0404

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/154

10:00 a.m., December 21, 1992

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
	T. P. Thomas, Temporary
	Wei B.
T. C. Dawson	M. E. Hansen, Temporary
	B. Szombati, Temporary
	A. M. Tetangco, Jr.
R. Filosa	
I. Fridriksson	J. A. Solheim
	M. Nakagawa, Temporary
	S. Shimizu, Temporary
J. E. Ismael	
	K. Link
A. Kafka	J. C. Jaramillo
	C. J. Jarvis, Temporary
	I. Martel
	H. Dognin, Temporary
R. Marino	G. Torres
	M. A. Ahmed, Temporary
	B. S. Dlamini
	J. Dorrington
G. A. Posthumus	
	J.-C. Obame, Temporary
S. Schoenberg	
	Y. Y. Mohammed
	G. F. Murphy
	G. Lindsay-Nanton, Temporary
	S. del C. Olgiati, Temporary

J. W. Lang, Acting Secretary
R. I. Vera-Bunge, Assistant
L. Collier, Assistant

Also Present

IBRD: C. Parel, J. Sokol, Latin America and the Caribbean Regional Office. External Relations: H. P. Puentes. Policy Development and Review Department: J. Ferrán, Deputy Director; T. Leddy, Deputy Director; B. de Schaetzen, P. Patrawimolpon. Secretary's Department: A. Jbili, A. Leipold. Treasurer's Department: C. A. Hatch. Western Hemisphere Department: S. T. Beza, Counsellor and Director; S. Bayas, M. A. Da Costa, R. A. Elson, A. J.-P. Feler, J. Gold, C. Gonzalez, A. M. Jul, S. Kawar, P. C. Leme, J. V. Levy, E.-G. Lim, O. Nyawata, L. L. Pérez, L. Schmitz, M. Torres, A. J. Tweedie, F. van Beek, G. Yadav. Advisors to Executive Directors: J. M. Abbott, S. K. Fayyad, G. Y. Glazkov, Hon C.-W., W. Laux, R. Meron. Assistants to Executive Directors: S. Al-Huseini, G. M. Blome, J. M. Burdiel, C. D. Cuong, C. Gaseltine, H. Golriz, V. Harris, P. K. Kafle, T.-M. Kudiwu, V. Kural, K. Langdon, G. J. Matthews, P. L. Rubianes, P. Salles, L. Tase, A. Viirg, S. Vori.

1. VENEZUELA - 1992 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1992 Article IV consultation with Venezuela (EBS/92/194, 11/30/92). They also had before them a statistical appendix (SM/92/215, 12/9/92).

Mr. Torres observed that he had just been notified that the Venezuelan Congress was to hold a formal session on January 12, 1993 to discuss tax reform. That did not mean that the tax reform would be approved, but, at least it would finally be discussed.

Mr. Torres then made the following statement:

> Before discussing the economic developments in Venezuela, I would like to apologize to the Board on behalf of my authorities for the delay in the Article IV consultation. This year's political developments have made it difficult to implement the Government's economic program. The authorities have had to revise some of the initial targets established for this year, and this delayed the Article IV consultation. I also would like to thank the staff for the very useful discussions held during the last mission to Venezuela and the technical assistance that has been provided.
>
> This year has been a very difficult one for Venezuela. Non-economic factors have slowed the pace of the economic reform program initiated in 1989. Failed military coup attempts in February and November are the more significant events, but they are not the only expressions of the difficulties the Government has been facing in its effort to radically change the Venezuelan economic development model. Nevertheless, my authorities have remained committed to the reform program despite all the political obstacles. For example, a package of laws was submitted to Congress last July to implement the fiscal and financial reforms. Also, the new economic members of the cabinet that were appointed in March were, and continue to be, supportive of the economic reform program initiated in 1989.
>
> In 1989 the new Government launched a global and comprehensive economic reform program that was a major departure in conceptualization and philosophy from the predominant economic culture and the beliefs of the main political parties and social leaders at that time. The program was an answer to short-term as well as structural problems that had been developing over decades in an economy based on the distribution of oil rents. The plan contained three main elements: a macroeconomic adjustment program, a structural reform program, and a set of social programs aimed at softening the burden on the poor of the economic adjustment program.

The macroeconomic adjustment program included the establishment of a unified and flexible exchange rate system, the liberalization of prices and interest rates, the elimination of general subsidies and tax exemptions, the restructuring of external debt, and price increases for some public goods and services. The structural adjustment program included a trade liberalization effort to be implemented during a three-year period, the restructuring and privatization of a large number of public enterprises, fiscal reform, which encompassed a congressionally approved value-added tax, a new tax code, and a new income tax law, and financial reform. The package of social programs included direct transfers to the poorest groups of the population of cash, food, and school supplies. These programs were equal to 1.1 percent of GDP in 1991 and 1992.

The bulk of these reforms has been implemented, as documented in Attachment II of the staff report. Some have been completed ahead of schedule, such as the trade liberalization program, which was completed a year earlier than planned. However, there have been delays in the implementation of two structural reforms; the value-added tax and the laws that are at the core of the financial reform program have yet to be approved. These reforms require congressional approval, and that is beyond the control of the Administration.

Only a year later, the adjustment effort that was initiated in 1989 started yielding positive results. After a significant GDP decline of about 9 percent in 1989 and an annual inflation rate of 80 percent, associated in part with the price liberalization and the devaluation of the currency, the economy started to grow steadily, at a rate of 6.5 percent in 1990 and 10.4 percent in 1991. A revised projection indicates that the economy could grow at a rate close to 8 percent in real terms in 1992. Consistent with this performance, the rate of unemployment has dropped from 10 percent to about 7 percent during the same period. Net official international reserves have recovered substantially, from $5.8 billion in 1988 to $10 billion in 1992. The annual inflation rate declined from 80 percent in 1989 to 36.5 percent in 1990 and 31 percent in 1991, and it is projected to reach 33 percent in 1992. This year is the first in the adjustment program in which the inflation rate has not declined, a fact that has greatly concerned my authorities.

Notwithstanding the important progress made in other areas of the reform program, the problem of fiscal policy has become the major economic problem of Venezuela. The fiscal deficit amounted to 3.5 percent of GDP in 1991, and for 1992 the deficit has been contained to about 5.8 percent of GDP, as a result of efforts to cut and postpone expenditures in the last quarter of the year.

Five factors contributed to fiscal deterioration during 1991 and 1992. First, oil revenue dropped sharply in 1991, as oil export prices declined by 22 percent, an oil revenue shortfall equivalent to 4.5 percent of GDP. In 1992, oil export prices declined by 5 percent and oil revenue by 4.2 percent of GDP. Second, the value-added tax law, which was initially submitted to Congress in mid-1990, has not yet been approved. A new version of the value-added tax and a proposal for a gross assets tax were submitted to Congress in July 1992. The revenue yield of these taxes is expected to be about 2.7 percent of GDP in the first full year of their implementation. Third, the execution of the investment program of PDVSA, the state oil company, was another cause of fiscal deterioration. This investment is extremely important to keep an efficient oil production structure to expand oil output capacity, and in addition to being one of the most profitable investments in the Venezuelan economy. Although it would be a better option to have more private capital participation in these investments, there are legal as well as political restrictions that prevent this occurring at present. Fourth, due to the political situation, the prices of some public goods and services, such as gasoline, have had to be adjusted to a level that now represents only about 33 percent of the export opportunity cost. These price freezes resulted in a revenue decline equivalent to about 1.5 percent of GDP in 1992. Fifth, public sector expenditures have declined in relation to GDP to a level at which further cutting is difficult without risking institutional collapse in vital areas, like the health or educational infrastructures. It is important to say here that, in the 1992 budget, a large amount of resources were allocated to the restructuring of the public sector--one of the reform program objectives--which is a costly process.

However, as a result of the recent congressional approval of certain important fiscal reforms, the fiscal outlook for the future seems better. Congress passed important fiscal measures and reforms last November that will help to restore fiscal equilibrium. These laws are a revised tax code, a public credit law, the 1993 budgetary law, and a new central bank law. The new tax code is expected to reduce fiscal evasion, as the capacity of the authorities to punish evaders has been strengthened considerably. The public credit law prohibits public enterprises from borrowing with government guarantees and increases their lending requirements considerably. It also prohibits the financing of extrabudgetary expenditures and is intended to introduce greater fiscal discipline; the Government will be allowed to ask only once a year for congressional authorization of new credits, and in coordination with the budget proposal. This law and the new budget law also require that the General Comptroller authorize only expenditures whose financing has been identified.

An area where the program has kept pace is the restructuring of the public sector. Large and extremely inefficient public institutions, like the National Institute of Water, the National Institute of Technical Training, the National Hippodrome Institute, and the National Social Security Institute, have been or are being decentralized or liquidated. A total of 57,000 workers from these four institutes have been laid off or relocated.

The privatization program is again being reactivated. A list of important enterprises scheduled for divestiture in the coming months has been prepared. Electricity plants, sugar mills, manufacturing plants, hotels, and other assets are on the list. This will contribute to the strengthening of the fiscal balance by reducing the need for central government transfers.

Along the same lines, the decentralization process, which started three years ago with the direct and popular election of governors and mayors, will result in the transferring of some important responsibilities to local governments. So far, the decentralization has involved resources but not responsibilities. On the basis of this, educational and health services are the first ones to be decentralized. Taking these actions into account, decentralization will also reduce the Central Government's fiscal burden.

Developments in monetary policy in 1991 and 1992 have been greatly affected by fiscal events. In 1991, the Central Bank had to tighten credit through a sharp increase in open market sales, in order to comply with the quantitative performance criteria on net international reserves and on base money. However, in view of the magnitude involved in open market operations, there was a sharp increase in interest rates and in quasi-fiscal losses at the Central Bank. This led my authorities to resort to an increase in the legal reserve ratio in May and October 1991, as an alternative means of tightening credit. As a result, the performance criteria on net international reserves and base money were met with ample margins by the end of the year.

The pressures on credit policy increased in 1992, because of the widening of the fiscal deficit, resulting mainly from the deterioration in the terms of trade. In addition, political developments have contributed to a sharp decline in the real demand for money this year. In these circumstances, in order to maintain price pressures under control and to cope with speculative attacks against the bolivar, the Central Bank has tightened credit with determination. At the same time, the Central Bank has had to conduct monetary policy in a manner that would be consistent with a realistic structure of interest rates, and that would avoid a liquidity crisis that could pose systemic risks for the domestic financial system.

Notwithstanding the difficult political and fiscal situation, the authorities believe that the implementation of this credit policy has succeeded in neutralizing the speculative attacks against the currency, and in keeping international reserve losses at a reasonable level, while, at the same time, maintaining the rate of inflation at about the same level as in 1991.

With regard to financial reform, the central bank law amendment was approved by Congress in late November. According to the amendment, the autonomy of the Central Bank will be considerably strengthened, as the composition of its executive board is changed and its capacity for implementing monetary policy is strengthened. Other important features of the amendment to the law include the prohibition of the monetary authority from providing direct financing to the Government and the restriction of lending activities of the Central Bank to short-term operations.

Other laws that are part of the financial reform are expected to be discussed during the extraordinary sessions scheduled for January 1993. With these laws, bank supervision will be strengthened and clearly separated from the Central Bank functions. Also, they will contribute to the developments of capital markets, and new financial instruments. The system will be more transparent and competitive, and foreign investment will be permitted.

The Central Bank has pursued a flexible exchange rate policy since 1989, but the fact that it intermediates the oil export revenue of the State, which is the major source of foreign exchange for Venezuela, makes the Bank the most important participant in the foreign exchange market. In practice, the Central Bank has implemented a managed float exchange rate system, taking into consideration the level of international monetary reserves and external competitiveness.

The external current account balance is projected to shift from a surplus of 2.9 percent of GDP in 1991 to a deficit of about 6 percent of GDP in 1992. This has been the result of the previously mentioned decline in prices of oil, the higher imports associated with the oil company's investment program, and the rapid recovery in private sector activity.

Recent events in the exchange market seem to indicate that Venezuela is quickly returning to normal. Just before the November coup attempt, the bolivar was trading at Bs 78.35 per US$1. Today, the current exchange rate is about Bs 78.80 per US$1, showing no noticeable deterioration. This stability has been produced without any significant intervention on the part of the Central Bank. Interest rates have also been maintained at the same level and there is no pressure to raise them.

After the coup attempt in February of this year, tariff adjustments on some public goods and services, such as water, electricity, and gasoline, were stopped, and administrative controls were imposed on the prices of seven privately produced goods. Nevertheless, the Government made it clear that there would not be a return to a general system of price control and that these adjustments were temporary. During the last few months, the Government has reinitiated the adjustment of electricity tariffs and has also liberalized most of the prices of privately produced goods. In 1989, when the present Administration took office, there were 100 products under direct administrative control. Today, there are only three.

With regard to incomes policy, the Government has remained committed to avoiding general wage increases. Although real salaries grew in 1991 for the first time in many years, it should be noted that in 1991 wages remained 30 percent below their level at the outset of the economic program in 1989. It is the authorities' belief that collective bargaining negotiations were influenced more by the deterioration of real wages than from the Government's decision to increase the monthly minimum salary from $80 to $120. While my authorities are very concerned about the level of inflation, they are also concerned with the disequilibrium in income distribution.

Therefore, I want to express to the Board the strong commitment of my authorities to continue with the economic reform program initiated in 1989, as it is the only way to attain a sustainable and noninflationary level of economic growth.

As important as the assessment of the economic performance of the country is the evaluation of the political and social context in which the implementation of an economic reform program takes place. I would like to share with my colleagues what I believe are four important lessons to be learned from the Venezuelan experience, as this experience is one in which an economic reform program has been--literally speaking--under fire.

First, an economic reform program is not enough to reform an economy. No matter how global and comprehensive the economic reform program is, it is absolutely essential to count on extraordinary political and public opinion support to be able to implement the reforms successfully. The political and public opinion support does not pre-exist, no matter how deteriorated the present economic situation is or has been. This support has to be built up as part of the reforms themselves.

To build political support, the Government has to create an alliance of all those forces that favor change and make them act permanently in an aggressive way. It is a mistake to expect that the reforms will convince people slowly and passively about the program's benefits. Once the reforms appear on the scene, so does the counter-reform movement. The counter-reform movement is usually well organized and equipped; it is integrated by those sectors that have enjoyed many privileges for a long time.

To build public opinion support, the Government has to carry out a very professional marketing task. It goes far beyond just informing people what the reforms are about. In many cases, the reforms are painful, so people have not only to understand them, but also to see clearly what the gains will be in the future.

Second, in designing a reform program, the role to play for each actor must be clearly defined and, ideally, his responsibilities must be clearly differentiated. In formulating the reform program, the Government makes the commitment, internally and externally, of implementing a list of measures that often requires the participation of other institutional actors--like Congress--over which the Government has no control. When this support does not come, the Government is the one blamed for the reform's lack of success. Thus, it might be much more convenient for the Government and for international institutions like the Fund to differentiate what are their commitments and responsibilities. If the Government explains to the people that an economic reform program is to be launched and that it requires certain obligations from other social institutions, it might be in a better position to press for the reforms. For international institutions, it also might help to assess the feasibility of the different reforms proposed.

Third, in judging an economic reform program, the speed and the direction of change must be differentiated. When evaluating an economic reform program, it is tempting to judge it exclusively, or on the whole, in terms of quantitative performance criteria, such as the rate of inflation, the fiscal deficit, and the rate of growth. Although important qualitative criteria might have been defined at the beginning of the program, they are left in second place in the overall evaluation.

In the case of the Venezuelan economic reform program, internal evaluation by different sectors has concentrated nearly exclusively on the inflation rate or the fiscal deficit. Although these are important variables, it would be totally misleading to evaluate a whole economic reform program based only on them. Elements, such as the changes in the incentive structure for the allocation of resources or modifications in the structure of public spending, should have equal value.

Fourth, ideally, the compensatory programs directed to soften the burden of the adjustment program among the poorest should be in place just before the economic reform starts. It has been clearly shown that economic reforms are easier to implement and have quicker effects than social programs. Devaluation or price liberalization can take place in minutes or even seconds. On the other hand, the implementation of a social program may take months and even years. Therefore, by the time the compensatory programs start yielding significant effects, there may be excessive social unrest. Because of this, governments should be encouraged to strengthen, as much as possible, their planning and managerial capacity in the social area, in order to deal successfully with the social programs before the economic reforms are launched.

Mr. Jaramillo made the following statement:

We welcome this opportunity to review Venezuela's policies and prospects. As Mr. Torres has emphasized, Venezuela is, at present, facing a particularly delicate situation in which political uncertainties make the continued adoption of adjustment measures most difficult, albeit necessary, to consolidate the undeniable gains that have been made on the debt front and with regard to the structural transformation within the economy in the past several years. Imbalances have reached considerable magnitudes, and their unchecked persistence for a prolonged period could well reduce the opportunity to reap the benefits of efforts to come to grips with the country's basic economic problems. In these circumstances, therefore, the authorities will have to make very difficult choices that will permit them to handle a volatile political situation, while, at the same time, reorienting their fiscal and foreign accounts toward more sustainable medium-term paths.

The relative importance of oil revenues is still very significant for both the fiscal and the external accounts in Venezuela. In fact, in recent years, oil revenues seem to have increased as a percentage of total public sector revenues and represent about 80 percent of total exports of goods. The deterioration of the macroeconomic situation stems, to a large extent, from the volatility of these revenues. Consequently, Venezuela could surely benefit from a broader diversification of both its fiscal income and its export base. In this connection, one might question the size of the investment program in the petroleum sector, both in the recent past and in the immediate future. We understand, of course, that large investments are required for the adequate functioning of oil production as fields age. And, as Mr. Torres explains in his statement, these investments seem highly profitable in the case of Venezuela. However, in view of the present sizable fiscal imbalances and of those that will probably prevail for several years, and given the difficult choices that the authorities will have to take to address these imbalances, a more gradual execution of planned oil sector investments might prove worth considering.

Continuing on the fiscal front, the introduction of the value-added tax and the enactment of legislation designed to considerably increase tax revenues seem to us crucial, both to address the existing fiscal imbalance and to reduce the public sector's dependency on oil revenues. It is thus regrettable that these measures have been delayed by Congress. Failure to successfully implement these measures would require additional budgetary cuts, if the overall macroeconomic situation is to be kept under control, cuts that would prove particularly difficult in the immediate future. We are thus encouraged by Mr. Torres's positive reassurances in this regard.

Decentralization will help streamline public administration. However, experience in many countries, including my own, has shown that the resistance of local authorities to accepting expenditure responsibilities is quite significant and is at least as forceful as their willingness to apply for, and receive, income transfers. It seems that Venezuela has not been an exception to this pattern. Thus, we encourage the authorities to act forcefully in transferring expenditure responsibilities pari passu with the transfer of revenues. Failure to do so could further erode the already delicate fiscal situation. Also, we are encouraged by the decision of the authorities to reactivate their privatization program, but we agree with the staff that care should be taken not to excessively finance recurring expenditure with privatization proceeds.

Inflation has remained stubbornly high, but its trend could be decelerated by a forceful fiscal stance. This, however, might not suffice, and tight monetary conditions will continue to prove indispensable. So far, Venezuela has managed to avoid widespread indexation, and this should greatly facilitate reducing inflation through conventional financial restraint without incurring severe output losses. However, the longer inflation is maintained at present levels, the higher the probability that past inflation will be incorporated into the wage bargaining process. If this occurs and indexation takes hold, it will be far more difficult to return to Venezuela's traditional single-digit inflation levels. Finally, we agree that certain exchange rate flexibility will remain a necessity, in view of both current inflation and the vulnerability of Venezuela's external sector to exogenous shocks.

We are acutely aware of the particularly difficult situation that the Venezuelan authorities are facing at present. Although in such circumstances stabilization measures become increasingly problematic, it is also true that avoiding them can only aggravate the situation. Tough choices will thus have to be made. Both the adoption of certain tax measures, and probably also the postponement of certain investments, or the execution of such investments at a slower pace, may become unavoidable. If forcefully and steadily implemented, a gradual approach to stabilization, despite its shortcomings, may prove a feasible route under the circumstances, particularly if, as the authorities have said is their intention, it is accompanied by continued structural reform and further privatization.

Mr. Ismael made the following statement:

At the beginning of its five-year term in early 1989, the present Venezuelan Administration formulated a series of important economic reforms aimed at reducing state intervention, promoting competition, removing barriers to international capital flows, and generally moving toward a free market system. These strong adjustment and reform efforts unfortunately began to unravel in early 1991, when a large decline in oil revenue derailed the program, and remedial efforts to maintain a degree of fiscal balance were hampered by the legislature. This turn of events highlighted the deep-rooted problems confronting the Venezuelan authorities.

High oil prices in the 1970s had given rise to a golden decade for the Venezuelan economy, allowing the installation of a comprehensive and generous welfare system. When oil prices began to fall in the early 1980s and stabilize at a lower level, a number of oil producing countries made tremendous efforts to diversify their economies in order to reduce their reliance on oil revenue. In this endeavor, there have been a number of success stories, including two in my constituency. However, recent events in Venezuela have indicated that there is still a lack of political consensus to do likewise. It has been estimated by some economists that to maintain the level of social services and subsidies implanted in Venezuela during the 1970s, oil prices would have to reach a level of $53 a barrel. Very few people would believe this could occur in the near future. It is, therefore, imperative that the authorities seek political consensus so that the fiscal imbalance be remedied by enacting an equitable income tax that not only raises revenue but also addresses the problem of unequal distribution of income, the source of social discontent. In this connection, the indications given in the staff report that a value-added tax and a gross assets tax would be enacted by the end of this year are to be welcomed. I would also like to encourage the authorities not to water down the provisions of the two legislations, as was done earlier in the tax reform act of July 1991, when more deductions and exemptions were added instead of being eliminated.

In the area of price and wage policies, I welcome the assurance given by the authorities that price controls on a small number of goods, reintroduced in the aftermath of the social unrest in early 1992, are meant to be temporary. These controls, as well as that for gasoline, have to be lifted at the earliest opportunity. On wage policy, I welcome the enactment of a new labor law in 1991. While the new law has helped to create an environment that is more conducive to employment creation, a number of provisos for government arbitrary intervention remain. This is best illustrated in the 50 percent mandatory increase in the minimum wage through executive order in February 1992. In this regard, I agree with the staff that this has sent the wrong signal to the parties involved in collective bargaining.

In the area of privatization, I welcome the good initial efforts and would like to encourage the authorities to speed up those projects that have been in the pipeline.

Finally, I welcome the proposed social investment program, the so-called "mega social projects" to expand health, water, sanitation, education, and other social services. This is an important initiative in the right direction of addressing the problem of social discontent, as well as fulfilling the obligations of the State to provide the population with those rights that have been enshrined in the constitution.

Mr. Schoenberg made the following statement:

Like previous speakers, I endorse the thrust of the analysis and recommendations in the staff report, which I found well written and concise. Therefore, I will limit my statement to emphasizing a few points and asking some additional questions.

To start, I would like to express my disappointment that the extended Fund facility (EFF) arrangement has not been completed successfully, due to considerable policy slippages. The unsatisfactory track record under-lines the need for a substantial strengthening of adjustment policies. Therefore, I welcome, in principle, the authorities' intention to develop a new adjustment program in close cooperation with the Fund.

I wonder, however, whether Venezuela has a real balance of payments need at the moment, as the reserve position, in spite of recent reserve losses, is still quite strong. The authorities' intention not to draw under the envisaged program is to be welcomed in this respect, but doubts remain whether a stand-by arrangement, even a precautionary one, is really necessary, and whether it might not be more appropriate to agree on a Fund-monitored program. I am deliberately putting this into the form of a question. Perhaps the staff would like to comment on this alternative. In addition, I would like to ask the staff whether there is sufficient public and political support now for a new adjustment program. I refer in this context to Mr. Torres's statement on the indispensable need of such public and political support. This question is very important, in my view, as the policy slippages in the past were partly due to considerable delays in congressional approval of the tax and other reforms. To demonstrate the existence of such support, I think that the authorities should implement far-reaching prior actions, including a substantial tightening of fiscal policy, before a Board discussion of a new Fund program, because fiscal consolidation is crucial for the success of a future adjustment program.

In this context, it is disquieting to note that, on the basis of the currently announced policies, the overall public sector deficit for 1993 will only be moderately reduced. The deficit could even rise if approval of the tax proposals under consideration in the Congress should be delayed further. To this end, the information, given by Mr. Torres, that there will be discussion on these proposals in the next year is, of course, very welcome. One should also keep in mind that the non-oil public sector borrowing requirement has not been reduced at all since 1988. This performance underscores the need for considerable prior actions in the area of fiscal policy before approval of a new Fund program. In this connection, I would like to recommend a rapid implementation of the additional consolidation measures proposed by the staff. Fiscal consolidation could also be supported by an acceleration of the privatization plans; this appears to be desirable for the oil industry, in particular in order to reduce the unhealthy dependence of public finances on terms of trade developments.

With respect to monetary policy, I agree that a tight credit policy needs to be pursued in the short run, in order to avoid further reserve losses and a rise in inflation. However, the influence of monetary policy on price performance in the short run may be limited, as developments in 1992 demonstrate. In this year, the inflation rate rose to nearly 35 percent, despite a tightening of monetary policy. Perhaps the staff could give us some additional information on the reasons for this development. In addition, I would like to ask the staff whether it has already made some projections about the probable price performance in 1993.

As to exchange rate policy, I tend to agree with the staff that, given the present inflation rate and the recent real appreciation of the bolivar, the appropriate way to reconcile the objectives of both reducing the inflation rate and preserving external competitiveness is to pursue a flexible exchange rate policy for the time being. However, as soon as the necessary tightening of fiscal policy, which I mentioned earlier, together with appropriate credit and wage policies, brings down inflation considerably, the authorities could aim at preserving nominal exchange rate stability, thereby locking in such stability gains.

With respect to the requirement of the "appropriate" price and wage policies I have just mentioned, I am concerned about the reintroduction of price controls in March 1992. This is clearly a step in the wrong direction, and I hope that the authorities will remove these controls as soon as possible. As to wages in the public sector, I wonder whether the agreed increases in various salaries by 8 to 30 percent in 1993 might not prove to be too high and send the wrong signals to other branches of the economy.

Finally, like Mr. Jaramillo, I would like to point out that the authorities should intensify their efforts to diversify the economy in a future adjustment program. In my view, a gradual reduction of the dependence on oil revenue is very important, in order to make the balance of payments less vulnerable to oil price changes, to broaden the basis for economic development, and, in the final analysis, to enhance social and political stability. Perhaps the staff could also give us some information about the authorities' plans in this respect.

Mr. Jarvis made the following statement:

The year 1992 has clearly been difficult for Venezuela. The public finances have suffered from a serious loss of oil revenue. The anticipated consolidation of the non-oil fiscal position has not materialized, and inflation, instead of falling, has risen slightly. However, there are also some good signs. The authorities have continued a tight monetary policy, which has enabled them to contain inflation despite adverse developments in the government finances. A further reduction in current expenditure of the Central Government has been achieved. Perhaps most important, the Government has continued its pursuit of structural reforms.

Turning first to fiscal policy, the continued volatility of receipts from the oil sector underlines the importance of broadening the fiscal base, and in particular of enacting new tax measures. The authorities have been struggling to enact a value-added tax virtually since the beginning of the program. I note that this proposal is to be discussed by Congress again early in the new year. I certainly hope that this legislation is passed; if not, then the Government may need to simply accept defeat and try to come up with alternative revenue measures that will be acceptable to Congress. It is difficult to imagine that alternative measures will have quite the benefits in terms of simplicity or ease of collection of a broad-based consumption tax, but, in the circumstances, something would be better than nothing, and the Venezuelan Government clearly needs at least something in 1993, if a reasonable fiscal position is to be achieved.

On the expenditure side, I have great sympathy with what Mr. Torres says in his statement about the difficulty of cutting expenditure further. I did wonder though whether there would be any scope for reducing the size of the public sector wage bill by cutting the number of civil servants. Many IMF- and World Bank-supported programs include measures to promote a smaller and better-paid civil service as a contribution to both efficiency and expenditure control, and this might also be useful in the case of Venezuela. I also think that there is some scope for cutting the capital expenditures of the PDVSA. According to the paper, these are estimated at 6 percent of GDP in 1992, and at only a little less than this in 1991. I wonder whether investment at this level is really sustainable, in view of the fragility of the fiscal position. In any event, I would certainly agree with the staff that attempts should be made to generate private sector investment in the oil sector, and thereby relieve the pressure on the public sector to invest. It appears that the authorities are also interested in this possibility.

The authorities' monetary policy has clearly been complicated both by the state of the public sector finances and by an autonomous fall in the demand for money. This makes their pursuit of a tight monetary policy all the more admirable, and I would endorse their and the staff's views on the continued need for this. However, I have some doubts about the suggestion in the paper that the authorities should be ready to use higher reserve requirements as a technique of monetary policy. Since no interest is paid on mandatory reserves, such a policy would increase the costs of financial intermediation and risk further impairing the financial position of the commercial banks. If the authorities are concerned about the systemic consequences of a tight monetary policy, they should be aware that tightening reserve requirements could be at least as damaging as raising real interest rates further.

I welcome the progress that the authorities have made on price liberalization, and I would certainly urge them, within the constraints of their political situation, to avoid backtracking on this if at all possible. On wages, I see some justification for the increase in minimum wages that the authorities have introduced, especially given the very skewed income distribution in Venezuela, which is discussed in Attachment III of the paper.

On external policies, I am broadly in agreement with the staff's recommendations; however, I would be somewhat less worried about the risk of external shocks than the staff appears to be. At over nine months of imports, Venezuela's reserves are still very strong, and if external shocks, such as a decline in the oil price, were to materialize, the authorities should have ample time to take corrective steps.

If Venezuela's progress on macroeconomic stabilization has been disappointing in the past year, the authorities' progress in implementing structural reforms continues to be impressive. Reading through Attachment II of the paper, one is struck by how much the authorities have accomplished in a short time, and also by the number of reforms that have been approved recently. As the staff points out, perhaps the authorities' most important achievement has been the liberalization of trade. The transformation of Venezuela's position on this between the start of the adjustment program in 1989 and today is quite remarkable. The privatization program is also an extremely important element of the structural reforms. Progress on this seems to have slowed somewhat in 1992, but I note, and very much welcome, the authorities' intention to privatize further enterprises next year.

The experience of the authorities on structural reform may also have lessons for other countries. The adjustment process in Venezuela has not been an easy one. Only a month ago, it was threatened once again by an attempted coup. Looking at the record of the last three years, it seems to us that the authorities have used their political capital wisely. The structural reforms that they have put through have transformed the nature of the Venezuelan economy and, perhaps even more important, attitudes toward management of the economy. Although progress on economic stabilization has not been adequate, the authorities have the power to correct this within a relatively short period of time. On the other hand, if the authorities had been successful with economic stabilization but had failed in their structural reforms, the longer-term prospects for Venezuela would be much bleaker. At the very least, the adjustment process would have much longer to run.

Finally, let me turn to the issue of Fund support for Venezuela. This has been substantial, especially early on in the adjustment process, when it was perhaps most critically needed. Venezuela clearly has less need of such support now, having regularized its debt position and consolidated its reserves. Nevertheless, Venezuela could still clearly benefit from the Fund's advice, and, assuming that sound policies can be adopted, from the Fund's endorsement of those policies. I would, therefore, support the idea of a precautionary stand-by arrangement next year, if agreement can be reached on the major policy issues outstanding.

Mr. Dawson made the following statement:

The staff report for this year's Article IV consultation paints a rather gloomy picture of the Venezuelan economy and its immediate prospects. Although growth has been quite high over the last several years, the fiscal situation has deteriorated markedly, contributing to a weakening of the external position and a loss of reserves, and precluding the hoped-for reduction in inflation. We recognize that it is difficult under current political circumstances for the authorities to take the decisive action that is needed. Nevertheless, without such action, Venezuela's economic problems seem likely to deepen.

We are in strong agreement with Mr. Torres's statement that "the fiscal problem has become the number one economic problem of Venezuela." This is also the consistent message of the staff report. It is encouraging that the staff and the authorities agree on the diagnosis, but, in our view, the prognosis for fiscal policy and, hence, for the Venezuelan economy as a whole, is still in question.

On the revenue side, the oil receipts that the Government depends upon for most of its revenue have been quite volatile, and the Government's inability so far to establish a permanent oil contingency fund compromises its ability to smooth out the effect of this volatility on the budget. At the same time, non-oil revenue is low and has shrunk considerably as a share of GDP since 1988.

These deep-seated revenue problems make it essential to broaden the tax base, as the EFF envisioned would be done through the implementation of a value-added tax. We recognize that the authorities have been pressing for this legislation for some time. However, having heard that its passage was imminent for at least the last year and a half, we are not sure that this legislation's prospects are any brighter now than they have been earlier. The staff paper indicates that the authorities expected a 10 percent value-added tax at the wholesale level to be passed by the end of 1992.

It is also disturbing that the Government continues to lose substantial amounts of revenue by not raising domestic fuel prices to international levels. The staff report notes that domestic fuel prices currently stand at some 33 percent of world market prices, down from 56 percent at the beginning of the program. What is the outlook for raising fuel and other key prices, such as water and electricity prices?

On the expenditure side, we take note of Mr. Torres's point that there is little additional non-oil expenditure left to cut without seriously undermining vital areas such as health and education. With revenue prospects still rather bleak, this points then to the need to trim public outlays in the oil sector. Here, we support the staff's call for private investment as a way to carry out the desired capacity expansion, without continuing to overburden public finances.

The more than doubling of the public sector deficit this year to 8 percent of GDP raises concerns about its financing. On the one hand, monetary policy is clearly overburdened. The Central Bank's growing interest expense on domestic debt has evidently made it reluctant, at times, to carry out open market operations on a sufficient scale to counteract the excess liquidity created by the credit extended to the public sector. As an alternative, the monetary authorities have resorted to a rather erratic use of reserve requirements and other administrative measures to restrict credit. We welcome the new central banking law and hope that increased autonomy for the Central Bank will help strengthen monetary policy. However, there is no escaping the fact that the conduct of monetary policy will continue to be difficult until the fiscal problem is significantly reduced.

It is also worrisome that half of the deficit is being financed externally. Given the volatility of oil revenues, not to mention the efforts made only a few years ago to reduce the Venezuelan debt burden to a more manageable level, the authorities need to be very cautious not to allow external debt to mount up again. We share the authorities' concern about the higher spreads associated with Venezuela's sovereign debt, but it is difficult to be very optimistic that they will decline on the basis of current policies.

With regard to exchange rate policy, we believe that the current managed float is appropriate in Venezuela's circumstances. However, unless the authorities can significantly strengthen fiscal policy, or are willing to accept continued reserve losses, the system will have to be a good deal more "floating" than "managed," with all the attendant inflationary pressures that that will entail.

Turning to the subject of structural reform, we recognize that progress is being made in a variety of areas, including privatization and financial market reform. Nevertheless, more needs to be done to diversify the economy away from its dependence on oil and, in so doing, encourage the development of the private sector. Fiscal and monetary policies that crowd the private sector "in," rather than "out," would be a first critical step in that direction.

In its medium-term scenario, the staff makes the case that a gradualist approach to fiscal adjustment will noticeably increase Venezuela's vulnerability to external shocks, which in Venezuela's case can be quite strong. While this conclusion is grounds enough for concern, recent developments leave some doubt that even the gradual path leading to overall fiscal balance in 1997 will be achieved.

In this connection, I note that the authorities have expressed interest in a precautionary stand-by arrangement to cover the period from March 1993, when the EFF arrangement expires, to the end of the current Venezuelan Administration in February 1994. In principle, I would agree that it would be helpful to establish the framework and discipline that a follow-on program would presumably entail. Nevertheless, I would think that a stand-by arrangement, regardless of whether it was intended to be precautionary, would have to meet the same Fund standards as any other program. Indeed, it would seem that the same fiscal problems that derailed the EFF arrangement would make it very difficult to have a new program, unless some very strong corrective measures were in place. I would welcome some further elaboration on this point from the staff.

In conclusion, I share Mr. Torres's views on the critical importance of developing a domestic consensus for adjustment programs. This is a point that the Managing Director has made repeatedly in recent years and that, sadly in this case, has been all too clearly demonstrated in Venezuela. We hope that the authorities will persevere in their adjustment efforts and that they will be able to convince their compatriots of the urgency of the task.

Mr. Dorrington made the following statement:

I agree with all of Mr. Dawson's comments and, indeed, most of what previous speakers have said. Before turning to the economy, let me say that I welcome the realistic decision to hold this Article IV discussion today rather than wait longer for policy actions in Venezuela. The need for surveillance in Venezuela is all too clear.

I share the concern of other speakers at the size of the fiscal task facing Venezuela and the disappointment at the failure to implement much-needed reforms. Some progress has been made since 1989 in building up the financial and private sectors, but it is clear that monetary policy is overburdened. Indeed, I found it very difficult to understand the description of monetary policy actions in 1992, given on page 5 of the staff report, but I agree with Mr. Jarvis's comments on monetary policy, including reserve ratios. Perhaps the main lesson is that it is futile to attempt simultaneously to achieve all of an inconsistent set of objectives. Certainly, until there has been a radical change on the fiscal front, it will be impossible to achieve sustained nominal exchange rate stability.

Controlling public expenditure and making the fiscal position less vulnerable to oil-related developments are at the heart of many of Venezuela's financial problems. Thus, I welcome the intention to introduce a modified value-added tax at the wholesale level, and the apparent urgency to which Mr. Torres referred is being addressed; but this tax is projected to yield only 1.6 percent of GDP, and it is very much a second-best alternative to the full-fledged value-added tax originally proposed. Could staff tell us whether the authorities have any other measures up their sleeves, in case their current proposals fail in the Congress? And is there any prospect of a reversal of the freezing of gasoline prices last March? Action here could obviously make a significant impact on the fiscal position, as well as provide benefits more generally.

On the expenditure side, I wonder whether shifting responsibility for health and education to local authorities will provide the hoped-for check on public expenditure. The large increase in current transfers to local government--by about 40 percent in real terms between 1990 and 1991--without a commensurate increase in responsibility to date, does not bode well for the efficiency of any future shift. Have the authorities given assurances that no further increases in expenditure will be countenanced?

With regard to the privatization program, I hope that this can be resumed in earnest soon, and that it will include some bigger fish than those mentioned in the staff paper. For example, there is a clear need to open up the oil sector to private investment if efficient production is to be built up, without a continuing significant drain on the public sector. Early action needs to be taken to address the legal obstacles to this that Mr. Torres's statement identifies; is there any prospect of that?

The resource constraints on the PDVSA suggest that the estimated rise in oil output capacity to 3.6 million barrels in 1997 may be ambitious. Perhaps the staff could comment on this and, more widely, on the assumptions underlying their projected medium-term balance of payments position.

I note the key--and surely highly optimistic--assumption that the fiscal deficit will be eliminated by 1997. But I also have in mind three other detailed factors. First is the threat posed to oil export prices with the possible return to the market of Iraqi supplies; this is particularly important given the sensitivity analysis summarized on page 10 of the staff report. The second is the potential effect on imports growth--which is projected to be gradual--of continuing trade liberalization and average annual real GDP growth of 4 percent in the non-oil sector. The third is the political uncertainties surrounding continued access to international capital markets. The combination of these makes me even less sanguine than the staff about Venezuela's medium-term viability.

I fully support the suggestion that nonrecurring or windfall revenues from privatization or oil price rises should be used to strengthen reserves rather than be set against fiscal deficits.

In the light of Venezuela's track record, I would expect to see some very significant progress, in fiscal policy in particular, before any new program is brought to the Board. I do not underestimate the political difficulties involved, and I have considerable sympathy with much of what Mr. Torres calls the lessons to be learned. But it is for Venezuela itself to decide which route to follow among those available to it. It would be irresponsible of this Board, and against the long-term interests of Venezuela, to grant a stand-by arrangement until we can be reasonably sure that it will be supplemented by appropriate policies in Venezuela.

The staff representative from the Western Hemisphere Department remarked that, during the second and third quarters of 1992, credit policy had not been as tight as it should have been, given the fiscal deterioration that had taken place and that explained to a large extent why there had been no decline in inflation. Furthermore, the demand for money had started to fall rapidly, particularly in the second half of the year, which had made monetary policy more difficult. During the coming year, inflation policy would rely crucially on the monetary policy stance of the authorities. A continuing increase in inflationary pressures in Venezuela could be foreseen unless financial policy was tightened. In that sense, the authorities were now at a turning point. In the staff's discussions with them on the outlook for 1993, the authorities would be setting up a program that would aim at reducing inflation to about 25 percent and attaining balance of payments equilibrium. The authorities' policy intentions would have to be fully fleshed out if a program was to be negotiated.

On the use of reserve requirements as an instrument to tighten credit, the policy had been a second- or third-best alternative, but it had become necessary to offset the weakening of fiscal policy, the staff representative commented. Based on that policy, which was in effect at the time of the Fund mission, the staff had made its recommendation in the staff report of a more flexible exchange rate arrangement.

As to whether there was sufficient political support for a new program for 1993, the staff representative noted that the political situation continued to be quite difficult in Venezuela. The Government had been negotiating actively with the opposition parties, and an agreement had been reached with the main opposition party to obtain congressional approval of the tax laws. Mr. Torres's earlier announcement that Congress had agreed to consider the new tax laws again, and that it was committed to reach a decision soon, was welcome. However, it was difficult to predict what would be the final outcome.

In the discussion of the 1993 budget, the Venezuelan Congress had been eager to reduce the public sector deficit by keeping expenditures down, the staff representative observed. Congress was also willing to look for new sources of revenues as could be provided by new tax laws. Congress was conscious that Venezuela could not continue to run a deficit as it had in the past. In January 1993, the Administration planned to discuss the tax laws with Congress at the same time as it discussed the financing package for the budget. Given the recent difficulties that Venezuela had had in placing bond issues abroad, the only alternative that Congress had was to implement the new taxes to cut expenditures further.

The authorities would like to have a Fund program in 1993, in order to establish fiscal discipline, to improve Venezuela's access to international capital markets, and to facilitate their relations with multilateral institutions, the staff representative said.

With respect to public sector prices, the staff representative pointed out that electricity tariffs had been increased in October. The authorities were hopeful that these increases would strengthen the electricity companies' finances and facilitate their privatization. As to water tariffs, attempts had been made to privatize Caracas's water company. But the offers from the private sector that the Government had received requested large increases in water tariffs that the Government had not been in a position to impose. The authorities knew, however, that water tariffs had to be increased sharply. Concerning gasoline prices, the authorities were acutely aware that prices were out of line and should be revised for efficiency and revenue purposes. However, that was a difficult and delicate problem in Venezuela, and the authorities would have to handle it in due course, if they wanted to tighten fiscal policy in 1993.

On the matter of safety nets, the staff representative noted that the present Government had targeted various social programs. However, insufficient action had been taken because, in part, of implementation problems. For 1992, a new social investment program had been prepared, but, unfortunately, had been implemented very slowly. The program was part of the budget that had been approved for 1993 and was an area in which the Government wished to make progress.

In order to improve the oil sector, further diversification and privatization were needed, the staff representative said. The investment required merely to maintain the current level of capacity was considerable. It was approximately half of the investment of the state petroleum company in the staff report's projections, about 3 percent of GDP. Although many of these oil wells were old, there were a number of interesting investment opportunities available with more private equity investment, the staff representative from the Western Hemisphere Department declared.

The Deputy Director of the Policy Development and Review Department, in explaining why the authorities were contemplating a request for a precautionary stand-by arrangement from the Fund, remarked that the authorities hoped that that would make it easier for them to obtain access to foreign markets through the roll-over of some obligations and new lending. Furthermore, a program would provide a macro framework that would help the authorities to control the domestic situation, particularly in the coming year, the last prior to general elections. The authorities' objectives could possibly be achieved through a Fund-monitored program as well as through a stand-by arrangement, but it had to be stressed that in either case, strong prior actions would be required. One of those actions would be the approval of the tax legislation that had been pending for quite some time. However, more action than that would be needed, including adjustments in domestic petroleum prices.

Mr. Al-Tuwaijri made the following statement:

> Venezuela's program of adjustment and structural reform, begun in 1989, achieved considerable progress toward correcting earlier economic and financial imbalances in its first two years. Unfortunately, the momentum of the adjustment effort was interrupted, and more policy slippages occurred in 1991. In addition, the economic gains of previous years were reversed, in part, due to the decline in oil revenue, further delays in approving the proposed tax measures, and the difficult political situation in 1992. By the end of this year, the overall public sector deficit is projected to be about 8 percent of GDP, and the inflation rate is projected to increase to 35 percent. Moreover, the Central Bank's intervention to counter attacks against the bolivar has resulted in a loss of international reserves.
>
> Given the precarious condition of the Venezuelan economy at this time, it is important that the authorities concentrate on designing economic policies that, if implemented, will safeguard Venezuela's net international reserve position and reduce price pressures. Indeed, it is encouraging to note from the staff report and Mr. Torres's helpful statement that it is the Government's intention to pursue such policies.
>
> Not surprisingly, the backbone of the Government's efforts is fiscal consolidation, where there is a need to diversify the revenue base and to adjust sufficiently to reduce inflation and protect the balance of payments. On the revenue side, notwithstanding the expected improvement in the tax administration as a result of the new tax code, and given the weakness of domestic tax

revenue, the speedy congressional approval of the pending tax reforms is imperative. However, with the approval of the tax measures, the overall public sector deficit is expected to be 6 percent of GDP in 1993. Both the authorities and the staff agree that this fiscal deficit needs to be reduced, in order to curtail inflation and to avoid further losses in net official international reserves. Therefore, I agree with the staff that more concerted efforts in both revenue raising and expenditure reduction are required, and I support the staff's recommendations in this area. Moreover, I share the authorities' view that revenues from privatization should be used to improve the external position of the country through an increase in foreign reserves or debt reduction, rather than using these proceeds to cover a fiscal gap.

I welcome the completion of the trade liberalization program, which includes, among other things, the elimination of any quantitative import restrictions. In addition, the Government's intention to improve trade ties with other countries in the region is a step in the right direction.

Finally, with regard to the medium-term outlook, the Government envisages, by 1997, an elimination of the fiscal deficit, a balanced external current account, and a reduction in the inflation rate to 10 percent. The attainment of these goals, especially with the planned gradual approach for fiscal consolidation, is a formidable task and contains a high degree of risk. This is underscored by the dependence of fiscal consolidation on the future behavior of the oil market, whose vagaries the country is very vulnerable to.

Indeed, I agree with the staff that a gradualist approach to fiscal consolidation may adversely affect private sector expectations, especially as international reserves continue to decline. However, it may be equally true that a more aggressive approach to fiscal consolidation, in the present context of significant political uncertainties and lack of a strong social consensus, could engender pressure that would derail the entire adjustment effort. In sum, the balance of risks may render the authorities' current strategy more appropriate for the immediate future. However, I hasten to add that the authorities should accelerate their adjustment efforts markedly once the domestic situation permits.

Mr. Filosa made the following statement:

The past Article IV consultation with Venezuela was concluded by the Board in December 1990. Discussions for the 1992 Article IV were initiated in December 1991 and continued through October 1992. The grace period for the consultation was exceeded because of the impossibility of reaching an understanding with the authorities. I wish I were able to say, today, that I am happy we are finally discussing the conclusion of this consultation. However, I am recalled to reality by the staff's remarks on page 25 of the report, "the passage of key tax and financial reform laws has been delayed and, as a result, it has been decided to conclude the Article IV consultation to avoid any further delays." By concluding today's Article IV consultation, we must avoid sending the signal that the country is returning to a sustained stabilization effort, unless we are genuinely convinced that it actually is. Also, we must not give the wrong impression to the member country that its economy can continue to avoid some indispensable policy actions, when, in fact it can not and should not.

During the December 1991 review and extension of Venezuela's arrangement, this Board stressed that there were risks that had emerged from the policy slippages of 1991 and underscored the areas in which urgent action was needed to keep the program on track. Economic developments and policy performance in 1992 have magnified these tendencies that were already present in 1991. I could accept, in good faith, that political events and constraints in 1992 had reduced the extent to which the adjustment and reform policies that had started bringing positive results in 1990 could be revitalized. I sincerely hope that the period of ad hoc, circumstantial, and unsustainable policies is close to being over.

At the heart of Venezuela's economic problem remains the need for regaining control of fiscal policy. The recent approval of the tax code and the long-awaited, expected congressional approval of the value-added tax could go a long way toward strengthening the tax structure and restoring healthy, medium-term fiscal prospects. But, even in the best scenario, if the breakthrough in the tax structure actually materializes, it will take time to bring about sizable budgetary gains in terms of revenue, while public sector management still leaves much to be desired. The 1993 budget is full of disturbing elements, for example, the future of gasoline prices, the reduction of the PDVSA's tax payments, the increase of transfers to local authorities, and the increases in social outlays that, despite the urgency of the situation, continue to reflect an overly dangerous attraction to a gradualist fiscal adjustment.

The scenario put forward by the staff highlights the risks associated with this situation, if it continues uncorrected. The potential fiscal deficit for 1993, 6 percent of GDP, is incompatible with the aims of safeguarding the economy's external position, reducing price pressures, and containing the debt-service burden. Additional fiscal measures, early in 1993, along the lines suggested by the staff, are needed to contain the underlying fiscal imbalances, deal with excess uncertainties, and reduce at least some of the excessive burden that has fallen on monetary and exchange rate policies. In the list of measures that the staff has suggested to improve Venezuela's fiscal position, I do not find any recommendation to increase non-petroleum income tax. The low level of this item in the budget, which is low not only by international but also by Venezuelan standards, deserves more attention. The tax reform enacted in June failed to expand the tax base as had been planned, and, in fact, the elimination of exemptions and deductions was not carried out. I think that we should not fail to mention the need to increase income tax in our recommendation to Venezuela. I am interested in having the staff's view on the need to increase income tax revenue. Also, the authorities must realize that, in the absence of sufficient financial tightening in 1993, their presence in international capital markets could remain problematic, and any substantial decline in the spreads associated with sovereign risk is unlikely to materialize.

With respect to medium-term balance of payments prospects, there are more than the usual risks associated with an insufficient fiscal adjustment path or with the economy's vulnerability to external shocks.

Along with a strong medium-term fiscal adjustment effort, at least in the short run, tight credit policies are important elements of a strategy that would reduce inflation and minimize further reserve losses. Adequate real interest rates should be maintained, and legal reserve requirements should be effectively enforced. Central bank rediscounts to counterbalance quasi-fiscal losses and minimize bank liquidity strains should be limited to actions in exceptional circumstances, and at terms compatible with market efficiency, not conflicting with the pursuit of overall credit restraint. In past discussions on Venezuela, this chair had expressed concern about the negative effects produced by high interest rates on the real sector of the economy and the distribution of profits among non-bank enterprises and the banking sector. I note in the staff paper that the authorities have gone beyond my concern, because they fear that high interest rates will negatively affect the domestic financial system. However, the solution to this problem is straightforward and essentially stresses an early correction of the many weaknesses of the budget.

On exchange rate policy, I would agree that, in the present circumstances, flexibility may provide some temporary relief from excessive loss of external competitiveness. In the more medium-term perspective, however, exchange rate policy should not be treated, as has been the case in the recent past, as a substitute for strong fiscal policy backed by appropriate wage and credit policies. Although the share of non-traditional to total exports is relatively small in Venezuela, roughly 20 percent, there may be enough scope left for exchange rate policy to contribute to internal price stability, once a credible, full-fledged anti-inflation strategy has been put back in place.

I have difficulty in reconciling the authorities' interest in a precautionary stand-by arrangement after March with the inability of the authorities to continue with the adjustment they started three years ago. In particular, I continue to have doubts that Venezuela would have had balance of payments needs if its fiscal policy had been kept under reasonable control instead of adopting inappropriate or ad hoc measures. The country experienced a huge current account surplus, 15.3 percent of GDP in 1990, as a result, to some extent, of the Middle East developments, but mainly because of the progress that had been achieved in implementing the original program. In 1991, the current account surplus was still considerable, 4 percent of GDP, despite the reduction in world oil prices, and despite program slippages. Net international reserves at end-1992, notwithstanding their large decline during the course of the year, still stand at the equivalent of nine months of imports. The sharp deterioration of the current account in 1992, a deficit of 6 percent of GDP, was due to the program's collapse.

More importantly, we are artificially keeping alive the present arrangement when the authorities' intentions to follow the recommendation of this Executive Board and the staff are not evident. On the contrary, in discussions with the staff, the authorities seem to resist many of the actions that in present circumstances seem appropriate and urgent.

The first prerequisite of a precautionary stand-by arrangement is the clear commitment to address the basic weaknesses of Venezuela's economic policy, and I am afraid that in the staff report I have been unable to detect such a commitment. As always, we need to ensure that the member is given an opportunity to obtain the most appropriate and effective form of Fund assistance, to support its own genuine efforts to turn the country's full economic potential into reality. However, this would require that we receive a clear indication of the authorities' resolve to adjust that, in my view, is lacking at the moment.

Therefore, like Mr. Schoenberg, I believe that substantial prior actions, including the approval of the value-added tax and/or a real reform of the nonpetroleum income tax, are needed before the Board can consider a precautionary stand-by arrangement.

Mr. Tetangco made the following statement:

There can be little doubt that in the period 1989-90, the Venezuelan authorities made substantial progress in implementing a program of economic reform. The strong improvement in the fiscal balance and the determination shown in implementing structural reform during that period were particularly encouraging. Unfortunately, developments since that time have been, to say the least, less than encouraging. The authorities are now faced with a difficult macroeconomic situation, and one that could quickly deteriorate further unless corrective action is urgently taken.

During 1992, the area of greatest deterioration was in the national budget, as noted by Mr Torres and other speakers. The projected rise of the public sector deficit to 8 percent of GDP in 1992 is indeed of serious concern. Such a deficit is due in part to a decline in oil revenue and other factors. However, there is also the question of how much the authorities can do to address this problem. In particular, the value-added tax legislation still has not been passed by Congress. I am sure that many Directors will recall that the implementation of the value-added tax was a structural performance criterion for the fifth review under the extended arrangement. At the time of that review, this chair indicated that we were concerned that the Board was being asked to complete that review ahead of value-added tax implementation, but we were prepared to accept the assurances given by the authorities and by staff that the value-added tax would be enacted by March 1992 at the latest. Now, as I understand it, Congress failed to even consider this matter before it went into recess for 1992 and will not consider it until the coming year.

Failure to pass revenue-raising measures means that the authorities will need to resolutely focus their attention on expenditure reduction. Here, the staff has some worthwhile suggestions, particularly the need for reductions in the level of government employment and restraint in public sector wages growth. The losses of the public sector trading authorities must also be reduced. However, I doubt that a simple shifting of expenditure responsibility to the local government level will do much to improve the macroeconomic outlook. Of course, the measured public sector deficit of the national Government would fall, but the total net public financing requirement, for example, would be unchanged. Indeed, to the extent that any shift of expenditure to local government reduces the pressure on the national authorities for fiscal consolidation, the staff's suggestion could be totally counterproductive.

I was interested to read the staff's view that privatization revenue should be used to increase reserves or reduce debt, rather than as a means of covering a fiscal gap. As a general principle, this is true. But in a situation where the Government is facing a large deficit, it hardly seems useful to suggest that the authorities pay off debt from privatization revenue with one hand, only to have to issue more debt with the other hand. Indeed, given the transaction costs involved, this approach would result in a net loss to the authorities.

The slight decline in the external current account deficit expected for 1993 is based on an assumed depreciation of the bolivar. Given the high rate of inflation in Venezuela, further nominal depreciations will be required to maintain competitiveness. Of course, such depreciations may also add to inflation, but this only highlights the need for the authorities to implement more restrictive monetary and fiscal policies to tackle the inflation problem. Stabilizing the currency without first implementing such policies will not result in a lasting reduction in inflation.

The staff suggests that the medium-term projections for the balance of payments indicate that viability would be reached by 1997. However, it would be a strange type of viability indeed, if international reserves, as a proportion of imports, continue to fall, as indicated in the staff's projections. At the same time, the external public debt-service ratio to exports of goods and non-factor services is projected to increase, indicating further vulnerability of Venezuela's external sector. Moreover, these projections show very clearly that, without timely and substantial fiscal consolidation, significant exchange rate depreciation, both nominal and real, and/or international reserve losses, will continue, as Mr. Dawson has also pointed out.

Mrs. Szombati made the following statement:

During the past two years we have witnessed a period of mixed economic and policy implementation performance in the Venezuelan economy. Among the major achievements of the Government's medium-term adjustment program have been the restoration of vigorous economic growth, the rebuilding of international reserves to a substantial level, as well as the considerable progress achieved in restructuring the public enterprise sector and in the area of trade liberalization. Adjustment measures, however, were insufficient in the face of the substantial decline in oil revenues during 1991-92, which in turn led to a renewal of macroeconomic instability, as reflected in the widening fiscal deficit, the high rate of inflation, and reserve losses.

We fully agree with the staff that a progressive reduction of the large fiscal deficit will be necessary in the period ahead, in order to improve the balance of payments, stop the erosion of reserves, and maintain external confidence. Economic policies for the remaining period of the current administration should be centered on implementing major corrections in both fiscal revenue and expenditure patterns, maintaining positive real interest rates, and tightening the wage policy, while sustaining the pace of structural reform efforts. Regarding the possibility of a precautionary stand-by arrangement to bolster a program for that period, we agree with Mr. Schoenberg and others that strong policies with significant prior actions, including the long-delayed congressional approval of the value-added tax, would be necessary to elicit support for such a program.

Like other speakers, I would like to stress the need for the reinforcement of fiscal policy that is the key to the restoration of the adjustment process. Given the need for reducing dependence on oil revenues, a major element of fiscal adjustment would be the approval of the pending tax reform by the Congress, as has already been emphasized by the Board at previous occasions. The persistent uncertainties experienced in this respect are very disturbing because, as Mr. Torres says in his statement, it is difficult to cut further public sector expenditure without risking a collapse in fundamental government services, and it seems rather uncertain that sufficient expenditure cuts can be achieved in the shorter term to cope with the shortfall in revenues.

Nevertheless, I agree with the staff on the necessity of additional fiscal measures. Besides the increase in fuel prices and water tariffs, improvement in the efficiency and the financial position of public enterprises and further progress with their privatization could greatly contribute to fiscal savings. The political tensions highlight the importance of adequate and efficient social programs; progress in this area seems to be insufficient and lags behind the possibilities, however limited. Hopefully, the decentralization of resources and responsibilities for educational and health services will improve the efficiency of these services.

Mr. Ahmed made the following statement:

An unfortunate confluence of political difficulties and adverse exogenous developments have led to a slowdown in the pace of Venezuela's adjustment and reform efforts. The political constraints, emanating from the aftermath of two failed coup attempts, have reduced the scope for strong corrective measures, while the sharp decline in oil export revenue had to be accommodated through a larger than expected recourse to financing. Mr. Torres's statement provides a vivid description of how these events have made 1992 a very difficult year for Venezuela.

Nevertheless, we note the authorities' strong commitment to continue with the economic reform program initiated in 1989 as being the only way to re-establish a healthy and durable growth track. This reassurance of their commitment is particularly welcome at this juncture as the economy has begun to show signs of the strains typically associated with pressures on resources. This is evident in the strength of domestic demand, the edging up of inflation, and the re-emergence of large financial imbalances.

The immediate challenge facing macroeconomic policies is how best to bring the level of demand into a more appropriate alignment with supply capacity. Central to this task will be a fiscal stance in 1993 that, even after assuming the passage of the tax package in late 1992, will require reinforcement. While concerns about the political feasibility of stronger actions are understandable, postponing action would only cause the economy to move further away from the original path of adjustment and make the authorities' subsequent task more difficult. We look forward to the outcome of the extraordinary session of Congress which is to commence on January 12.

The stringent monetary posture being advocated by the staff is appropriate in the light of the momentum of domestic demand and the upturn in inflation. However, the continuation of such a strategy is bound to raise concerns--sooner or later--about the prospects for investment and net exports. Therefore, it is important to underscore that the very heavy reliance on high interest rates can involve adverse side effects. Again, this brings out the importance of additional fiscal action as a necessary complement to a restrained monetary policy.

On wage policy, we can see the need to take corrective action to stem the decline in real living standards--or as Mr. Torres puts it aptly--to correct the "disequilibrium in income distribution." The authorities should recognize, however, that should the upward pressure on wages be allowed to persist, it could be extremely difficult to reverse the process. Moreover, there is a risk that the price level increase that can be expected from the introduction of the value-added tax and the resumption of other price adjustments will provoke still higher wage demands. Only significantly tighter financial policies will ensure that the effects of these measures are limited to a one-time impact on the price level and are not incorporated into core inflation through wage catch-up.

The Government's accomplishments in the area of structural reforms have been substantial and, in some cases, ahead of schedule. This is commendable. The thrust of these reforms in the period ahead should be to extend the gains already achieved, and I note, inter alia, the intention to reactivate the privatization program. The opportunities opened up by these structural initiatives must be consolidated so as to improve economic efficiency, strengthen the fiscal position, and enhance market flexibility.

We feel somewhat uneasy with the staff's advice on exchange rate policy. The staff would probably say that some flexibility needs to be retained because of Venezuela's trade structure and the pattern of exogenous shocks. But it can also be said that, in order to enhance the credibility of efforts to bring greater discipline with respect to wages and prices, Venezuela might see benefits in a more stable exchange rate policy.

Miss Olgiati made the following statement:

The strong adjustment and reform program of 1989-90 began to falter in 1991 because different factors contributed to the fiscal deterioration. Most notable among them was the further decline in oil revenue as a consequence of a significant reduction of oil export prices, the value-added tax that has been delayed since mid-1990 awaiting congressional approval, the larger than programmed increase in capital spending by the state oil company, the suspension, in light of recent political developments, of price adjustments of certain public goods and services, and the rigidities in paring down further public sector expenditures without risking major disruptions in the health or education infrastructure. Nevertheless, I wish to note the resiliency of the Venezuelan economy, demonstrated in 1989-90, when the need for adjustment and reform was translated into effective action. As Mr. Torres reminds us in his comprehensive statement, economic transformation toward sustainable and noninflationary growth is a long process. In light of recent events, the authorities' commitment to continue with the agenda of reform is deemed both encouraging and worthy of support.

Given the weakening of the fiscal accounts, pursuit of a restrictive monetary policy and maintenance of exchange rate flexibility have not prevented price and balance of payments deterioration. The need to reduce the dependence, in an orderly and systematic fashion, of public finance on oil revenues is unquestionable. In general, I agree with the thrust of the observations of earlier speakers and of the staff appraisal in this regard, and I note, in particular, the positive impact that congressional approval of the pending tax reform would have both on strengthening public finances and adding credibility to the anti-inflation effort.

Progress has been made in trade liberalization. Similarly, in the area of public sector restructuring and privatization, progress should be sustained. Adherence to the schedule of privatizations, such as electricity plants, sugar mills, manufacturing plants, and hotels announced for the coming months, can significantly contribute to the permanent improvement of the fiscal balance and to the consolidation of private sector confidence by reducing the need for central government transfers and broadening the tax base. In addition, approval of laws aimed at strengthening the regulatory framework of the financial system and promoting greater competition in the sector are deemed essential for the more efficient allocation of resources in the economy.

In concluding, I would ask Mr. Torres to convey to his authorities the best wishes of this chair for the success of their adjustment program at this crucial stage of the transformation process.

Mr. Dlamini made the following statement:

The vulnerability of the Venezuelan economy to international oil-price shocks and the effects of political uncertainties constituted the major factors that influenced the faltering of the adjustment process in the country during 1991 and 1992. However, it is encouraging to note that the authorities recognize the need for renewed commitment to the adjustment process and have, indeed, started to take steps that should bring about improvements in the economy.

The need for substantial reductions in the public sector deficit has been duly emphasized by the staff and Mr. Torres. It would seem that efforts to increase non-oil revenues should be accompanied by cuts in government outlays on subsidies to release resources for increased spending in the social sector, particularly on health and education. There is no doubt that the recent congressional approval of some important elements of the fiscal reform program will help to instill financial discipline in the public sector and improve efficiency in tax administration. It is necessary now to go forward with approval of the rest of the tax package.

Fiscal consolidation would also be facilitated by accelerating the pace of policy implementation in the structural areas, particularly public enterprise reform and privatization.

The authorities should maintain their tight monetary stance as a complement to fiscal reform in order to ensure price and exchange rate stability. Expeditious completion of the ongoing financial sector reform should pave the way for increased effectiveness of the Central Bank in monetary management.

Finally, Mr. Chairman, I agree with Mr. Torres that political support is crucial to the success of adjustment programs. The constraints imposed by this unpredictable factor should always be taken into consideration by the staff in their design and monitoring of adjustment programs. There are several other countries in a similar situation.

Mr. Link made the following statement:

I would like to make a few comments on the staff report for the 1992 Article IV consultation of Venezuela at the beginning of my statement on Venezuela.

First, we welcome the progress made by Venezuela since 1989 on the trade liberalization program. It constitutes the greatest achievement of all adjustment and reform efforts. For the sake of synergy, this program requires complementary economic measures to be taken at the appropriate moment.

Second, we share the view expressed in the staff report that the underlying fiscal imbalance should be dealt with as quickly as possible. It is, therefore, important that the Venezuelan authorities increase their efforts to obtain congressional approval of the value-added tax and the gross assets tax. In this context, we wish to express our concern regarding the political problems that resulted in the lack of maneuverability of the authorities in the fiscal area.

Third, the overall deficit of PDVSA is another area of concern. In order to cut public expenditure, the staff report suggests limiting the growth of PDVSA's debt by opening the petroleum sector to private investments at a faster pace. We support this proposal, but also would like to point out that while PDVSA is Venezuela's principal source of revenue, at the same time, it increases the public sector debt burden. Obviously this is somewhat counterproductive.

According to the staff report, discussions on free trade status between Venezuela and Mexico seem to be under way. But it could be interesting for us to be informed about the Venezuelan assessment of the consequences of the North American Free Trade Agreement. Could the agreement deflect investments at the expense of countries like Venezuela?

Finally, we agree with the IMF staff recommendation that the next Article IV consultations take place on the standard 12-month cycle.

Mr. Dognin made the following statement:

At this stage, I shall only make three short remarks. First, it is obvious that the cornerstone of Venezuela's efforts to stabilize its economy lies in fiscal reform, and, especially, the implementation of the value-added tax, which has been delayed for many years now. Implementation might be especially difficult in the present social and political circumstances. Here, the "lessons to be learned" that are enumerated by Mr. Torres in a remarkably thorough and articulate statement are of great relevance and importance. There has to be political support behind any economic reform program. The buildup of that support and its preservation throughout the process are an essential part of the program itself.

Second, in the absence of sufficient fiscal discipline, monetary and credit policies have to bear the brunt of the stabilization and adjustment effort. As in any other country, high real interest rates are the price to pay for slippages in fiscal policy, if and when the inflation objectives are to be met, all the more so if, as may be the case in Venezuela with respect to minimum wage regulation, incomes policy allows for an excessive increase in wages. We fully support the staff report in this regard.

Finally, on exchange rate policy, the staff makes a convincing case for a managed float, in Venezuela's present circumstances, together with strong supporting credit, fiscal, and income policies. The succession of short periods of stability in the exchange rate--which cannot be sustained--and sharp depreciations is certainly not optimal. However, there might be some merit in putting, at least as long as oil prices are relatively stable, the managed float into a more consistent and announced in advance framework for depreciation. If and when income growth can be controlled, especially in the public sector, the rate of depreciation could be progressively reduced, so as to keep a disciplinary effect on internal policies.

Mr. Posthumus raised some issues about the nature of a precautionary stand-by arrangement and the message it would be intended to give. From the Fund's point of view, a precautionary stand-by arrangement was the same as a stand-by arrangement. Under a stand-by arrangement, the Fund could not force a country to draw, and, under a precautionary stand-by arrangement, it could not prohibit a country from drawing. Under a precautionary arrangement, the message the country sent was that it did not intend to draw, although it could do so.

In the case of Venezuela, there was an estimated balance of payments deficit in the current and coming years, Mr. Posthumus noted. In the past year, when the Board had discussed the EFF, there had been no deficit. Therefore, he could not see the consistency in having a precautionary stand-by arrangement at present.

Mr. Nakagawa said that it was regrettable that the Venezuelan authorities' performance over the last year of the EFF program had been interrupted by political disturbances. However, the causes of the widening imbalances in the domestic, international, and external sectors; the stoppage had deep roots in the delayed comprehensive reforms in the fiscal sector. In that sense, he fully shared the concerns raised about developments in fiscal policy, primarily the delays in executing the comprehensive tax reform, including the introduction of the value-added tax. On the expenditure side, the authorities could have done more. In that respect, he supported Mr. Jarvis's recommendation to reduce the wage bill by cutting the number of civil servants, and he was concerned about wage developments, particularly in the current year.

Given the current exchange rate policy mix, Mr. Nakagawa observed, a more flexible management of the exchange rate would be warranted for the time being, in order to restore the currency's international credibility.

As to the precautionary stand-by arrangement, Mr. Nakagawa stated, he shared the opinion of Mr. Schoenberg and others that, only after strong prior actions, including the introduction of the value-added tax, were completed, should such an arrangement be presented to the Board for approval.

Mr. Murphy made the following statement:

> Venezuela made considerable progress in reducing internal and external imbalances and implementing structural reforms during the first two years of its extended arrangement approved in May 1989. More recently, however, the country seems to have lost its way and many of the gains made earlier have been reversed. Admittedly, real growth has remained robust--more than 10 percent in 1991 and 7 percent in 1992. However, over the same period, there was a deterioration in the accounts of the consolidated public sector equivalent to 9 percent of GDP. As a result, the deficit of the overall public sector is now estimated to reach 8 percent of GDP in 1992, not much different from the level prevailing prior to the launch of Venezuela's extended arrangement with the Fund. Clearly, neither recent rates of growth nor the size of the government deficit (the two being, undoubtedly, related) are sustainable.
>
> Not surprisingly, there has been little progress toward reducing inflation over the past two years. At the same time, there has been virtually no progress in diversifying the economy and reducing the country's high dependence on oil revenues, which is the main reason behind the weakening of the fiscal position and the even more pronounced deterioration of the external accounts. The other important factor is the Government's inability, particularly in the wake of the attempted coup last February, to push through Congress badly needed corrective measures, including importantly a tax reform. Moreover, there seems to have been little (if any) discernible improvement in income or land

distribution, which are necessary to maintain a public consensus for reform. The only area in which there has been significant sustained progress to date is trade liberalization.

It is not hard to see that the present situation is unsustainable and that the authorities cannot afford not to take action. A relatively high level of reserves (recent net losses notwithstanding) and limited access to capital markets have, thus far, cushioned the effects of a decline in oil prices. However, as the medium-term outlook amply illustrates, Venezuela is extremely vulnerable to new shocks. There is little room for further delays or slippages.

It is particularly important in this respect to deal quickly and decisively with the underlying fiscal imbalance. The staff now projects a narrowing of the deficit of the overall public sector to about 6 percent of GDP, from an estimated 8 percent in 1992. However, even this moderate reduction of the deficit is predicated on the passage of the 1993 budget and quick implementation of the tax package (which includes a value-added tax and a tax on gross assets). Should the Government fail to ensure approval of the tax reform package, the deficit could rise to as high as 8.6 percent of GDP in 1993.

Even assuming that the tax measures are implemented on schedule, the envisaged reduction of the deficit to 6 percent of GDP would be insufficient to achieve a desired permanent reduction of inflation and avoid further losses of net international reserves. Indeed, as suggested by the staff, a much larger reduction would be necessary for that. Additional revenue-raising and expenditure-reducing measures, along the lines suggested by the staff, would be appropriate. In particular, we would stress the importance of cutting back transfers to public enterprises, reversing the expansion of government employment, and shifting some of the spending responsibilities to regional governments, in line with the increasing share of the latter in public sector revenues.

Tight monetary and credit policies are also essential if further losses of reserves and a rise in inflation are to be avoided. In this context, we welcome the authorities' intentions to enforce more strictly the legal reserve requirements, as well as their recent decision to raise the rediscount rate. Strict fiscal and monetary policies must also be backed by wage discipline. While we note that the authorities have not granted any general increases in wages in 1992, we worry about the signals sent out by a 50 percent increase in the minimum wage at the beginning of 1992.

An accelerated structural reform agenda would also provide much-needed support to the adjustment process. In particular, the

> authorities should push for adoption of the main laws restructuring the Central Bank and financial institutions, in order to improve the efficiency of monetary management, foster competition, and strengthen the regulatory environment. We note that, after a disappointing virtual standstill over the past several months, efforts have been made recently to revive the privatization program. In October, the Government unveiled plans to privatize more than 100 state companies in 1993 and submitted a law reducing the time limit for Congress's approval of the sale of state enterprises. In light of concerns regarding the growth of debt of the PDVSA, the Government should also contemplate accelerating private sector participation in the oil industry.
>
> Finally, I agree with the staff that a flexible exchange rate arrangement may serve the country best in achieving its objectives of noninflationary growth and international competitiveness. However, the authorities must ensure that their fiscal, monetary, and income policies are geared to these same objectives.

Mr. Wei noted that there had been policy slippages during the current year, but that these had occurred in extraordinary circumstances, particularly the recent coup attempts. In that connection, he declared that he fully shared Mr. Torres's view, in his statement, that a good economic program should have political and public support; otherwise, it could not succeed. Furthermore, Mr. Torres had raised an interesting question on how to evaluate an economic program, particularly how to judge the usefulness of quantitative performance criteria, which should be considered in the context of the overall evaluation. Perhaps that question could be left to the future evaluation office to resolve and provide constructive ideas.

Mr. Wei then made the following statement:

> The Venezuelan authorities are to be commended for their strong adjustment and reform efforts in 1989-90 that reduced the economic imbalances significantly. The performance under the 1992 program has been a mixed one. While the bulk of the program targets has been met, there have been some policy slippages that occurred mainly due to the decline of oil prices.
>
> I fully share Mr. Torres's views, expressed in his helpful and comprehensive statement, that a good economic program should have political and public opinion support, if it is to succeed, and that there is much to be explored in how to assess an economic reform program. The performance with respect to the quantitative performance criteria should be considered in the context of the overall evaluation. Also, we are in broad agreement with the staff's appraisal in the report. Thus, we shall make some brief remarks on this appraisal.

On the fiscal front, the formidable challenge faced by the Government is to reduce the overall fiscal deficit that, for the current year, is more than 5 percent of GDP, which is indeed high. We agree with the staff that the number one task for the Government is to cut the public sector deficit. On the expenditure side, the Central Government should shift the responsibility for a certain amount of the spending on health and education to local governments. In this respect, we are concerned about the increase of foreign borrowing of more than $1 billion by the public sector, and we wonder whether there is room to cut some of the borrowing or finance it from domestic resources. On the revenue side, the authorities are encouraged to approve the pending tax reform, particularly the value-added tax, as soon as possible. With respect to increasing domestic fuel product prices to international price levels, due to the political sensitivity of this issue, it would be better to implement this gradually.

As to monetary policy, the authorities are encouraged to maintain positive real interest rates and enforce the legal reserve requirements more strictly. Because the inflation rate is so high, the Central Bank should be firm in controlling credits to financial institutions. Furthermore, the expected approval of eight new laws for reforming the financial sector are of vital importance to enhance the efficiency of financial institutions. Therefore, the earlier the approval of the laws, the better for the authorities in order to effectively implement their financial reform programs.

In conclusion, we are pleased to learn that the authorities have remained committed to the reform program despite the difficulties caused by the coup attempts this year. We are confident that the authorities will overcome the events that occurred in 1992 and will successfully implement the reforms measures for 1993. It should be emphasized that the success of the 1993 program will have a far-reaching impact on the medium-term economic prospects of the country.

Mr. Obame noted that the authorities wished to have a precautionary stand-by arrangement. In addition to using that arrangement as a framework for containing the current economic and financial imbalances until the coming general election, they also wanted to use the precautionary program to negotiate with their creditors. He wondered whether the authorities also intended to reschedule their Paris Club debt.

The staff representative from the Western Hemisphere Department noted that the staff appraisal recommended the elimination of income tax loopholes and exemptions. During the staff's discussions with the authorities, the staff had emphasized that they move away from their strong dependence on petroleum revenues and try to augment nonpetroleum revenues, as a means of strengthening fiscal policy. In addition to trying to pass legislation on the value-added tax, the authorities were trying to improve tax administration with a program to closely monitor the tax payments of the largest corporations in Venezuela; they believed that, once the gross asset tax legislation was also passed, it would facilitate the monitoring of income tax collection. The value-added tax, in its first year of implementation, would yield 1 1/2 percent of GDP, and the gross asset tax would yield another 1 percent of GDP. The authorities could obviously further widen the tax base by broadening the value-added tax in the future.

By law, local and regional governments received a large share of the Central Government's revenues, and no clear understanding existed between the Central Government and the local governments on how those resources were spent, the staff representative pointed out. At the same time, the spending obligations that the Central Government had for education and health had not yet been shifted to local governments. However, once the shift was completed, it would increase accountability in that area, allow the regional governments to use resources--in all likelihood in a more efficient manner--and would relieve, to a degree, the Central Government's financial pressures. However, it had to be noted that, owing to a lack of information, the regional governments were not part of the consolidation of the public sector used for the policy discussions.

Concerning the use of revenue from privatization for either debt reduction or financing the Government's fiscal deficit, the staff representative said that the use of privatization revenues to finance recurring expenditures in 1993 was not a long-term, viable proposition. The best use of privatization revenue would be to use it to reduce debt to maintain the country's net worth.

With respect to the impact of the North American Free Trade Association on Venezuela, the staff had not analyzed in detail whether it would cause some trade diversion or what opportunities it could provide to Venezuela, the staff representative said. Given the significant liberalization of the exchange and trade systems, Venezuela should be able to compete in the North American market, if the country could improve its macroeconomic environment. The authorities were interested in becoming involved in the North American Free Trade Association and had taken the initial step of negotiating with Mexico.

With inflation at present between 33 1/2 and 35 percent, which was higher than that of Venezuela's trading partners, the authorities' main priority should be to tighten fiscal and credit policies, rather than to reduce the rate of exchange rate depreciation, as had been suggested, the staff representative commented. The authorities had attempted, toward the middle of 1992, to stabilize the exchange rate, but that had had no effect on inflation.

On the part of the authorities, the precautionary nature of the proposed stand-by arrangement was being used to send a signal to the Fund that the authorities did not intend to make purchases, the staff representative remarked. Another motive for the request was to facilitate relations with the international capital markets. In early 1993, a considerable amount of bonds that had not been refinanced in 1990 were falling due; of those, over $400 million were held by nonresidents and roughly $200 million by residents. In addition, with the loss of over $1 billion in net official international reserves, Venezuela's external performance had weakened and, without a tightening of fiscal policy, the outlook for 1993 was not bright. Thus, another motive for an arrangement with the Fund was to promote fiscal discipline and a better external performance.

Finally, in considering substituting foreign borrowing with domestic borrowing in 1993, the staff had noted in its report that domestic debt had already been rising over the past two years, the staff representative from the Western Hemisphere Department added. Furthermore, in the coming year, greater financing through domestic markets would result in an increased crowding-out of the private sector. For those reasons, the staff had not recommended the substitution.

The Deputy Director of the Policy Development and Review Department observed that Venezuela had not made use of the Paris Club for rescheduling its debt in the past and it was not expected to do so in the future.

Mr. Dorrington asked whether the purpose of the precautionary stand-by arrangement could be served by a stand-by arrangement permitting a low access, of say, 1 percent of the quota.

The Deputy Director of the Policy Development and Review Department remarked that access under a precautionary arrangement could indeed be quite small. However, the number that Mr. Dorrington had used was so low it might take away credibility from the arrangement. Also, it should be noted that, if the country met the performance criteria, it would be able to draw even if the arrangement were meant to be precautionary. It was important to emphasize, however, that a precautionary arrangement had conditionality, and that the performance criteria applied in the case of Venezuela would be consistent with upper credit tranche conditionality.

The Acting Chairman noted that, in the past, stand-by arrangements were meant in principle to be precautionary in character, but the nature of the arrangements had changed in practice over time.

Mr. Torres commented that the majority of the Directors had found that solving the fiscal problem was of far greater priority than solving the rest of Venezuela's economic problems. However, that problem, in turn, created difficulties for the monetary sector, the external current account, and important sectors of the economy. The fiscal problem was not one of policy adjustment but of structural reform. The Government had shown a great commitment to achieving fiscal consolidation and, during the last quarter of 1992, from the time that the staff mission had gone to Venezuela until the present, it had cut expenditures by roughly 2 percent of GDP. In the staff report, the deficit was described as being approximately 8 percent of GDP;

in fact, it was roughly 6 percent. That cut in expenditures, in an election year, had cost the political party in power the electoral support of five or six states.

There were several examples of the Government's commitment to achieving fiscal consolidation, Mr. Torres said. At the start of 1992, after the first coup attempt, the Government had had to suspend tariff increases, although it had announced that that suspension was temporary. Since then, some of the scheduled tariff increases, for electricity for example, had been resumed.

Another example of the Government's commitment to fiscal consolidation was the oil expansion program, which was very important for Venezuela not only because it was one of the most profitable investments that could be made in the economy, but also because, in its absence, the industry would have faced considerable cost increases as a result of capital wearing out, Mr. Torres said. The Government had been privatizing important areas in the oil industry. In fact, the only area of the oil industry that was not open currently to private capital was that of exploration and production in new fields. Even old oil fields had been opened to private capital. However, if the sector were open completely to private investment, there would be political problems and other difficulties, due to the law that regulated the oil sector.

During the previous year, the Government had restructured many public enterprises, and approximately 57,000 people were laid off or relocated, Mr. Torres recalled. Thus, the fiscal problem was not a result of the Government abandoning the economic reform program; rather, there had been difficulties in carrying out the reforms in the middle of the program.

For the coming year, the fiscal outlook looked better, Mr. Torres remarked. First, there was every likelihood that the tax legislation would finally be approved, because, as the main opposition political party expected to win the next general elections, it was willing to approve the legislation in the coming congressional session. Second, Congress had approved in November an important set of laws, such as the new budgetary and credit laws, that would lend greater discipline to fiscal policy. For example, the Government would be allowed to request credit only once a year and, when it presented its budgetary proposal for the whole year, it would be obliged to commit all budgetary resources by the end of the first quarter of that year. Those resources that were not committed by that time could not be spent. Furthermore, a new law had given more autonomy to the Central Bank. The government representative on the board of the Bank would be a minority position, and the new law prohibited the Central Bank from lending money directly to the Government. Finally, with the sacrifice of GDP growth, the authorities were committed in the coming year to battling inflation, which in the past year had been 33 percent.

The Acting Chairman made the following summing up:

Directors were in general agreement with the thrust of the staff appraisal. Directors expressed concern that, following the successful program implemented by Venezuela in 1989-90, the adjustment effort had experienced difficulties, especially with regard to fiscal policy, and that agreement had not been reached on the program for 1992 under the extended arrangement. Directors recognized that developments in 1992 had been dominated by difficult political events which had influenced the Government's capacity to adopt measures to deal with the further decline in oil revenues and had led to some reversals in fiscal policy. In this regard, Directors expressed their regret that a value-added tax had not yet been implemented, as had been expected at the time of the last review, and felt that the freezing of domestic fuel prices and electricity tariffs in March 1992 was also damaging, given the magnitude of the country's fiscal problem and the large subsidy element implicit in these prices. A number of Directors remarked that credit policy had been relatively weak in the light of the fiscal deterioration and the need to make progress in reducing inflation. Thus, Directors stressed the importance of Venezuela resuming its program of adjustment policy measures and structural reforms.

Directors stressed that a strengthening of fiscal policy was urgently needed in order to reduce the threat of exchange market pressures, to help reduce inflation, and to make room for private sector investment required to achieve sustained growth. Therefore, Directors strongly supported the authorities' intention to adopt fiscal measures that would reduce the public deficit in 1993, while improving the social safety net. In this connection, Directors urged the authorities to persevere in their efforts to obtain congressional approval of the taxes on value added and gross assets. Directors also noted, however, the need for actions beyond those already identified in order that the fiscal position be strengthened to the extent required. This would, naturally, include alternative tax measures should the value-added tax eventually not be approved. In addition, Directors encouraged the authorities to address the problem of loopholes in the current income tax system, and, while welcoming the decision to raise electricity tariffs, they stressed that similar action was needed with regard to domestic fuel prices.

Directors underscored the need to curb central government outlays by decentralizing expenditure responsibilities to local governments, cutting transfers to public enterprises, exercising wage restraint, and reducing employment in the public sector. Directors also stressed the importance of limiting the current expenditures of the state oil company, and of continuing to scale down the investment program to a more manageable level. Several

Directors referred to the desirability of increasing private sector participation in the development of the oil industry. A resumption of the Government's privatization effort was viewed as a means for improving the public finances and also raising efficiency.

While efforts to reduce the fiscal imbalance are in progress, Directors stressed that the authorities would need to maintain a very restrained credit policy to avoid further losses of international reserves and to bring inflation under control. The problems associated with using reserve requirement changes as a major instrument of monetary policy were cited. In this context, the central banking law was welcomed, and the need for greater use of open market instruments noted. Directors observed that, in the present circumstances, it was advisable for Venezuela to maintain a degree of exchange rate flexibility and to rely on the tightening of fiscal, credit, and wage policies to reduce inflation and preserve external competitiveness. Some Directors noted that a more stable nominal exchange rate could reinforce efforts to reduce inflation. It was important that this policy be applied in a steady and even manner to avoid a repetition of the unsettled market conditions.

Directors stressed that the softening of oil export prices had weakened Venezuela's external prospects for the medium term relative to the outlook that was discussed in late 1991. It was also noted that Venezuela continued to be vulnerable to external oil price shocks. Directors remarked that these factors indicated a need to plan for a stronger fiscal policy over the medium term. The authorities were encouraged to continue to seek legislative approval of a permanent oil stabilization fund for the purpose of smoothing the effects of oil revenue fluctuations on government expenditures and public finances. The need to reduce Venezuela's excessive dependence on oil revenues and to diversify the economy was also stressed and was seen as the basis for a more intense effort to implement structural reforms.

Directors commended the authorities for their achievements in the area of structural reform, particularly with regard to the trade system. They were encouraged by the approval of the new law for the Central Bank, which augers well for a completion of reforms in the financial sector. They stressed the importance of moving ahead with the public sector reform, including the restructuring of public enterprises.

Directors noted the authorities' intention to develop a program that could be supported by a precautionary stand-by arrangement from the Fund. They stressed that such a program would need to include a substantial fiscal correction, with significant prior actions in this area to ensure that this correction will be taken up front.

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

2. GUYANA - 1992 ARTICLE IV CONSULTATION; AND ENHANCED STRUCTURAL ADJUSTMENT FACILITY - REQUEST FOR THIRD ANNUAL ARRANGEMENT

The Executive Directors considered the staff report (EBS/92/191, 11/25/92) for the 1992 Article IV consultation with Guyana and Guyana's request for the third annual arrangement under the enhanced structural adjustment facility (ESAF). They also had before them a policy framework paper for 1992-94 (EBD/92/286, 11/25/92) as well as a statistical annex (SM/92/212, 12/7/92).

Mr. Kafka made the following statement:

Since the introduction of the Economic Recovery Program in mid-1988, Guyana has radically adjusted its economy through far-reaching measures that sought to address its macroeconomic imbalances and to put the economy on a path to sustainable growth. To date, the achievements have been remarkable, considering the relatively hostile global environment during the period of implementation. Only recently, Guyana completed a transfer of power from one regime, which had been in power for over 28 years, to the present Administration. My new authorities have wasted no time in addressing themselves to the challenges of the adjustment process, a fact reflected in their Memorandum on Economic and Financial Policies and in the updated policy framework paper.

After rebounding to 6.0 percent in 1991, real GDP growth is projected to be 6.5 percent in 1992, and, during the period January-June 1992, Guyana overperformed on all its financial performance criteria and observed all but one of its structural benchmarks.

In the fiscal sector, central government revenue grew substantially, reflecting higher corporate incomes recorded in 1991. In the rest of the public sector, there was also a strengthening in the revenue outturn. Revised forecasts now expect the overall public sector deficit to be 85 percent of its original targeted level by end-1992.

In the monetary sector, private sector savings increased substantially while credit expansion to the nonfinancial public sector was less than anticipated, resulting in a better than programmed net foreign assets position of the banking system. The increase in private sector savings reflected the impact of positive real interest rates, greater confidence in the economic policy framework, particularly as regards inflation, and the continued relative stability of the exchange rate. There was also a substantial overperformance with respect to gross international reserves of the Bank of Guyana, which are now expected to increase by US$23 million during 1992.

Structural reforms, which have been critical to maintaining the momentum of Guyana's adjustment program, continued in 1992. My authorities ensured that there were no restrictions in the cambio market and continued to conduct official market transactions based on the rates existing in that market. Prices continued to be freely determined, with the exception of sugar and electricity prices. The absence of the former need for large discretionary price adjustments, together with sound monetary policy, resulted in a further slowdown in the rate of inflation during the year. Furthermore, my authorities initiated a household survey in May 1992 with a view to restoring the publication of a consumer price index by the third quarter of 1993.

The exercise to simplify and reform the tax regime continued in 1992. One area of slippage, however, was with respect to the strengthening of tax administration and the computerization of the Inland Revenue Department. My authorities regret the slow pace of implementation of this project financed by the Inter-American Development Bank (IDB), which partly reflected difficulties between the IDB and the United Nations Development Program (UNDP), the executing agency for the project. They believe that in 1993 the difficulties encountered in the previous year will be overcome.

In the public sector, adjustments were made to electricity prices, and external consultants were hired to strengthen the managerial capacity of the Guyana Electricity Corporation (GEC). In addition, after protracted discussions with the creditors of GUYMINE, my authorities initiated their own financial restructuring plan for the company, and this included a management contract with a foreign corporation. During the year, they also concluded a debt buy-back arrangement that has eliminated all outstanding obligations to commercial banks.

The divestment program also continued in 1992 with the divestment of two additional entities. My new authorities have expressed their commitment to continuing with the divestment process but wish to bring to bear their own priorities in this exercise. To this end, they intend to produce a document on the future strategy for privatization by March 1993.

In the medium term, and as spelled out in the updated policy framework paper, 1992-94, my authorities intend to consolidate and build upon the gains made over the past few years.

Fiscal consolidation will continue. In 1993, the overall deficit of the nonfinancial public sector is expected to decline despite a substantial but necessary increase in capital outlays. This will be achieved partially by continued efforts to strengthen tax enforcement and by strong control over current expenditure--including wages--of the Central Government. Lower interest payments, partly owing to the commercial bank debt-reduction exercise of 1992, are also expected to contribute to this outcome. In 1994, the combined effects of strengthened revenue and expenditure efforts of the Central Government and the rest of the nonfinancial public sector are expected to lead to an even greater reduction in the overall balance of the nonfinancial public sector.

In the monetary sector, the Bank of Guyana will continue to pursue a flexible interest rate policy, keeping its administered rates in line with the average interest rate determined in the monthly tendering of treasury bills. My authorities, in consultation with the Fund, are giving consideration to broadening the range of monetary instruments to improve the ability of the Central Bank to conduct monetary policy. My authorities view the recent applications for new bank licenses as a positive development and a sign of confidence in the financial sector, and they intend to implement necessary amendments to the existing financial legislation before processing such applications.

The agenda for structural reforms continues to be substantial. In addition to preparing a new strategy on divestment, my authorities will prepare new legislation in 1993 that will increase the supervisory powers of the Central Bank, widen its financial responsibilities, and strengthen its regulatory powers. They will also seek ways to strengthen the links between the cambio and official markets with the aim ultimately of shifting all transactions to the cambio market. My authorities will continue the process of trade liberalization and, in keeping with the other Caribbean Community (CARICOM) member states, will reduce the Common External Tariff on a phased basis from its present level of 0-45 percent to 5-20 percent by January 1, 1997.

The process of addressing the macroeconomic imbalances of the country has had an adverse impact on a large segment of the population, particularly the unemployed and the low-income earners. My authorities will seek to improve upon the now established Social Impact Amelioration Program (SIMAP) in order to redress the more devastating effects of the adjustment process. The current resources under SIMAP will be strengthened in 1993 by a World Bank loan to support improvements in social infrastructure. Assistance from the UNDP, the IDB, and the Canadian Hunger Foundation have also been particularly helpful.

Notwithstanding the achievements described, the medium-term outlook remains fragile. While the current account deficit is expected to narrow between 1994 and 1998 and gross international reserves to remain at six months of imports, financing gaps in excess of US$40 million a year will exist. Moreover, as previously rescheduled debt repayments fall due in the latter half of the decade, debt-service repayments, already substantial, are expected to climb to 44 percent of merchandise exports by 1999.

In this context, my authorities' attempt to restructure their debt to the Paris Club under enhanced concessions is of critical importance. In addition, having reached agreement with commercial bank creditors in 1992, they are also holding discussions with their largest bilateral creditor, Trinidad and Tobago, in an effort to restructure those debt obligations in the medium term. My authorities have proved in the past their willingness to undergo rigorous adjustment policies in the interest of normalizing their relationship with their creditors and to set the stage for their own economic recovery. My new authorities have equally committed themselves to continuing the task of the adjustment process. It is, therefore, only fitting that the international community grant Guyana enhanced concessions under the Paris Club.

The commitment to adjustment by my authorities is beyond question, but there is little doubt that the success of their efforts is dependent upon the willingness of the international community to provide the required financial support. While many countries have supported the efforts of my authorities in the past, support for which my authorities are grateful, there is much more to be done. My authorities hope that they will be able to count on the catalytic role of this institution and, more important, on timely and appropriate financial support from its major members in the immediate future.

Ms. Lindsay-Nanton made the following statement:

Good progress continues to be made by the Guyanese authorities in the conduct of their Economic Recovery Program. In 1992, real GDP is estimated to be stronger than anticipated at 6.5 percent, the overall deficit of the nonfinancial public sector is projected at about 80 percent of the programmed level, and gross international reserves have increased substantially, owing largely to higher sugar exports and lower fuel and sugar imports.

As a consequence of these favorable developments, Guyana met all the quantitative benchmarks and all but one of the structural benchmarks for end-June under the enhanced structural adjustment arrangement. I wish to congratulate the Guyanese authorities on these achievements, and I can support the proposed decisions.

Although satisfactory progress continues to be made, Guyana's economic situation remains very difficult. In the area of fiscal policy, although the strengthening of central government finances is welcomed, this was largely as a result of stronger growth in corporate tax receipts in 1991. Indeed, while several measures to rationalize the tax system, including the introduction of single and lower corporate tax rates, have been introduced, I must caution that, in view of the uncertainty of the revenue yield, the fiscal situation must be monitored closely and the tax base broadened to increase revenues on a sustained basis. Furthermore, in this respect, expenditure restraint, particularly wage restraint, is called for, and I welcome the new Government's commitment in this regard.

Given the centrality of fiscal consolidation to the Economic Recovery Program's success, I must express my disappointment with the further delay in the operationalization of the tax administration project funded by the IDB. According to Mr. Kafka, this reflects difficulties between the IDB and the UNDP, which the authorities "believe" will be overcome in 1993. Could the staff offer a perspective on the likelihood that this will in fact be the case?

While an improvement in the performance of the public enterprises is projected in 1992 over 1991, this is estimated to be weaker than programmed. This shortfall resulted largely from GUYSUCO on account of higher wages and increased expenditures related to replanting and refurbishment, as well as a weaker performance from GUYMINE owing to delays in its restructuring.

GEC, I am pleased to observe, after several delays, has begun the drawdown of the IDB supplemental loan. With a strengthening of its management and operations capacity, the financial position of GEC is projected to improve greatly in 1993. However, I fully support the Government's commitment to undertake whatever additional measures might be required in order to eliminate the need for current transfers to GEC by end-1993.

Interestingly, in 1993, while performance of most state enterprises, including GUYMINE, is projected to strengthen significantly, the total operating balances of the public enterprises, because of GUYSUCO's deteriorating financial position on account of lower average sugar prices, are projected to deteriorate by some 2 percentage points of GDP over 1992. This being the case, it is imperative that the Government develop a strategy for the future rehabilitation of the sugar industry as well as ownership arrangements. Likewise, in general, the commitment to free trade as well as open markets on the part of the industrial countries must be stressed, if developing countries are not to be unduly threatened.

The weakened state of Guyana's economic and social infrastructure continues to be a major challenge of the Economic Recovery Program. Regrettably, public investment expenditure is projected to fall 2 percentage points of GDP below that envisaged in 1992, and about 13 percentage points below the 1990 level. The staff notes that this shortfall is due to a sharp decline in foreign financing, although the staff observes that this would in part be compensated for by increases in local counterpart funding by the Central Government and expenditures related to the rehabilitation of the bauxite company (LINMINE).

Several bottlenecks hamper rehabilitation, including weak implementation capacity. The human resource capacity constraint in Guyana is well known, and lasting solutions must be found to this problem. In this regard, I was particularly interested in the authorities' plans for strengthening implementation capacity with the World Bank's assistance, and I would be grateful for comment from the staff or World Bank representative on what is envisaged. I recall from the April 1991 review (EBM/91/63, 4/24/91), efforts were being made by the authorities to improve the institutional arrangements for project preparation, execution, and monitoring. How does the staff assess the capacity now as opposed to then?

As to delays in disbursements on the part of creditors and donors, let me say that burdensome procedures and numerous conditions only compound the delay in project implementation and hence infrastructural rehabilitation, already sadly lacking in Guyana.

The strengthening of SIMAP to address poverty and ease the burden of adjustment on the disadvantaged in the society is welcome. Indeed, I fully support the planned survey of income and expenditure with a view to better targeting the Program's assistance. However, I was somewhat curious about the duration of the cash transfer program to low-income public servants and wondered what were the expectations after the one-year period had elapsed. Perhaps the staff could comment.

In the financial sector, the sharp increase in private sector savings along with the increase in private capital inflows in 1992 would suggest the return of a large measure of confidence in the Guyanese economy. Indeed, the Bank of Guyana's flexible interest rate policy, which has brought about positive real interest rates as well as exchange rate stability, has been a contributing factor. I welcome the authorities' intention to strengthen the institutional framework with appropriate legislation early in

1993, which would allow for increased competition in the financial sector. Furthermore, I support the authorities' request for technical assistance from the Fund to facilitate the Bank of Guyana in engaging more actively in the conduct of monetary policy.

As regards the external sector, owing to a strong recovery in sugar sales and notwithstanding a deterioration in average export prices, the current account of the balance of payments is projected to narrow by some 13 percent in U.S. dollar terms in 1992 over 1991. Some deterioration is projected in 1993, although this is primarily on account of increased inputs for the bauxite industry and larger public investment outlays.

Despite the strong growth in exports projected in 1993, however, the debt-service burden continues to be a major constraining factor on Guyana's ability to address its large social and infrastructural needs, and the country will continue to need significant debt relief from the international community. Indeed, the staff points out that while some US$77 million will be required in exceptional financing, which has been secured through rescheduling agreements and balance of payments support, a financing gap of US$21 million will remain in 1993.

We have noted the authorities' request for a new Paris Club rescheduling, covering pre-cutoff obligations falling due through December 1993 on enhanced concessions. Given Guyana's track record of performance and compliance with the terms of its rescheduling agreements over the past years, a good case can be made for considering, at an early stage, a stock-of-debt reduction exercise, as envisaged by creditors under the provisions of the Trinidad terms.

The new Administration has an excellent opportunity to build on the hard-won gains that have thus far been achieved in Guyana. The return of confidence to the economy, to which I referred earlier, must be maintained with the continued implementation of sound economic policies. I therefore welcome the authorities' stated commitment to the Program. Similarly, the Government's commitment to the process of privatization of public enterprises, both to improve the efficiency of the public sector as well as to generate much-needed resources, is welcome. I look forward to the issuance of the authorities' policy document on privatization by March 1993.

Mrs. Hansen made the following statement:

Guyana has been making very good progress in reorienting and reactivating its economy since it initiated its Economic Recovery Program in 1988. This latest report on performance under the second year of Guyana's three-year enhanced structural adjustment arrangement is particularly commendable and encouraging. Not only were all the quantitative performance criteria met, and all but one of the structural benchmarks fulfilled, but the economy outperformed the goals set out in the program. Growth, at 6.5 percent, was stronger than had been expected, and inflation seems to be running a little lower than anticipated, at about 12 percent. It is also noteworthy that this positive performance was achieved in a difficult economic environment. Guyana's terms of trade continued to drift lower last year, and the important bauxite sector has continued to slip.

We are pleased that the new Government in Guyana has committed itself to build on the economic reforms that have been put in place over the past few years and that it is prepared to embark on a well-structured program to be supported by a third-year ESAF arrangement.

While Guyana's economic fortunes are improving, the country started from a very deep hole. The analysis in the staff report makes clear that, even with extensive debt relief, the external position will remain fragile throughout the balance of this decade. Getting the major industries on a sustainable footing will require diligent hard work over a number of years. The government sector is still sorting itself out, trying to find a way to pay a reasonable level of compensation, while keeping the overall wage bill under tight control.

Over the past year, a rising tide of improving economic activity has provided a little latitude for needed upgrades both in the Government and in the public sector corporations. Improved tax collections have allowed an increase in government wages, without violating the fiscal targets of the second-year ESAF arrangement. Likewise, strong recovery in the sugar sector has provided the wherewithal to undertake additional refurbishments. Given the run-down state of much of the official Guyanese economy, we would not quarrel with these decisions. Looking ahead, however, the authorities will need to exercise discipline, particularly in the area of wages, to be sure they do not get ahead of what the economy's resources can provide.

In this regard, we are a little uneasy with the subtle rebalancing of the basic economic strategy that the new Government contemplates. The overall targets for the public sector are to continue as before, but within these totals, the position of the government sector is to be substantially strengthened, offsetting a weakening in the position of the public enterprises. The Government plans to develop a new divestment policy to replace the privatization program of the previous Government, while social expenditures will receive a higher priority.

As we understand the situation in Guyana, the weak performance of the dominant public sector corporations is the fundamental hurdle to improving prosperity in the country. Some progress has been made, particularly in the sugar sector, where improved management has made a major contribution. The bauxite sector, however, has had a harder time grafting on outside contract management. Even though this situation may now be improving, prospects for bauxite in international markets remain poor. The electricity corporation seems to be doing better but clearly needs to adjust tariff rates to achieve economic pricing. These entities were also the earlier beneficiaries of significant amounts of now restructured foreign debt.

The common theme seems to be that the state enterprises in Guyana, as in a lot of other countries in the area, suffer from an excess of governmental involvement and weak financial discipline. This situation is on the way to being improved, but the job is not yet finished. It is possible that the major entities are not yet ripe for privatization. Nevertheless, we believe privatization should be retained as the ultimate objective. A clear goal of privatization will impose greater urgency on the intermediate task of making the companies into viable commercial entities.

We would appreciate some additional explanation from the staff about the new Government's thinking on this subject. If the position of state enterprises is to be allowed to weaken, what would be the intended sources and uses of this weakened position: productivity-enhancing investments, recapitalization, higher wages, controlled prices, or deteriorating operating results? We have considered that increased tax collection from the state enterprises was one of the successes of recent reforms; we hope that will not be reversed. How will performance in the government sector be strengthened to compensate for the anticipated weakening of the state enterprises? The desire to enhance social spending, while understandable, seems to conflict with the objective of having the government sector become a larger contributor to the overall public sector balance.

In conclusion, we would urge the Guyanese authorities to be very cautious in adjusting these key elements of their economic strategy. Clear consolidation of the gains that have been made should be the first order of business, before the public sector takes on additional burdens--or retains activities it had expected to devolve to the private sector. We are happy to support the proposed decisions.

Mr. Ismael made the following statement:

The Guyanese authorities' steadfast implementation of their macroeconomic and structural adjustment programs during the past years, including the second annual arrangement under the ESAF, is commendable. I am pleased to note that the program is broadly on track and that all the quantitative performance criteria and structural benchmarks for end-June 1992 have been met. The authorities' endeavors, therefore, deserve our appreciation and continued support. I can endorse the proposed decisions.

I am in broad agreement with the staff's assessment of the Guyanese economy. The measures proposed by the authorities for the remaining period of 1992 are broadly in line with the basic objectives of the program. However, I will comment specifically on some areas of concern.

First, despite the debt relief obtained to date, Guyana's external position will remain precarious over the medium term, with the ratio of public debt service to merchandise exports averaging about 40 percent during the rest of the decade. More intensive measures to generate nontraditional exports should be pursued. Although the diversification of the export base continues to be the declared policy of the Government, it is disappointing to note that under the balance of payments projections for 1990-2000, export items other than sugar, rice, and bauxite will continue to account for only one third of Guyana's total export earnings of this century. I would be interested in hearing staff comments on this important matter.

Given the 1991 large stock of public debt--776 percent of total merchandise exports--I agree with the staff that the authorities should continue to search for a solution to this problem, in close cooperation with the donor and creditor community. Generally, improvements in the external accounts rely on generous donor support and exceptional assistance, including a major concessional restructuring of debt. In this context, credible program implementation, adequate structural reforms, and the re-establishment of constructive debtor-creditor relations by overcoming the arrears problem are essential to maintain external confidence, among both official donors and foreign private investors.

Second, Guyana's 1991 inflation rate of 106 percent is by any standard high. As the underlying cause is the high fiscal deficit, which is primarily financed through money creation, a drastic reduction of the fiscal deficit is obviously needed in order to reduce money growth and ultimately reduce inflation. The objective to reduce inflation to 15 percent in 1992 and further to 8 percent in 1994 appears to be very ambitious. However, the objective to reduce the overall budgetary deficit from 36 percent of GDP in 1991 to 22 percent in 1994 seems too low to be effective in achieving the inflation reduction target. Could the staff comment on these apparently inconsistent sets of targets?

A speedy reduction of inflation is important so that all interest rates can become positive as soon as possible, which would support the exchange rate policy pursued and strengthen the mobilization of domestic savings. It is therefore reassuring to note that the Bank of Guyana intends to pursue a flexible interest rate policy by adjusting its administered interest rates in line with the average interest rate determined in the monthly treasury bill auctions.

Consequently, a stable macroeconomic environment, although by itself conducive to a desirable private investment response, should be supplemented by structural reform. I welcome the intention to review the banking sector legislation in early 1993, which, together with the planned tax reform, could lead to a transparent regulatory structure and thereby further support the growth of private sector activity.

In the final analysis, however, growth of the private sector presumes the existence of a viable entrepreneurial class. I welcome the specific measures that have been recently taken to foster growth of a viable national entrepreneurial class and to reduce the number of strikes in the industrial units, a number that is high by any standard.

The program before us embodies a set of appropriate objectives and measures. Given Guyana's good track record, I am confident that the 1992 program will be implemented with resolve and determination and that the success of Guyana's reform efforts will be greatly facilitated by continued support of the international community.

Mr. Dorrington made the following statement:

The first sentence of the staff appraisal states: "Guyana's performance under its economic program has continued to be satisfactory." I cannot agree. It has been better than satisfactory. Mr. Kafka uses the word "remarkable," and I agree with him. Of course, there is much more to be done and room for improvement, and I will concentrate my remarks on these areas; but my main message is that the new authorities should keep up and build on the good work of the old, who have seen their efforts rewarded with growth greater, and inflation less, than envisaged in the program, with a gratifying recovery in confidence in Guyana.

Having said this, external viability remains a distant prospect, mainly because of a huge debt overhang. Table 15 illustrates the balance of payments position on the basis of currently agreed debt-rescheduling agreements. The financing gap will average some US$65 million until the end of the decade, an amount approximately equal to one fourth of this year's GDP. There has been some further recent progress with Guyana's debt burden, including the welcome elimination of payments arrears to commercial banks. But I would appreciate some comments from the staff on the further actions that will undoubtedly be needed to reduce debt and debt-service obligations to more manageable proportions. Board approval of this ESAF arrangement will unlock the final tranche of Guyana's September 1990 Paris Club rescheduling agreement, consolidating debts on Toronto terms to the end of July 1993. When this agreement runs out, and assuming continued strong adjustment in the interim, the United Kingdom for one would be prepared to consider exceptional debt relief from the Paris Club.

I also have some concerns in the area of fiscal policy. It is worrisome that reform in so crucial an area as tax administration is being held up because of unresolved issues surrounding the employment of consultants to advise the Government on the measures needed. Could the staff please comment as to how and when this problem might be resolved.

The temporary boom in corporation taxes seems to be at least in part reflected in an overrun on expenditure. Such slippages are particularly worrisome when they consist of a large overrun in current expenditure and a shortfall in capital expenditure, and they are always more difficult to reverse than to concede. Perhaps staff could comment on whether control systems need to be improved.

The report refers only briefly to a planned Public Administration Project, developed with the assistance of the World Bank. It notes the need to increase salaries as an incentive to improved quality in the civil service; but it does not address the possibility of finding savings by reducing public sector employment. Perhaps the staff could comment on this as well.

I note that the implementation of projects supported by offshore financing continues to present problems. Will the planned reforms in the civil service do something to address poor implementation capacity? What else might be planned?

It is understandable that the new Administration has decided to conduct a major review of the privatization program. But it is important that this not lead to undue delays and that the March deadline for announcing a strategy be kept; I would like confirmation that this is indeed in prospect. It will also be important for the Government to make the privatization process as open and transparent as possible. This will be essential in order to encourage, rather than undermine, the present climate of private sector confidence in Guyana.

In this context, both the staff report and Mr. Kafka's statement refer to the strong increase in private financial savings this year. This appears to be inconsistent with the figures in Table 4 (EBS/92/191), which show a reduction in private savings compared with both last year's level and this year's program. There could have been some explanation of this apparent inconsistency in the text, and perhaps the staff could comment.

I understand that there are plans to open a stock exchange in Guyana, with trading due to start in the middle of 1993. Can the staff say what progress is being made in setting this up? The stock exchange should provide important underpinning to the privatization process, once established.

I would also like to stress the importance of the planned amendments to legislation in the financial sector. This too should help to strengthen the private sector's response to the adjustment program in Guyana, including to the public enterprise reform program.

Finally, I welcome the substantial steps already taken toward unifying the exchange markets, and I would be grateful for the staff's assessment of when that process might be complete. I can, of course, support the proposed decisions.

Mr. Shimizu made the following statement:

The Guyanese authorities are to be commended for their sound economic management. Economic growth continues to be robust, the inflation rate has declined, the exchange rate has been stabilized, and foreign reserves have increased. The authorities have observed almost all the quantitative and structural benchmarks for end-June. Like previous speakers, I am happy to support the authorities' request for the third ESAF arrangement. This being said, since the macroeconomic imbalances, both internal and external, are still very large, there is a long way to go. Further efforts by the authorities to consolidate the gains achieved thus far and to further strengthen adjustment are required.

On fiscal policy, while I welcome the improvement of the primary current balance of the Central Government, it is worrisome that the overall primary balance in 1993 is expected to move to a deficit position because of a large increase in capital expenditure. I understand the need to improve infrastructure, but given the limited absorptive capacity of the economy, I wonder whether such a large increase is desirable. I also believe that a large fluctuation in investment should be avoided. On the revenue side, further efforts to improve tax administration are warranted. In this connection, like previous speakers, I am interested in hearing the staff's elaboration of the current status of the IDB-funded tax administration project.

With respect to monetary policy. I welcome the steady reduction in inflation from 82 percent in 1991 to 15 percent in 1992. A better foundation for price stability in 1993 is being established; positive real interest rates are being maintained and credit to the public sector is expected to decline. In addition, no major price adjustment is expected in 1993. I therefore believe that the inflation target of 10 percent in 1993 could be more ambitious. I would be interested in hearing comments from the staff on this matter.

Financial sector reform is necessary to improve the efficiency of resource allocation. In this regard, I welcome the authorities' intention to proceed with legislative action on financial sector reform in line with the Fund's recommendation.

The performance of public enterprises remains a source of great concern. It is regrettable that the better than expected performance in the first half of this year deteriorated rapidly in the second half. In particular, it is worrisome that the deficit of the GEC has increased. In spite of this deficit in 1993, the authorities do not intend to increase the tariff because of their program to improve its financial position. I understand the need for such efforts, but they will not be adequate in themselves to cope with the financial difficulties of the GEC. I would therefore encourage the authorities' endeavors on both fronts.

As for the divestment of public enterprises, I welcome the authorities' intention to review the privatization process; however, given the need to reduce the role of the public sector in the economy, the authorities are encouraged to press ahead with the divestment of enterprises.

Guyana's external position will continue to be difficult in the medium term because of the large external debt. In this regard, I welcome the recent debt buy-back operation with commercial banks, which will eliminate commercial bank debt.

The program envisages the maintenance of a fairly large amount of reserves, equivalent to six months of imports. I wonder whether such large reserves are really necessary. The staff's comments would be welcome.

The stabilization of the exchange rate is a welcome sign, but given the relatively high rate of inflation, the deterioration of external competitiveness is a source of concern. I would appreciate the staff's comment on the adequacy of competitiveness. With these remarks, I support the proposed decisions.

Mrs. Martel made the following statement:

Guyana's economic performance under the ESAF-supported program continues to be impressive. All the quantitative benchmarks for end-June 1992 and nearly all the structural benchmarks, with the exception of measures aimed at strengthening tax administration, were met. Activity growth has resumed and has reached the much better than programmed level of 6.5 percent. Prospects are favorable as far as the disinflation process is concerned, and the private sector's financial savings expanded very rapidly in 1992. However, the fiscal and external sectors' deficits remain very high, reflecting Guyana's heavy external debt burden and weaknesses in government revenue collection. Also, the Government has to face major challenges arising from the necessary improvement of the functioning of the public sector and the provision of an adequate infrastructure for development. Clearly, the situation calls for continued determination in reducing imbalances.

Commenting more specifically on the situation and on the program for 1992-93, fiscal adjustment was quite remarkable in 1991 and for the first half of 1992. Fiscal adjustment remains a crucial element of the program, and I welcome the objectives of reducing the overall deficit of the public sector from 45 percent of GDP in 1991 to 36 percent in 1993 and 23 percent in 1994. Thorough implementation of a tight policy stance is indeed essential for the achievement of such rightly targeted objectives.

Four elements are worth underlining in this regard. First, in spite of the progress already attained in the tax reform area, the IDB-funded project aimed at strengthening tax administration should now be given high priority. It is true that the strong performance of tax revenue in 1992 is particularly encouraging, but tax administration remains weak and there is a need for further reform of the tax system, notably in the pursuit of broadening the tax base. I was pleased to note that this tax administration project is a structural benchmark for December 1992. Could the staff give us some indication of how far this project has advanced?

Second, after the increases in noninterest current spending in 1992, the program for 1993 rightly calls for restraint in this area. However, improved performance of the central administration requires measures to attract and retain skilled staff. I agree that, for the short term, the immediate pressures should be addressed by the World Bank project, but, for the longer term, a sustained improvement in revenue performance is needed.

Third, taking into account the important need for reconstruction and rehabilitation, public investment expenditures should be given more attention. In 1992, these expenditures are projected to be lower by about 2 percent of GDP, reflecting shortfalls in foreign financing. In 1993, the projected increase by 5 percent of GDP is a very important commitment and development.

Fourth, the restructuring of public enterprises should be accelerated and completed. The financial position of public enterprises did not improve as much as projected and is supposed to weaken in 1993--the current primary surplus of public enterprises is projected to fall short of the programmed level by about 2.5 percent of GDP and to decrease to 18.5 percent of GDP in 1993. In this regard, I welcome the authorities' commitment to eliminate transfers to the GEC by the end of 1993, all the more so since they were to have been eliminated by end-1992, and also to take additional measures to increase GEC revenues or cut its expenditures should any slippages occur in this area. I noted with satisfaction the ongoing restructuring.of the bauxite company. For GUYSUCO, noticeable progress has been realized in management and production, but I share the view that the authorities should now give priority to the rehabilitation program for the sugar company.

Privatization is an essential element in the authorities' strategy to increase the role of the private sector in the economy. I understand the need to implement an approach that ensures transparency of the operations, but I urge the authorities not to delay the process too much.

As to monetary policy, I agree with the staff on the need to continue the current flexible interest rate policy and to increase, as much as feasible, the depth of, and the degree of competition in, the financial sector.

Like other speakers, I think that pursuing exchange rate stability will certainly be helpful for the adjustment process of the economy. Indeed, the remarkable policy-induced stability in the exchange rate of the Guyana dollar since the second part of 1991 did not prevent a positive performance of Guyana's exports--especially Guyana's nontraditional exports--and certainly contributed to substantial capital inflows.

On the external front, the situation of Guyana will remain precarious over the medium term. Considering the heavy debt burden of this country, I particularly welcome the agreement reached with commercial banks and wish to point out that my authorities would be ready, when the time comes, to grant rescheduling on London terms.

Finally, I wholeheartedly support both the priority attached by the Government to poverty alleviation and the measures designed to effectively address this country's environmental problems. I support the proposed decisions.

The staff representative from the Western Hemisphere Department commented that it was the staff's understanding that the issues that had delayed implementation of the IDB tax administration project had now been resolved by the agencies involved. Moreover, the coordinator, whose presence was crucial to the process, had arrived in Guyana at the end of October. Therefore, the staff expected that the structural benchmark relating to commencement of the project by end-1992 would be met.

The latest figures indicated that inflation for the year through October amounted to about 13 percent; therefore, prospects were good that the 15 percent ceiling for 1992 would be met, the staff representative remarked. As regards the inflation objective for 1993, there could be some further one-off price adjustments to come, for example, in the area of electricity tariffs, that could push inflation somewhat higher, but the staff considered that 10 percent was not an overly ambitious objective. The authorities had agreed that the increase in central government wages would be held in line with that inflation objective in 1993.

In that connection, Mr. Ismael had asked whether the target for inflation was not inconsistent with the rather modest target for the reduction of the overall public sector deficit, and the staff representative explained that most of the deficit arose from external interest obligations. Based on the debt rescheduling that had been referred to by Directors, the stock of domestic debt of the nonfinancial public sector would fall by about 3 percent of GDP in 1993 and a further 13 percent of GDP in 1994. Given these projections, the staff believed that the inflation ceilings of 10 percent in 1993 and 8 percent in 1994 were feasible.

The improved performance of the state enterprises was a crucial element of the program, the staff representative stated. It was encouraging that the financing package for the rehabilitation of the bauxite company (LINMINE) had been agreed and should be in place by January 1993; the Government intended to divest the company after the initial rehabilitation period of 18-24 months. The other part of the bauxite operation (BERMINE), which was ready for divestment, would be included in the privatization exercise. As for GEC, consultants were assisting with the rehabilitation process, funded by a supplemental loan from the IDB. At present, the condition of the enterprise did not make it attractive for divestment, but measures were under way to improve its performance. In the sugar industry, an estimated US$100 million would be needed for plant rehabilitation, and the Government was aware that at least partial divestment would be required to obtain the necessary resources. The World Bank may contribute US$15-20 million to such an external financing package, but that would be contingent on the Government's commitment to majority private sector ownership of the industry. The Government planned to issue a paper on its privatization strategy, prepared with technical assistance from the UNDP and the World Bank, by March 1993.

As mentioned in the policy framework paper, the enterprises considered for divestment were basically the same as had been envisaged by the previous Administration, the staff representative added. However, until privatization actually occurred, the staff projections for the state enterprises would continue to assume that the enterprises would remain in the hands of the Government.

Investment expenditure was expected to increase significantly in 1993, following difficulties in 1992 associated with the elections, which had led to a reluctance on the part of donors and creditors to fund new projects, the staff representative said. The expected implementation of new programs in 1993 would increase the overall primary deficit, but there would be a corresponding increase in foreign financing, thereby relieving pressures on domestic resources. The deterioration of the physical and social infrastructure of the country, including the shortage of skilled labor, remained one of the most serious problems facing the economy. Accordingly, an increase in the level of foreign-financed investment was appropriate.

In addition to the IDB-funded cash transfers to certain vulnerable groups, including low-income public servants, the World Bank was considering a project to supplement the central government wage bill for a period of three to four years and thus address the problem of attracting and retaining skilled labor, the staff representative remarked. It was hoped that by the end of the latter period, the revenue situation of the Central Government would permit the absorption by the public sector of the cost of such supplements and thereby eliminate the need for further donor assistance.

As regards nontraditional exports, the staff representative commented that there had been a significant increase in 1992, but medium-term prospects would depend heavily on future levels of foreign and private investment in the nontraditional sector. Nonetheless, the staff projections might be somewhat conservative regarding the potential for future growth in that area.

She understood that various creditors would be willing to provide Trinidad terms in the coming Paris Club rescheduling, the staff representative remarked. On the basis of comparability of treatment from non-Paris Club creditors and under the assumptions regarding future debt reduction described in the footnote on page 31 of the staff report, the debt-service ratio could decline from 40 percent of merchandise exports to about 25 percent. While still high, that would represent a significant improvement over the current situation. It was also possible that, under certain conditions, the debt reduction could be larger than contemplated at present by the staff.

The program levels for noninterest current expenditures of the Central Government were very tight, particularly for maintenance and repairs--an area that had borne the brunt of adjustment during the past three or four years, the staff representative commented. As a consequence, the situation was very difficult, but the Government had indicated a willingness to maintain its firm stance on expenditures until revenues were strengthened on a sustainable basis. Implementation of expenditure controls in the Central Government had improved significantly over the past few years, although there was undoubtedly room for further improvement. A World Bank public sector review project would cover both the issues of expenditure control and the composition of expenditures, for example, in order to ensure that an adequate level of maintenance expenditures was provided to support new investment projects.

The scope for decreasing expenditures through a reduction of employment might be limited as there already existed a high level of vacancies in the Central Government at the present wage scale, the staff representative added. Following a restructuring of the central government ministries based on the recommendations of a U.K. technical assistance project, vacancies had been reduced from about one half of actual staff positions to about one third, which was indicative of the continued difficulties faced by the Government in attracting and retaining skilled staff.

The figures mentioned in the text of the staff report for private financial savings reflected the recent rapid growth in time and savings deposits with the banking system, the staff representative explained. Unfortunately, there were no reliable national income accounts for Guyana at present, and accordingly, the data for savings given in Table 4 were estimates. The data, which included the public enterprises, were compiled on the basis of 1988 prices and also reflected interest payments and receipts. The Guyanese authorities were working to overcome the current difficulties with data availability and hoped to present a more complete set of national income accounts in 1993.

As a first stage toward the establishment of a stock market, in January 1993 the Fund planned to provide technical assistance in developing a secondary market for government securities, the staff representative noted. The United Kingdom had laid the groundwork during two earlier technical assistance visits, and the Minister of Finance was eager to establish a stock market to facilitate trading of shares in public enterprises in connection with the Government's planned privatization efforts. However, it might be advisable to concentrate initial efforts on a secondary market in government securities and on the related issues of development of an interbank market and completion of the unification of the exchange market. At present, the exchange market was segmented not only between the official and cambio markets, but also with respect to the transactions within the cambio market; very few transactions took place between banks and nonbank dealers, and banks still preferred to deal directly with the Bank of Guyana, which was counterproductive for the development of the market.

Given Guyana's heavy burden of external debt, as well as its recent experience of foreign exchange shortages and arrears, the current level of reserves could be viewed as broadly appropriate, the staff representative commented. However, those reserve levels had not been a target of the program but rather resulted from overperformance with respect to the reserve targets over the past two years. As she had explained earlier, that overperformance reflected the lack of integration in the exchange market. To date, the private sector had been willing to generate sufficient financial savings to accommodate the accumulation of reserves. Nonetheless, the staff projections were based on a more modest increase in reserves of about US$10 million a year through the end of the decade.

Despite Guyana's inflation rate and the resulting real appreciation of the exchange rate, external competitiveness did not seem to be a cause for concern to date, given the behavior of nontraditional exports and other anecdotal indicators, the staff representative from the Western Hemisphere Department said. The sharp depreciation of the real exchange rate in 1991 had probably been an overshoot and that had been followed by a lengthy period of stability in the nominal rate, which had permitted the real rate to move toward its equilibrium level.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/92/153 (12/18/92) and EBM/92/154 (12/21/92).

3. STAFF COMPENSATION ISSUES - REVIEW OF TAX ALLOWANCE SYSTEM

The Executive Board approves the recommendations of the Committee on Administrative Policies with respect to the review and modification of the tax allowance system as set forth in EBAP/92/164 (12/15/92).

Adopted December 18, 1992

APPROVED: June 30, 1993

LEO VAN HOUTVEN
Secretary