.8	-1.8	0.4	0.6
Petroleum	(-2.2)	(7.7)	(-6.2)	(-4.4)	(-6.6)
Nonpetroleum	(3.7)	(0.1)	(-1.3)	(0.8)	(1.3)
Nominal GDP	9.7	23.0	21.5	13.6	2.8
Petroleum	(-8.4)	(60.0)	(29.5)	(8.7)	(-13.7)
Nonpetroleum	(15.6)	(13.3)	(18.6)	(15.6)	(9.0)
Domestic expenditures (at current prices)	15.1	6.7	13.8	16.6	11.4
Investment	(12.8)	(-7.8)	(-7.6)	(9.3)	(15.8)
Consumption	(16.4)	(15.4)	(24.1)	(19.2)	(10.0)
GDP implicit price deflator	6.3	22.0	23.8	13.2	2.2
Petroleum	(-6.3)	(48.5)	(38.1)	(13.7)	(-7.6)
Nonpetroleum	(11.4)	(13.3)	(20.2)	(14.6)	(7.6)
Urban consumer price index (end of period)	7.0	20.1	19.2	11.4	7.7

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

Table 2. Venezuela: Consolidated Operations of the Central Government, the Venezuelan Investment Fund, and the Petroleum Sector

	1978	1979	1980	1981	Prel. 1982
(In billions of bolivares)					
Total receipts	57.5	79.7	105.0	114.3	103.4
Petroleum sales	39.6	60.6	80.8	84.4	70.7
Of which: taxes received by Central Government 1/	(25.4)	(33.5)	(45.5)	(70.9)	(49.2)
Nonpetroleum central government receipts	14.7	14.8	17.2	21.8	25.3
Interest and dividend income	3.2	4.3	7.0	8.1	7.4
Total expenditures	66.6	62.9	87.6	115.5	120.6
Current expenditures	35.5	42.5	54.5	68.3	68.7
Capital expenditures	31.1	20.4	33.1	47.2	51.9
VIF transfers to rest of the public sector	(6.8)	(3.1)	(4.6)	(10.4)	(10.3)
Central government transfers to the public sector (excluding VIF)	(14.9)	(7.2)	(14.5)	(16.4)	(15.6)
Petroleum sector investments	(4.6)	(6.4)	(9.5)	(15.6)	(18.6)
Other	(4.8)	(3.7)	(4.5)	(4.8)	(7.4)
Current account surplus or deficit (-)	21.6	37.2	50.5	45.8	34.7
Overall surplus or deficit (-)	-9.1	16.8	17.4	-1.4	-17.2
External financing	7.1	-13.9	-15.0	4.0	13.3
Net foreign assets of VIF	0.1	0.7	-3.0	-4.0	5.5
Medium- and long-term foreign assets of VIF	-0.8	-0.6	-0.7	-1.0	-0.8
Medium- and long-term foreign assets of PDVSA 2/	-3.1	-13.5	-15.8	11.2	6.5
Medium- and long-term external borrowing (net)	10.9	-0.5	4.5	-2.2	2.1
Financing by banking system	4.4	-1.7	0.7	-7.8 3/	7.2
Other sources of financing	-2.4	-1.2	-3.1	5.2	-3.3
(As percentage of GDP)					
Total receipts	33.6	37.9	41.0	39.3	34.6
Total expenditures	38.9	29.9	34.2	39.7	40.4
Overall surplus or deficit (-)	-5.3	8.0	6.8	-0.4	-5.8
(Annual rates of change)					
Total receipts	5.3	38.6	31.7	8.8	-9.5
Total expenditures	9.5	-5.6	39.3	31.9	4.4
Of which: current expenditures	(12.3)	(19.7)	(28.2)	(25.4)	(0.6)

Sources: Central Bank of Venezuela; Venezuelan Investment Fund (VIF); and National Petroleum Company (PDVSA); and Fund staff estimates.

1/ Includes indirect taxes paid by the National Petroleum Company to the Central Government.

2/ Includes changes in accounts receivable. In 1982, does not include the transfer of foreign assets held by the National Petroleum Company to the Central Bank.

3/ This number results from a Bs 7.2 billion decline in the net creditor position of the Central Government and the Venezuelan Investment Fund less bond placements by the Central Goverment with the banking system of Bs 10 billion, which were used to cancel interest arrears of the state enterprises.

and capital markets were high. Starting in August 1981, interest rates have been left free to adjust to market conditions, and for a time interest rates were determined with the framework of a relatively tight credit policy on the part of the Central Bank. After the middle of 1982, however, credit from the Central Bank expanded rapidly. In reflection of interest rate and credit market conditions, together with an apparent growing concern about the sustainability of exchange rate policy because of the deterioration of the external position, private capital transactions in the balance of payments registered outflows and errors and omissions were negative in the period 1980-82.

Focusing more closely on 1982, as already indicated, economic developments last year were affected significantly by the decline in petroleum export earnings. Early in the year the authorities adopted a policy package that was intended to counter in part the effects of the drop in oil export earnings that became apparent. As the fall in oil earnings was thought to be temporary, however, there also was to be substantial reliance on the use of international reserves to finance the fiscal and balance of payments deficits that were developing. The adjustment portion of the package included curbs over public spending (particularly investment outlays), while revenue was to be strengthened through the introduction of higher domestic gasoline prices, the imposition of duties on goods imported by the petroleum sector, and the increase of several minor taxes. Monetary policy was to be managed so as to help achieve a further reduction of inflation and provide protection to the balance of payments.

Central government revenue turned out to be lower than had been envisaged for 1982, however, owing to lower revenues that had been budgeted from nonpetroleum sources. At the same time, expenditures were significantly higher than budgeted, as spending cuts that had been announced were implemented only in part. As a result, the Central Government recorded an overall deficit equivalent to 2.7 per cent of GDP in 1982, compared with a surplus of 1.8 per cent of GDP in 1981. In addition, the combined deficit of the Venezuelan Investment Fund and the National Petroleum Company rose from 2.3 per cent of GDP to 3.1 per cent. Although detailed information on the operations of the rest of the public sector is still not fully available for 1982, the data on financing point to an overall public sector deficit of almost 8 per cent of GDP in 1982, compared with a deficit of 3 per cent in 1981. The financing of the deficit consisted mainly of a drawdown in the foreign exchange holdings of the public sector, the use of public sector deposits with the banking system, and the use of part of the balance of the Securities Stabilization Fund.1/

1/ The purpose of this fund is to protect the Central Bank from large valuation changes in its security holdings; in September 1982, two thirds of the fund was transferred to the Central Government, leaving an outstanding balance of Bs 1.5 billion.

As was mentioned above, credit policy was kept relatively tight in the first half of 1982, in continuation of the policy that had been followed in the latter part of 1981 after interest rates had been freed. The situation changed in the second half of the year, however, as the Central Bank lowered the rediscount rate and expanded its rediscounting operations in an endeavor to stimulate activity in the non-oil sector of the economy. The rapid growth in credit that followed resulted in sizable capital flight, which was reflected in the relatively slow growth of the banking system's liabilities to the private sector (Table 3). The financial situation became somewhat unsettled in late 1982 when the banking authorities intervened in the operations of the Venezuelan Workers' Bank because of difficulties stemming from nonperforming loans; at that time the bank accounted for about 10 per cent of total bank liabilities and was the largest bank in Venezuela.

The surplus in the trade account declined from US$8 billion in 1981 to US$3-1/2 billion in 1982, as the weakening of the international oil market led to a drop in oil export earnings from more than US$19 billion in 1981 to US$15-1/2 billion in 1982 (Table 4). Other exports fell slightly, to less than US$1 billion, with most of this change reflecting decreases in aluminum and steel shipments that occurred because of weak demand conditions abroad. The value of imports increased from US$12 billion in 1981 to US$13 billion in 1982. There are indications that part of the rise in imports was the product of an unusual buildup of inventories owing to fears over an exchange rate adjustment or other measures to contain imports, but it also should be noted that the real exchange value of the bolivar registered a large appreciation during 1981, followed by a further rise in 1982 (Chart 1). The deficit on services and transfers rose from less than US$6 billion in 1981 to about US$7 billion in 1982, with much of the deterioration attributable to reduced interest earnings from abroad and the widening of the deficit in the travel account. The current account showed a deficit of US$3-1/2 billion in 1982, equivalent to 5 per cent of GDP, compared with a surplus of more than 3-1/2 per cent of GDP in 1981.

The capital account registered a deficit of US$1.7 billion in 1982, down slightly from the deficit in 1981. The balance on capital account changed little only because a deterioration in the private nonbank capital account was offset by official foreign borrowing. Also, the outflow in net errors and omissions went up to nearly US$3 billion in 1982, more than double the outflow in the preceding year. The weakening of the private capital account (and the balance on errors and omissions) appears to have been related to credit market conditions as discussed above, and to the deterioration in confidence in the wake of the drop in oil exports and the real appreciation of the bolivar. Venezuela's overall balance of payments deficit was US$8 billion in 1982 and the country's net official international reserves were reduced to US$11-1/2 billion by the end of the year.1/

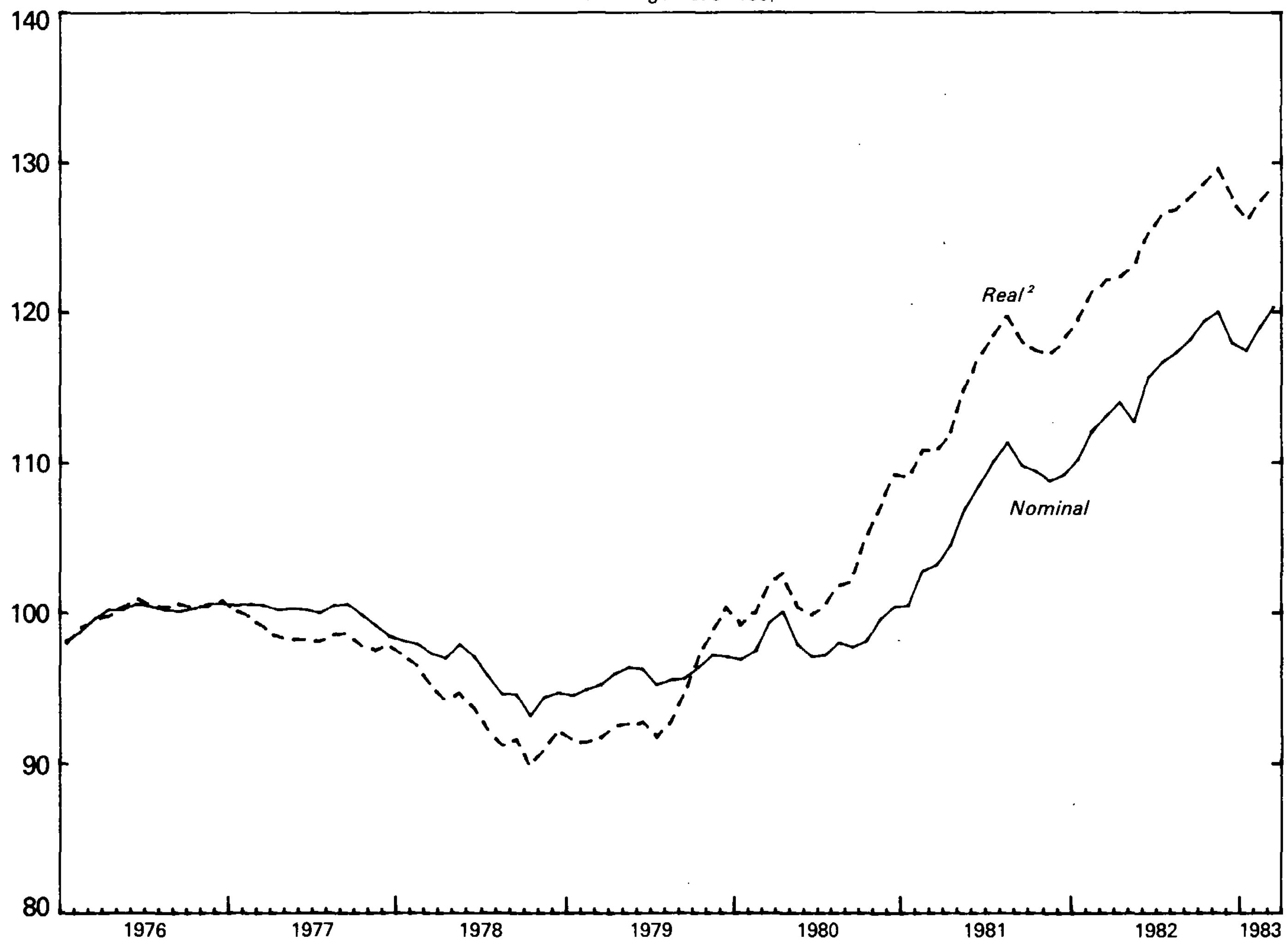
1/ This figure excludes a change in the valuation of gold holdings of some US$3 billion that took place in September 1982. In this report, gold is valued at SDR 35 an ounce, which facilitates comparison with previous years.

CHART 1

VENEZUELA

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES[1]

(Average 1976 =100)



Sources: IMF data Fund ;and Fund staff estimates.

[1]Weighted by import shares of principal trading partners during 1976-78.

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

Table 3. Venezuela: Summary Accounts of the Banking System

	1978	1979	1980	1981	1982 1/	1982 2/
(In millions of bolivares)						
I. Central Bank						
Net international reserves	27,917	33,512	30,345	36,783	29,998	42,836
Net domestic assets	-5,831	-8,727	-3,519	-5,121	6,668	-1,247
Net credit to public sector	-6,984	-9,469	-4,049	-7,200	-30	-11,625
Credit to banks	3,838	3,493	5,668	8,682	13,940	13,940
Other 3/	-2,685	-2,751	-5,138	-6,603	-7,242	-3,562
Valuation and other adjustments 4/	1,130	1,472	1,651	1,425	9,158	14,081
Liabilities to banks	11,582	13,056	12,812	16,614	14,129	14,129
Liabilities to private sector	9,374	10,257	12,363	13,623	13,379	13,379
II. Banking System						
Net foreign assets 5/	29,656	34,854	32,228	37,909	29,287	42,125
Net domestic assets	73,725	78,989	106,341	125,001	157,519	149,604
Net credit to public sector	-20,290	-23,907	-23,138	-21,010	-13,014	-24,609
Credit to private sector	88,123	99,860	125,137	141,924	162,062	162,062
Other 6/	5,892	3,036	4,342	4,087	8,471	12,151
Valuation and other adjustments 4/	1,130	1,472	1,651	1,425	9,158	14,081
Medium- and long-term foreign liabilities	6,475	8,594	10,160	12,040	16,188	16,188
Liabilities to private sector	95,776	103,777	126,758	149,445	161,460	161,460
(Percentage change in relation to liabilities to private sector at the beginning of the period)						
Net domestic credit	...	5.5	26.4	14.7	21.8	
Net credit to public sector	...	-3.8	0.7	1.7	5.4	
Credit to private sector	...	12.3	24.4	13.2	13.5	
Liabilities to private sector	...	8.4	22.1	17.9	8.0	
(As per cent of nonpetroleum GDP)						
Net domestic credit	54.3	51.4	58.3	71.2	68.6	
Net credit to public sector	-15.0	-15.6	-12.7	-10.0	-5.7	
Credit to private sector	64.9	65.0	68.6	67.4	70.6	
Liabilities to private sector	70.6	67.5	69.5	70.9	70.3	
Money and quasi-money	64.3	61.7	63.3	64.4	63.1	
Memorandum item						
Credit to private sector as proportion of liabilities to private sector	92.0	96.2	98.7	95.0	100.4	

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

1/ For purposes of comparison this column excludes 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/ In accordance with the end-of-year balance sheets.

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.

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.

Table 4. Venezuela: Summary Balance of Payments

(In billions of U.S. dollars)

	1978	1979	1980	1981	Prel. 1982
Current account	-6.2	-0.5	3.3	2.4	-3.5
Trade balance	-2.1	4.4	8.4	8.1	3.4
Exports, f.o.b.	(9.2)	(14.4)	(19.3)	(20.2)	(16.5)
Petroleum sector	[8.7]	[13.7]	[18.3]	[19.1]	[15.6]
Other sectors	[0.5]	[0.7]	[1.0]	[1.1]	[0.9]
Imports, f.o.b.	(-11.2)	(-10.0)	(-10.9)	(-12.1)	(-13.1)
Services and transfers	-4.1	-4.9	-5.1	-5.7	-6.9
Freight and insurance	(-1.2)	(-1.1)	(-0.9)	(-1.0)	(-1.0)
Travel	(-1.3)	(-1.5)	(-1.6)	(-2.1)	(-2.5)
Investment income	(-0.6)	(-1.0)	(-1.2)	(-1.1)	(-1.3)
Other	(-1.0)	(-1.3)	(-1.4)	(-1.5)	(-2.1)
Capital account 1/	3.1	3.4	0.2	-2.0	-1.7
Long-term capital	3.7	1.5	2.2	0.8	2.6
Public sector	(2.1)	(0.7)	(1.5)	(0.2)	(2.5)
Loans authorized by Public Credit Law	[2.4]	[1.0]	[1.5]	[0.1]	[2.7]
Loans registered with SIEX	[0.1]	[-0.1]	[0.2]	[0.2]	[--]
Venezuelan Investment Fund	[-0.2]	[-0.1]	[-0.2]	[-0.2]	[-0.2]
Other 2/	[-0.2]	[--]	[-0.1]	[0.1]	[--]
Private sector	(1.6)	(0.7)	(0.8)	(0.6)	(0.1)
Direct investment	[0.1]	[0.1]	[0.1]	[0.2]	[0.2]
Other	[1.5]	[0.6]	[0.7]	[0.4]	[-0.1]
Short-term capital	-0.6	1.9	-2.0	-2.8	-4.3
Private nonbank sector	(-0.3)	(-0.3)	(-1.3)	(-2.6)	(-4.5)
Public sector	(--)	(2.2)	(-0.7)	(-0.2)	(-0.1)
Commercial banks	(-0.2)	(--)	(--)	(--)	(0.3)
Net errors and omissions	2.6	1.4	-0.2	-1.4	-2.9
SDR allocation	--	0.1	0.1	0.1	--
Overall balance	-0.5	4.4	3.4	-0.9	-8.1
Valuation changes in reserves 3/	-0.4	--	0.2	0.7	3.0
Change in net international reserves (increase -)	0.9	-4.4	-3.6	0.2	5.1
Central Bank	(1.6)	(-1.3)	(0.7)	(-1.5)	(-1.4)
Venezuelan Investment Fund	(--)	(0.2)	(-0.7)	(-0.9)	(0.8)
National Petroleum Company	(-0.7)	(-3.3)	(-3.6)	(2.6)	(5.7)

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

1/ Excludes National Petroleum Company.
2/ Includes subscription to IMF.
3/ Gold holdings were revalued by US$3.0 billion in 1982. For earlier years this line reflects valuation changes in foreign exchange holdings.

Venezuela's external debt has increased rapidly in recent years and at the end of December 1982 the outstanding debt was estimated at US$34 billion, equivalent to about 50 per cent of GDP. The external debt of the public sector was close to US$27 billion (Table 5), of which some US$25 billion was owed to commercial banks and US$13 billion was to be repaid this year. Control over the external debt operations of public sector agencies and enterprises had been weak until recently, and the statistical coverage deficient. In August 1981 the Congress acted to tighten control over external public debt operations, and it authorized the Ministry of Finance to refinance the outstanding short-term debt. Despite a promising start at the beginning of 1982, Venezuela has had only limited success in rescheduling its short-term external public debt, reflecting in large measure the weakening of the country's external situation; the short-term debt of the public sector currently amounts to nearly US$11 billion, or some 40 per cent of the total public external debt. The external debt of Venezuela's private sector is estimated to be some US$7 billion, but it should be noted 4hat there are no reliable historical estimates on the external debt of this sector. With the freedom of private capital flows that prevailed in Venezuela, official records of private capital transactions were incomplete. Currently, efforts are under way to register the private external debt.

External debt service is likely to absorb a large portion of Venezuela's foreign exchange earnings during the period ahead. Even if the growth of external debt should be halted, and assuming interest rates in international money and capital markets stay at their current levels, the country's interest payments would be equivalent to some 20-25 per cent of exports of goods and services. As regards amortization payments, there is uncertainty about the schedule that the country will be facing since discussions with foreign banks on the possible restructuring of a large part of Venezuela's external public debt are still in progress. On the basis of existing obligations, Venezuela would need to make principal payments on external public debt of some US$13 billion in 1983, on top of interest payments of around US$3 billion. External private debt service payments (principal and interest) might be in the range of US$5-6 billion, but these figures are subject to a great deal of uncertainty. Thus, total debt service payments due this year probably exceed US$20 billion, compared with a staff estimate of exports of goods and services of less than US$17 billion.

Even if the discussions with creditors should lead to a restructuring of the external debt on relatively favorable maturity terms--say, an average maturity for all debt of seven years--amortization payments would still average some 30 per cent of exports of goods and services (excluding the effects of possible grace periods), and total debt service payments would be some 50 per cent of exports of goods and services. Apart from the effects of faster economic growth abroad or a decline in interest rates in international markets, Venezuela's external debt burden will be eased only as it improves its own growth performance and reduces its reliance on foreign borrowing.

Table 5. Venezuela: External Public Debt

(In millions of U.S. dollars)

	1978	1979	1980	1981	1982
Debt outstanding	14,766	18,233	21,872	23,731	26,690
Authorized medium- and long-term debt	7,266	8,233	9,672	9,531	13,992
External liabilities of the financial sector and short-term debt of the non-financial public sector 1/	7,500	10,000	12,200	14,200	12,698
Debt service	1,915	2,951	4,182	5,172	4,786
Amortization medium- and long-term debt	937	1,327	1,677	1,469	1,882
Authorized debt	(569)	(866)	(1,170)	(943)	(1,582)
Debt registered with SIEX	(168)	(241)	(267)	(256)	(--)
Official banks 1/	(200)	(220)	(240)	(270)	(300)
Interest payments	978	1,624	2,505	3,703	2,904
Authorized medium- and long-term debt	(403)	(561)	(955)	(1,342)	(1,213)
External liabilities of the financial sector and short-term debt of the nonfinancial sector 1/	(575)	(1,063)	(1,550)	(2,361)	(1,691)
Exports of goods and nonfactor services	9,803	14,959	19,968	20,938	17,180
Public debt service ratio	19.5	19.7	20.9	24.7	27.9

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

1/ Data for 1978-81 are staff estimates that differ from the amounts implicit in Venezuela's published balance of payments, which did not record most short-term public debt transactions until 1982.

As was noted above, inflation decelerated during 1982. This occurred notwithstanding a large rise in the public sector deficit, an expansionary Central Bank policy, and an increase in gasoline prices; the gasoline price changes had the effect of raising the general level of prices by some 2-1/2 per cent. The pressures emanating from expansionary financial policies apparently were absorbed by increased spending abroad and capital outflows--financed from the use of international reserves--and the rate of price increase in Venezuela came down in line with the fall in inflation abroad. The Government's success in resisting large wage demands since the sizable general wage increase in early 1980 probably also contributed to the abatement of inflation; however, there have been some offsets to the Government's wage restraint because of more liberal wage adjustments by certain public enterprises and entities.

Output growth continued to be weak in 1982, with real GDP increasing by only a little more than 1/2 per cent. Nonpetroleum output rose by about 1-1/4 per cent while petroleum output continued to decline. Gross fixed investment fell in real terms in 1982, as the drop in private investment more than outweighed a rise in public investment; inventories increased substantially, however.

In early 1983 there was an intensification of capital outflows and net international reserves declined further. To contain the large short-term private capital outflow that was developing, the Government suspended all exchange transactions on February 20, and two days later the President of the Republic issued a decree that established (effective February 27, 1983) a three-tier exchange rate system. The new arrangements included a preferential market based on the existing exhange rate of Bs 4.30 per U.S. dollar, a second market based on an exchange rate of Bs 6 per U.S. dollar, and a free exchange market with a floating rate.

The preferential rate was to be available for private imports such as food, medicine, certain raw materials, and agricultural inputs; official imports; amortization and interest payments on the public debt; most private sector debt obligations outstanding as of February 18, 1983, provided they were repayable over at least three years; and remittances to students and government offices abroad. The rate of Bs 6 per U.S. dollar was to be available for imports of nonessential goods and services, imports of other raw materials, and imports of private capital goods. The supply of foreign exchange for these controlled markets was to come from petroleum exports and other exports by government enterprises, and possibly proceeds from certain nontraditional exports. The free exchange market was to handle all other transactions, such as outward transfers of capital, travel, and profit remittances. The main sources of foreign exchange for this market were to be the proceeds from the rest of nontraditional exports, inflows of private capital, tourism, and services. There have been delays in establishing the machinery that is to administer the new exchange system, and the processing of import permits and payments has lagged; in addition, there has been uncertainty about the exchange rate treatment to be accorded to private debt operations, and some payments arrears have developed.

Together with the establishment of the new exchange system, the Government announced a 60-day price freeze and introduced quantitative restrictions on imports, including the outright prohibition of the importation of a large number of luxury goods.

III. Economic Prospects and Policies

The key question in the consultation discussions was how Venezuela would adjust to the large drop in foreign exchange earnings since 1981, a decline equivalent to some 10 per cent of GDP. Since the reduction in oil export earnings could not be regarded as temporary, continued reliance on financing through the drawdown of foreign exchange holdings or foreign borrowing, as occurred in 1982 and at the beginning of 1983, was neither appropriate nor feasible. Thus, the discussions centered on the means by which domestic expenditure would be brought into line with the country's reduced income and external adjustment accomplished, with the basic aim being to reestablish the conditions for the resumption of economic growth.

1. External sector prospects and policies

The authorities said that the balance of payments difficulties the country has been facing had stemmed from several exogenous factors. These included the decline in international oil prices, a lagging world economy, high international interest rates, and a general reduction in Latin America's access to international money and capital markets. These were the factors behind the large capital outflows the country had experienced, which in turn had had an adverse effect on its credit standing. In an attempt to reassure foreign creditors that Venezuela had the means to honor its debts and to promote confidence in the bolivar, the decision had been taken to transfer to the Central Bank the foreign reserves held abroad by the National Petroleum Corporation. At the same time, and with the same objective, gold holdings were revalued at US$300 per ounce. As it turned out, these actions did little to stem the outflow of capital or to enhance Venezuela's creditworthiness.

As was noted above, in early 1983 the authorities responded to continuing balance of payments pressures with the introduction of a three-tier exchange rate regime and measures to restrain imports. Also, the Government intensified its efforts to refinance the external public debt, and it appointed an Advisory Committee of 13 international commercial banks to assist it in these endeavors. In late March, the Government made a proposal to creditor banks to defer, until July 1, 1983, payment of short-term public debt and of longer term public debt falling due in 1983. Since that time representatives of the Government of Venezuela have met periodically with the advisory committee and with the creditor banks, reporting on developments in Venezuela, including on the policies the authorities are adopting to adjust the balance of payments and, thus, to provide the basis for a refinancing plan with the creditors.

In the discussion of the outlook for Venezuela's balance of payments in 1983, the authorities indicated that they expected petroleum export earnings to be about US$13-1/4 billion, down nearly US$2-1/2 billion from 1982. The average price for petroleum forecast for 1983 was US$24.57 a barrel, which incorporated the effects of efforts to increase the share of refined products in Venezuela's petroleum exports in the course of the year. The volume of petroleum exports was projected to average 1.471 million barrels a day. The estimate for volume in 1983 reflected actual exports of 1.611 million barrels a day during the first three months of the year, and for the remainder of the year it assumed observance of Venezuela's output quota under the recent agreement among OPEC members, production of liquified products of gas equivalent to 62,000 barrels a day of oil, and a drawdown of oil stocks equivalent to 102,000 barrels a day. Exports other than petroleum were expected to be a little more than US$1 billion in the official forecast for 1983.

Imports were projected to decline by more than 20 per cent in value from 1982 to 1983, reflecting the new direct restraints on imports, changes in relative prices, and the weakness of domestic demand. The drop in external earnings and the curbs on domestic public spending (discussed below) were expected to result in sluggish domestic economic conditions. Net payments for travel abroad in 1983 were projected to be reduced sharply because of the depreciation of the bolivar in the free market. Net interest payments abroad were projected to increase because foreign interest earnings would fall with the decline in the country's international reserves.

The authorities expected the current account of the balance of payments to show a deficit of just under US$1 billion in 1983, compared with one of US$3.5 billion in 1982.

In regard to the capital account of the balance of payments, the authorities were tentatively estimating a net outflow of a little more than US$3 billion. This figure took into account what had already occurred in early 1983 and assumed a limited net repayment of external debt; it also included the effects of some intervention in the free market aimed at stabilizing the rate. It was emphasized by the authorities that the capital account estimates could be regarded as no more than working assumptions, particularly since discussions were under way with foreign creditors on the refinancing of the country's external debt payments due in 1983.

On the basis of the above estimates for the current and capital accounts, the overall deficit in 1983 would be some US$4 billion, and would reduce the country's net international reserves to about US$7-1/2 billion by the end of 1983. The authorities noted that without any new foreign financing, immediately available reserves would be reduced to less than US$3 billion by the end of the current year.

Against this background, the mission questioned whether the exchange rate and other arrangements in place were adequate to deal with the country's balance of payments problems. The mission asked whether the commitments to provide foreign exchange at the two fixed exchange rates (of Bs 4.30 per U.S. dollar and Bs 6.00 per U.S. dollar) were consistent with the resources available to the authorities; in particular, the mission was concerned whether access to the preferential exchange rate of Bs 4.30 per U.S. dollar was not so liberal as to thwart achievement of the objective of reducing balance of payments pressures. The mission drew attention to data which indicated a significant real appreciation of the bolivar in the last few years on the basis of the exchange rate of Bs 4.30 per U.S. dollar, and it stressed in this connection the need to shift to a pattern of relative costs that would encourage diversification of the economy as required to restore growth.

The mission went on to observe that attempts to stabilize the exchange rate in the free market through official intervention, as the authorities had been doing, could be very costly in terms of reserve losses and might in fact spur capital flight, particularly since such intervention risked creating uncertainty about how the free market would be handled. Uncertainty of this kind also would impede a reflow of capital to Venezuela. More generally, the mission said, the free exchange market should be given greater scope to ensure that the adjustment of the balance of payments would be achieved on the basis of an efficient use of the country's resources.

The mission also questioned the use of import restrictions and prohibitions for balance of payments adjustment. The mission acknowledged that much of the adjustment in the balance of payments would have to come from a reduction of imports in the short term. However, to ensure that scarce resources would not be misused and to avoid an aggravation of inflation, import reduction should be based on a change in relative prices and curbs on domestic demand. Thus, exchange rate adjustment, which also could provide incentives for export, was to be preferred over direct controls over imports in correcting the balance of payments situation.

The authorities said that while there were problems to be overcome before the new exchange system would be fully operational, the administrative machinery was already in place for controlling imports eligible for the exchange rate of Bs 4.30 per U.S. dollar. For payments at the exchange rate of Bs 6.00 per U.S. dollar, however, the administrative machinery was in place only for some categories. The authorities said that they did not expect extraordinary inflationary pressures to develop as a consequence of the use of import restrictions and prohibitions since they believed that substantial excess capacity existed in the economy. They also noted that the import prohibitions generally affected luxury goods.

The authorities expressed concern about the mission's suggestion that more weight be given to the price mechanism (through the exchange rate) to restrain imports of the kinds covered by the preferential exchange rate of Bs 4.30 per U.S. dollar. According to them, such a policy would bring pressures to reintroduce domestic subsidies, and thus would undo the accomplishments of the past several years in this area. The authorities emphasized that the exchange and trade arrangements that were being put in place were provisional and had the same basic structure as those that had been introduced to deal with comparable problems some 20 years ago. Such controls had been phased out in due course, and it was again the intention of the authorities to restore a unified exchange rate regime in the future.

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 1982. This program covered the third year of the joint oil facility with Mexico, whereby both countries finance about 30 per cent of crude oil imports of at least 160,000 barrels a day of nine countries in the region. The financing consists of five-year loans, denominated in U.S. dollars, carrying an annual interest rate of 4 per cent. These credits are to be converted into 20-year development loans that carry a 2 per cent interest rate if the proceeds are used for mutually agreed development projects. The annual cost of this program to Venezuela has been about US$200 million. The mission acknowledged the important steps taken by Venezuela through this program to assist other countries at a time when they were under serious balance of payments pressures.

2. Domestic financial policies

The authorities noted that the problems that the country was currently facing stemmed in part from a failure last year to recognize the dimensions of the change in the international oil market situation, and the consequent decision to rely to a large extent on financing rather than immediately undertaking comprehensive measures of adjustment to cope with the imbalances that emerged. Thus, the revenue measures and expenditure cuts adopted in 1982 were not sufficient to deal with a problem of the magnitude of the one that developed and that apparently would not be reversed soon.

On the side of public sector revenue, the effects of the increases in retail prices for regular and premium gasoline were in part offset by a shift in consumption patterns to low-octane gasoline and diesel oil; thus, the effect on the domestic consumption of petroleum was smaller than had been expected and the additional revenue generated fell short of the projection. Although efforts had been made to lower public expenditure, only partial success had been achieved because of difficulties in slowing down the programs in progress. In the end, the authorities did manage to curb certain public works. Nevertheless, as was discussed above, the overall deficit of the Central Government, the National Petroleum Company, and the Venezuelan Investment Fund, taken together, reached the equivalent of close to 6 per cent of GDP in 1982.

The authorities said that they had believed last year that domestic activity could be stimulated through domestic credit expansion without significant adverse effects on the balance of payments. It was now recognized, however, that such policies had contributed to the large outflow of private capital that took place in 1982 and early 1983. There had been a failure to assess accurately the country's external situation and the degree to which the external position was vulnerable because of the size of the short-term external debt.

The authorities expressed their determination to undertake a significant fiscal adjustment this year. Based on the 1983 budget approved by Congress in March, together with the decision to slow down the public sector investment program and to reduce certain inventory holdings of the public sector, they projected for 1983 a deficit in the consolidated operations of the Central Government, the Venezuelan Investment Fund, and the National Petroleum Company of Bs 14 billion; such a deficit would be equivalent to around 4 per cent of GDP, or some 2 percentage points lower in relation to GDP than in 1982. Under this program, which assumed that oil revenue would fall by 11 per cent from 1982 to 1983, capital expenditure would decline some 30 per cent while current expenditure would increase slightly. The authorities noted that they were assuming a net repayment of external debt of some Bs 6.4 billion (subject to the same qualification mentioned earlier inasmuch as the debt refinancing negotiations still had to be completed).

On this basis, the overall financing requirement for 1983 was estimated to be somewhat more than Bs 20 billion. Some Bs 8 billion of this financing requirement would be met by the use of profits from exchange rate differentials under the three-tier exchange market described above. The remainder would be financed primarily from the drawdown of foreign and domestic deposits, although there also would be resort to a small amount of domestic bond financing and a limited use of suppliers' credits from abroad by the National Petroleum Company.

With respect to the nonpetroleum public enterprises, the authorities said that the Government had been making a concerted effort to strengthen the finances of these entities through improvements in expenditure control and more effective revenue collection. They noted that the financial discipline of these enterprises was being tightened as their access to external financing had been curtailed. In addition, the Government had been reducing transfers to these enterprises, which had been requested to make offsetting cuts in their current expenditure and to increase their prices and tariffs. The authorities said that the results achieved had been significant. Subsidies had been reduced substantially as public utility rates had been increased for services such as electricity, telephone, public transportation, and water and sewerage.

In its comments on the presentation by the authorities of their fiscal policies, the mission questioned whether, in the light of the severe weakening of revenues from the petroleum sector, enough was being done to put the public finances on a sound footing. The curbs on expenditures concentrated on capital outlays and rested in part on the use of materials in stock. There was a question about the suitability of these policies in view of their effects in the medium to longer run, and thus there were doubts about their sustainability. A similar issue arose on the side of revenue, inasmuch as stocks of petroleum were being drawn down for exports. Furthermore, the use of deposits, whether held at home or abroad, represented financing that was approaching its limits as international reserves were drawn down.

The mission said it saw an urgent need for actions that could be expected to produce a lasting adjustment of the public finances, including cuts in current expenditure and the strengthening of revenue. The mission noted in this connection the large subsidy that still prevailed in the pricing of domestic petroleum products. Elimination of this subsidy would produce a large increase in revenue and make an important contribution to a better allocation of resources. Also, the mission drew attention, as previous consultation missions had done, to the desirability of diversifying the tax system through the establishment of a sales or value-added tax. Recent experience had underscored the need for such diversification.

The authorities said that the drawing down of deposits by public sector agencies was in accordance with the plan that had been elaborated in the past to spread out over time the use of the resources that became available when oil prices had surged. Under that plan, resources (deposits) had been accumulated at the time when oil export earnings were very high, and those resources were being utilized now. The investment programs that had been financed by drawing down these deposits were coming to an end, and thus certain expenditure pressures would be disappearing. However, the authorities acknowledged that a need was developing for renewed public sector investment in traditional areas--such as for the modernization and expansion of infrastructure--and resources would have to be found for these purposes.

The authorities said that a committee with broad political support was looking into ways to strengthen the tax system, possibly by broadening the income tax and by increasing indirect taxation.1/ They said that they agreed that an increase in gasoline prices would be desirable, and they noted that a commission was studying the question of gasoline prices in the broader context of the optimum pricing policy for all energy sources, including electricity. They thought, however, that it was not feasible to think of early actions in these areas, particularly since presidential elections were to be held in December.

1/ The Fund staff has provided technical assistance to this committee, including the presentation of reports on taxation of the nonpetroleum sector and tax administration.

They also felt that these adjustments should be introduced in a manner that would limit the extent of social disruption, and for this reason it was important to conclude the studies referred to above to provide solid foundations for policy actions.

In the area of monetary management, the authorities noted that commercial banks and other institutions in the financial sector were permitted to set interest rates freely, and it was intended to maintain this policy. There was recognition of the need for restrained monetary and credit policies in the light of balance of payments prospects, and the Central Bank was working on a quantitative program that would help to guide its management of monetary policy in a way that would contribute to the protection of the balance of payments. The authorities added, however, that there were pressures on the Central Bank to act to stimulate activity, and there had been suggestions that this could be done without adding significantly to inflationary pressures through a selective credit expansion directed to sectors with excess capacity.1/ The mission doubted the feasibility of such an approach, as had been shown by the experience of many countries.

3. Price and wage policies

The Venezuelan representatives were pleased with the marked decline in domestic inflation from some 19 per cent during 1980 to 11 per cent during 1981 and to less than 8 per cent during 1982. Apart from the effects of the recent downward trend in inflation in key trading partners, they attributed the slowdown of inflation to the absence of general wage increases in the last two years and the gradual fading away of the effects of the corrective price changes that resulted from the price liberalization measures adopted in 1979-80. They added that the increases in gasoline prices and the adjustment of the tariffs of several public utilities undertaken in 1982 were obscuring to some extent the reduction that had taken place in the underlying inflation rate, which they estimated to have been reduced to less than 5 per cent during 1982. The authorities hoped that a moderate rate of inflation would be restored after the price increases related to the recent adjustments of exchange rates ceased to exert their effects. During 1983, the authorities expected prices to rise by some 18-20 per cent.

The authorities recognized that recent actions had reversed the Government's earlier policy of price liberalization. Price controls had gained importance again, particularly through the enforcement of a resolution which specified a 30-day advance notice 2/ before the prices of certain items can be raised, and through the increase in the number of goods and services subjected to direct price controls. At

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1/ On May 4, 1983, the Central Bank lowered the rediscount rate by 2 percentage points to 11 per cent. For agricultural loans this rate was reduced to 9 per cent.

2/ This period can be extended up to 6 months if a detailed study is deemed necessary.

the same time, however, some further progress was made in reducing subsidies. With respect to direct subsidies, the Government had unified the price of sugar at the beginning of 1982. In the same year, the subsidy on white corn flour, another staple, was eliminated altogether and subsidies for imports considered essential were reduced markedly. In contrast, the subsidy on mortgage interest payments for new low-income houses, which was introduced in July 1981, had been broadened somewhat in scope. Overall, direct subsidies (as measured in the national income accounts) fell by 11 per cent to Bs 3.1 billion in 1982. The major and growing subsidy is that for milk consumption, which amounted to almost one half of total direct subsidies last year. In 1983, the subsidy for sorghum, a widely used animal feed, was eliminated.

With respect to indirect subsidies (which do not enter into the budget as outlays), the one relating to the domestic consumption of petroleum products was reduced last year. Effective May 1, 1982, gasoline prices were increased from the equivalent of US$0.13 per gallon to US$0.27 per gallon for regular, and from US$0.31 per gallon to US$0.88 per gallon for premium fuel. 1/ Nevertheless, domestic sale prices of petroleum products at present are still based on an average price of less than US$7 a barrel for crude petroleum, which gives rise to an implicit annual subsidy of Bs 11.5 billion at the exchange rate of Bs 4.30 per U.S. dollar; at an exchange rate of Bs 6.00 per U.S. dollar the subsidy would be some Bs 16 million. The authorities confirmed that domestic sales prices of petroleum products were not even covering the costs of the crude petroleum input.

When the multiple exchange rate system was introduced in late February 1983, the authorities imposed a 60-day price freeze that was said to be aimed at the avoidance of speculative price increases. The authorities said that, following the termination of the price freeze, they would maintain a price surveillance mechanism as a temporary measure to avoid extraordinary rises in prices as compared with costs. The staff stressed the need to pass on fully to consumers the effect of the change in the exchange rate to ensure effective adjustment and encourage efficient import substitution. The staff also emphasized that price controls would become redundant if measures to control aggregate demand were put in place.

In the area of wages, the authorities said that they had been able to resist the growing pressures for a general increase and that the system of free bargaining would continue to determine wages and salaries. In addition, to demonstrate the authorities' determination in keeping wage increases to a minimum, the Central Government has offered its employees a very modest wage adjustment for 1983-85. Also, to avoid contributing to a further deterioration of the public finances, the authorities had postponed the proposed food stamps program that was to

1/ Estimated at the exchange rate of Bs 4.30 per U.S. dollar.

be initiated in the course of 1983 on an experimental basis in certain regions of the country. This proposal contemplated a monthly grant in food stamps of Bs 300 per family member for wage earners whose family monthly income was below Bs 1,500.

IV. Staff Appraisal

With the weakening of the international oil market, Venezuela has experienced a large drop in external income since 1981. Domestic expenditure was maintained last year by external borrowing and drawing down foreign assets, an approach that obviously has its limits. The pressures on the country's foreign exchange holdings were further aggravated by the sizable outflow of capital that developed because of doubts about the capacity of the authorities to maintain the official exchange rate that prevailed until recently. In these circumstances, the country's external debt, which is large in relation to the size of the economy and to a significant extent of short maturity, became much more difficult to manage.

Early this year, continuing capital flight and renewed signs of a weakening oil market led the authorities to introduce a three-tier exchange system and to increase restrictions on imports. Simultaneously, a 60-day price freeze was declared. The authorities also have taken steps to reduce public spending, in response to the drop in revenue occasioned by the fall in foreign earnings, and they have intensified the effort to refinance the country's external debt; Venezuela's total obligations for the payment of principal and interest on its external debt are estimated to be more than US$20 billion this year, which is well in excess of prospective earnings from exports of goods and services.

It is the view of the staff that these recent actions by the Venezuelan authorities fall short of what is needed to deal with the country's economic difficulties and that the measures employed are not those that would be appropriate. On the domestic side, the reliance on financing of the public sector is too great, the cuts in public spending are not of the kind that it would be desirable to seek and are likely to prove unsustainable, and the revenue projection incorporates a nonrecurring element since it counts on sales of oil out of stocks. On the external side, the reliance on direct import controls is excessive, the exchange arrangements adopted do not assure effective adjustment, and official intervention in the free exchange market has been financing capital flight. The staff is of the view that the measures taken by the authorities to deal with the problems confronted risk an early exhaustion of the country's international reserves, a serious acceleration of inflation, and distortions in the allocation of resources.

The staff is at the same time very much aware that bringing domestic expenditure into line with income while avoiding an inflationary spiral, achieving external adjustment in an efficient manner, and taking the other measures needed to create the conditions for a revival of growth are formidable tasks in present circumstances. However, the consequence of failing to act boldly in dealing with the country's economic problems is that adjustment to the new external situation, which is in any event inevitable, will be more severe.

Major action is needed to improve the public finances in view of the dim outlook for net external financing, the importance of not crowding out private investment, and the need to assure resources for public investments of high priority. Strong efforts will need to be made to curb current expenditure, including through the pursuit of wage restraint and a strict attitude toward public employment. It also will be important to press ahead with efforts to rationalize public investment expenditure; cutbacks in certain capital outlays by the public sector are probably desirable, but care obviously needs to be taken to avoid impairing the capacity of major producing sectors such as the petroleum industry.

The adjustment of the public finances that is necessary is a large one, however, and additional action to raise revenue appears inescapable. The elimination of the implicit subsidy for the domestic consumption of petroleum products would immediately produce a large increase in revenue, and would also raise the country's export potential. Work has been proceeding in Venezuela on possible changes in the tax system, in respect of both direct and indirect taxation, and early consideration should be given to measures that would bolster revenues. Also, the pricing policies of public sector entities should continue to be adjusted so as to reduce their dependence on transfers from the Central Government, and tax exemptions should be curtailed.

Implementation of a restrained fiscal policy would help the Central Bank in achieving adequate control over domestic credit. More generally, the Central Bank should restrict the growth of its net credit to a pace consistent with the early restoration of the country's traditional price stability--following the corrective change in the price level that is now in progress--and with a satisfactory development in international reserves. From the present starting point, the Central Bank would appear to have little room to absorb losses in net international reserves. To assist in the efficient management of credit policy and to discourage capital outflows, interest rates should be determined freely by market forces, within the framework provided by a prudent credit policy of the Central Bank. It should be emphasized in this connection that the Central Bank will need to exercise a strict control over its rediscounts to the rest of the banking system; thus, the recent reduction in the Central Bank's discount rate cannot be justified in Venezuela's current circumstances.

The downward adjustment in domestic expenditure that is necessary will require cutbacks in private spending as well as direct reductions in public expenditure. Some of the compression of private spending could occur as a result of modifications in public policies--e.g., increases in domestic oil prices, other public sector prices, and taxes--and some can be expected to occur as a result of the changes in the prices of imported goods and services as a consequence of the depreciation of Venezuela's currency.

To implement these corrective price changes without sparking an inflationary process and to mitigate adverse effects on employment, it is necessary to recognize that the price increases just mentioned cannot be offset by wage increases. The decline in the country's foreign earnings that has taken place represents a reduction in real income that will have to be borne. Strict implementation of a restrained incomes policy, complemented by fiscal and credit policies along the lines described above, would obviate recourse to price control mechanisms and thus reduce the danger that adjustment might be obstructed.

As was indicated above, it is the staff's view that Venezuela's exchange and trade policies do not address the problems that are being confronted. There is evidence that maintenance of the exchange rate of Bs 4.30 per U.S. dollar has given rise to a substantial real appreciation of the bolivar in recent years. The continued use of that rate hardly seems appropriate in current circumstances, in which development of the non-oil sector needs to be emphasized. More generally, multi-tier exchange systems of the kind Venezuela is now employing create distortions, raise issues of equity, and are inimical to effective adjustment. A major simplification of Venezuela's exchange arrangements clearly is in order. Also, it would seem indispensable, for the time being at least, to rely heavily on market forces in the determination of the exchange rate, on the basis of a target for international reserves. Until confidence is regained through the pursuit of satisfactory economic policies, it is not possible to say what exchange rate could be successfully defended by the authorities.

The extent to which the bolivar may depreciate will depend on the quality of the policies followed; with restrained fiscal, monetary, and incomes policies, the depreciation of the bolivar should be equilibrating and not a source of disturbance. It should be stressed that the country is not in a position to offer subsidies to purchasers of foreign exchange, given the need to limit any further loss of international reserves and the obvious inadvisability of incurring additional external debt to support any preferential exchange rate.

The decision of the authorities to rely on import controls may appear to be inevitable in the short run because of the urgency of reducing the demands for foreign exchange. However, these measures are an inefficient substitute for approaches that rely on the price mechanism--such as a flexible exchange rate policy--and they do not obviate the need for the adjustment of domestic demand if inflation is to be checked. On the basis of the adoption of suitable demand and exchange rate policies, the staff would urge the elimination of the quantitative import restrictions and prohibitions that were recently introduced, and an early return to the trade liberalization policies that were interrupted in 1982.

Venezuela's very difficult external debt problems will be resolved only through the adoption of adjustment measures of the kind referred to above. What is needed is to strengthen the fiscal position and thus to limit the growth of public debt, and at the same time to assure that the conditions for the resumption of economic growth are created. With the adoption of adequate adjustment measures, Venezuela would be in a better position to negotiate the refinancing of its external debt. It is important that this matter be dealt with soon to avoid that the deferral of debt service payments results in damage in the country's creditworthiness. It is also important in this connection that the uncertainties surrounding the exchange rate treatment of private debt operations be eliminated in order to avoid the further accumulation of arrears and to facilitate the early settlement of arrears that have developed.

The changes in exchange arrangements made by the Venezuelan authorities on February 27, 1983 and subsequently have involved the introduction of a three-tier exchange market that gives rise to exchange restrictions and multiple currency practices subject to the Fund's approval under Article VIII, Section 2(a) and 3. Also, the processing of the foreign exchange applications for transactions to be settled at the fixed rates has been subject to delays. The staff believes that these exchange measures together with the restrictions and prohibitions on imports that were imposed for balance of payments reasons have significantly increased the restrictiveness of the exchange and trade system. As discussed above, the staff urges the adoption of adjustment policies that would make recourse to these restrictive practices unnecessary. In the circumstances, approval under Article VIII of Venezuela's exchange measures is not proposed at this time.

Fund Relations with Venezuela

Status:	Article VIII, since July 1, 1976.		
Quota:	SDR 990 million.		
Fund holdings of Venezuelan bolivares:	As of May 31, 1983	Millions of SDRs	Per Cent of Quota
	Total currency holdings	563.0	56.9
SDR Department:	Cumulative SDR allocation	SDR 316.9 million	
	Net acquisition of SDRs	SDR 106.5 million	
	Holdings of SDRs	SDR 423.4 million (133.6 per cent of allocation)	
Exchange rate:	Effective February 27, 1983 a three-tier exchange system was established with the existing 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 nonessential imports; and a free rate applicable to all other transactions. As a temporary measure, the authorities maintain the rate of Bs 4.20 per U.S. dollar, which used to be applied to the transactions of the petroleum and iron ore industries, for the discharge of any pending liabilities of these industries arising from their activities prior to their nationalization.		
Restitution of gold:	Gold acquired	282,423 fine ounces	
Contributions to oil facility:	Committed and disbursed	SDR 650 million	
	Outstanding net of repayments	--	
Contribution to oil Subsidy Account:	Committed and disbursed	SDR 6 million	
Contributions to supplementary financing facility:	Pledged	SDR 500 million	
	Disbursed (net)	SDR 366.9 million	
Last Article IV consultation:	Mission	April 1982	
	Board discussions	July 12, 1982	
Other recent missions:	Technical assistance missions in October 1981 and February 1982 by FAD in the fields of tax administration and taxation of the nonpetroleum sectors.		

Venezuela--Basic Data

Area and population			
Area			912,000 sq. kilometers
Population (1982)			14.7 million
Annual rate of population increase (1978-82)			2.9 per cent
GNP per capita (1982)			SDR 4,202
Origin of nominal GDP (1982)			(per cent)
Agriculture			5.9
Petroleum (crude and refining) and mining			23.4
Manufacturing, construction, and utilities			18.7
Commerce			8.6
Transport and communications			12.0
Government			12.0
Other services			19.4
Ratios to GDP (1982) 1/			
Exports of goods and nonfactor services			25.0
Imports of goods and nonfactor services			-27.3
Net factor receipts from abroad			-1.9
Central government revenues			25.0
Central government expenditures			27.6
External public debt (end of year)			38.5
Savings			24.1
Investment			26.3
Money and quasi-money (end of year)			49.2

Annual changes in selected economic indicators	1980	1981	Prel. 1982
		(per cent)	
Real GDP	-1.8	0.4	0.6
Real GDP per capita	-4.6	-2.4	-2.2
GDP at current prices	21.5	13.6	2.8
GDP deflator (excluding petroleum)	21.5	13.6	2.8
Wholesale prices (annual averages)	20.1	13.8	8.1
Consumer prices (annual averages)	21.3	16.2	10.0
Central government revenues	29.8	47.8	-19.6
Central government expenditures	46.9	38.1	-5.7
Money and quasi-money	22.3	18.0	7.2
Money	(20.5)	(9.6)	(-8.2)
Quasi-money	(23.6)	(23.9)	(16.7)
Net domestic bank assets 2/	26.4	14.7	21.8
Credit to public sector (net)	(0.7)	(1.7)	(5.4)
Credit to private sector	(24.4)	(13.2)	(13.5)
Merchandise exports (f.o.b., in U.S. dollars)	34.2	4.7	-18.0
Merchandise imports (f.o.b., in U.S. dollars)	8.7	11.5	8.6

Public sector finances 3/	1980	1981	Prel. 1982
	(billions of bolivares)		
Revenues	105.0	114.3	103.4
Of which: petroleum revenues	(80.8)	(84.4)	(70.7)
Expenditures	87.6	115.5	120.6
Current account surplus or deficit (-)	50.5	45.8	34.7
Overall surplus or deficit (-)	17.4	-1.4	-17.2
External financing (net)	-15.0	4.0	13.3
Internal financing (net)	-2.4	-2.6	3.9
Balance of payments 1/	(millions of U.S. dollars)		
Merchandise exports, f.o.b.	19,275	20,181	16,549
Merchandise imports, f.o.b.	-10,877	-12,123	-13,166
Investment income (net)	-1,119	-1,116	-1,312
Other services and transfers (net)	-3,433	-4,583	-5,562
Balance on current and transfer accounts	3,328	2,359	-3,491
Official long-term capital (net)	1,469	238	2,507
Private long-term capital (net)	711	603	108
Short-term capital and errors and omissions	-1,965	-3,472	-7,188
SDR allocations	89	90	--
Change in net international reserves (increase -)	-3,632	182	8,044 4/

International reserve position	1980	1981	1982
	(millions of SDRs)		
Central Bank (gross)	5,571	7,364	6,366 4/
Central Bank (net)	5,542	7,405	6,335 4/
Venezuelan Investment Fund	1,472	2,408	1,796
National Petroleum Company	8,486	7,057	2,302

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 proper, the Venezuelan Investment Fund, and the National Petroleum Company.

4/ Valuation of gold holdings at SDR 35 per ounce.