FOR AGENDA

SM/95/28

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February 6, 1995

To: Members of the Executive Board

From: The Secretary

Subject: *Venezuela - Staff Report for the 1994 Article IV Consultation*

Attached for consideration by the Executive Directors is the staff report for the 1994 Article IV consultation with Venezuela, which is tentatively scheduled for discussion on Monday, February 27, 1995.

Mr. Pérez (ext. 37326), Mr. Tweedie (ext. 38245), or Mr. Rosales (ext. 37164) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Inter-American Development Bank (IDB), following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

VENEZUELA

Staff Report for the 1994 Article IV Consultation

Prepared by the Staff Representatives for the 1994 Consultation with Venezuela

Approved by C. Loser and D. Lachman

February 6, 1995

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I. Introduction

The 1994 Article IV consultation discussions were held in Caracas during November 2-18, 1994 continuing the policy dialogue that was initiated during three staff visits earlier in the year. Representatives of Venezuela included the Ministers of Finance, Planning, Energy and Mines, Development, and the Presidency; the Presidents of the Central Bank and the Venezuelan Investment Fund; and other senior officials. Mr. Berrizbeitia, Executive Director for Venezuela, participated in the discussions. 1/

The most recent Article IV consultation was concluded by the Executive Board on March 14, 1994 (EBM/94/21 and SM/94/30). 2/ Executive Directors noted that the banking crisis and the exchange pressures that emerged in mid-January 1994 had exacerbated an already difficult situation. These pressures highlighted the urgent need to adopt a strong program of macroeconomic adjustment and to resume the process of structural reform. Directors welcomed the intentions of the new Administration in these areas but expressed concern about the direction and adequacy of some of its early policy actions. 3/

II. Economic Background and Developments in 1994

The macroeconomic policies and reforms supported by the 1989 extended arrangement from the Fund 4/ and a temporary rise in oil receipts associated with the Middle East War in 1990 led to a strengthening of the balance of payments, a decline in inflation, and a strong recovery in activity during 1990-91 (Table 1). However, a fiscal imbalance re-emerged in 1991 and widened in 1992, reflecting a decline in oil export revenue and delays in instituting reforms to expand the non-oil tax base. Slippages in fiscal policy, together with increased political instability and erratic implementation of monetary policy, led to a decline in the growth of financial savings, frequent runs on the bolivar, and large losses of international reserves in 1992.

1/ The staff team comprised of Messrs. L. Pérez (Head), T. Duffy, J.R. Rosales, and A. Tweedie (all WHD), Ms. R. Krieger (PDR), and Ms. L. Casaravilla (Assistant-BLS). Mr. E. Feldman (MAE) participated in the last ten days of the mission to follow up on the progress in addressing the banking crisis.

2/ Venezuela accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement on July 1, 1976 and currently maintains certain restrictions subject to Fund approval under Article VIII. Attachment I contains information on relations with the Fund.

3/ The current Administration took office in early February 1994.

4/ For a discussion of the developments under the extended arrangement, see EBS/92/194, November 30, 1992.

The economy contracted in 1993 as uncertainty about the stability of the Government along with a further drop in oil export prices undermined private sector confidence. In midyear, Congress suspended President Pérez on charges of misuse of funds and elected Senator Ramón J. Velásquez as interim President. The interim Government maintained control over public expenditure, and, in the last quarter of 1993, passed a value-added tax (VAT) and a new law for banks and financial institutions that had been delayed since 1990-91. A large fiscal imbalance remained, however, and the public sector ended the year with significant arrears. Ahead of the general elections in December 1993, exchange pressures intensified, net international reserves fell sharply, and the 12-month rate of inflation increased to 46 percent.

The new Administration inherited a difficult fiscal situation. Moreover, the weaknesses in the public finances were seriously aggravated by a banking crisis that emerged in January 1994 with the collapse of Banco Latino, the second largest bank in the country. These factors accompanied by a relaxation of monetary policy contributed to large capital outflows, an acceleration of inflation, and a large depreciation of the currency during the first half of the year.

Fiscal measures adopted toward mid-1994 were not sufficient to stabilize the economy and, at the end of June the authorities fixed the exchange rate and imposed exchange controls. These controls permitted a recovery in net international reserves in the second half of the year but they also contributed to a sharp easing in banking system liquidity. Real interest rates became strongly negative and by end-1994 the 12-month rate of inflation reached 71 percent.

The banking crisis and the inadequate policy response of the authorities contributed to a large contraction in economic activity in 1994. Real non-oil GDP is estimated to have dropped by 6 percent in 1994 and the unemployment rate rose to 13.5 percent by the third quarter of 1994. The external current account balance swung from a deficit of 3.7 percent of GDP in 1993 to a surplus of 6.5 percent of GDP in 1994, as imports declined by close to 30 percent. Notwithstanding the current account surplus, net international reserves fell by more than US$1.1 billion during the year reflecting the substantial capital outflows in the early part of the year and reduced availability of external financing.

The banking crisis reflected the failure over a number of years to address weaknesses in the financial condition of banks and to strengthen bank supervision and the legal and regulatory framework. 1/ These factors were compounded by inadequate macroeconomic policies and the downturn in economic activity in 1993. After the initial closure of Banco Latino, the crisis spread quickly to seven other banks and a finance company, which

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1/ A staff paper on the banking crisis is being circulated along with the consultation reports for the information of Executive Directors.

received assistance from the Deposit Insurance Agency (FOGADE) amounting to Bs 500 billion (6 percent of GDP) before being closed by the authorities in mid-June. Banco Latino reopened in early April under state ownership following a recapitalization by FOGADE amounting to Bs 300 billion (3.6 percent of GDP).

In July 1994 a technical assistance mission from the Monetary and Exchange Affairs Department urged the authorities to carry out a rapid assessment of the financial condition of all remaining banks, and to liquidate those found to be nonviable as part of a comprehensive plan of action for the system as a whole. However, the authorities decided not to close any more banks during the second half of the year and instead were forced to nationalize five banks whose owners were not able to restore the estimated capital losses. By end-December the authorities had taken over or closed 13 banks (out of 47 prior to the crisis) accounting for about half of total bank deposits at end-1993. Total assistance from FOGADE to the banking system is estimated to have reached Bs 1,100 billion (13.2 percent of GDP) in 1994.

In the second quarter of 1994, actions were taken to address the widening fiscal imbalances, including measures to cut expenditure from budgeted levels and increase tax collections. The expenditure cuts subsequently were offset by new commitments, including those related to a 67 percent increase in the minimum wage. The revenue measures included replacement of the VAT with a general sales and luxury tax (GSLT) at the wholesale level, a temporary tax on bank debits, an increase in the maximum income tax rate from 30 percent to 34 percent (effective in 1995), the elimination of certain deductions from the income tax, increased fees on some government services, and stiffer penalties for tax code violations. The GSLT maintained the VAT structure with three rates and defined wholesale activities with a sufficiently low sales threshold to include most commercial establishments, both wholesale and retail, in the tax base.

For the year as a whole, the public sector deficit (including the quasi-fiscal losses of the Central Bank) is estimated to have increased from 3 percent of GDP in 1993 to about 15.4 percent of GDP in 1994, mainly on account of FOGADE's net lending to ailing banks (Tables 2-4). The public sector deficit was financed primarily through recourse to central bank credit, domestic bond financing of over 5 percent of GDP, and arrears accumulation.

Public sector external arrears are estimated to have increased from US$230 million at end-1993 to US$775 million at end-1994. These mainly took the form of arrears to bilateral export credit agencies. In addition, as a result of the initial delays associated with the exchange control system, some US$350 million in external arrears on private sector financial debt reportedly were incurred in the third quarter, only part of which were settled prior to the end of the year. In response to the accumulation of arrears, most export credit guarantee agencies took Venezuela off cover and access to private capital markets was curtailed. In late 1994-early 1995, the Government placed Bs 160 billion in bonds and began using the proceeds of these bonds to settle part of the public sector arrears.

In the early months of 1994, the authorities maintained the crawling peg exchange rate policy that had been followed since late 1992. However, in the face of heavy reserve losses, the Government abandoned this policy in April 1994 and permitted a nominal depreciation of about 10 percent against the U.S. dollar through mid-May, which brought the cumulative depreciation since the beginning of the year to 24 percent. Subsequently, the authorities experimented briefly with a system of foreign exchange auctions but the run on the currency continued and the loss in net international reserves amounted to US$3.8 billion in the first half of the year.

As indicated above, at the end of June, the Government introduced exchange controls and fixed the exchange rate at Bs 170 per U.S. dollar (compared with a prevailing market rate of Bs 200 = US$1), which was maintained unchanged for the rest of 1994. As a result, the real effective depreciation of the bolivar during the first half of the year is estimated to have been largely reversed by end-December (Chart 1). 1/

The exchange control system gave rise to substantial delays in foreign exchange sales by the Central Bank and contributed to a temporary recovery of about US$2.7 billion in net international reserves in the second half of the year. There were government delays in processing foreign exchange applications and the threat of substantial penalties against fraud also resulted in processing delays on the part of banks. 2/ There was some improvement in the working of the system during the last quarter of the year, but actual foreign exchange sales continued to lag behind authorizations.

Against the background of emerging difficulties in the banking system and a slowing in the economy in early 1994, the Central Bank sterilized only about half of the large liquidity injections associated with FOGADE's assistance to the banking sector. 3/ In June 1994 the Central Bank pushed interest rates on zero-coupon bonds up from an average of less than 50 percent during the first five months of the year to 68 percent in an effort to stem the reserve losses through monetary tightening.

1/ Substantial penalties have been established for black market trading in foreign exchange. However, there are reports that an active market has developed, with the premium over the official rate widening to close to 30 percent by end-1994.

2/ Limits were introduced on the allocation of foreign exchange for education, travel abroad, and family remittances, and were maintained for remittances of profits from certain investments.

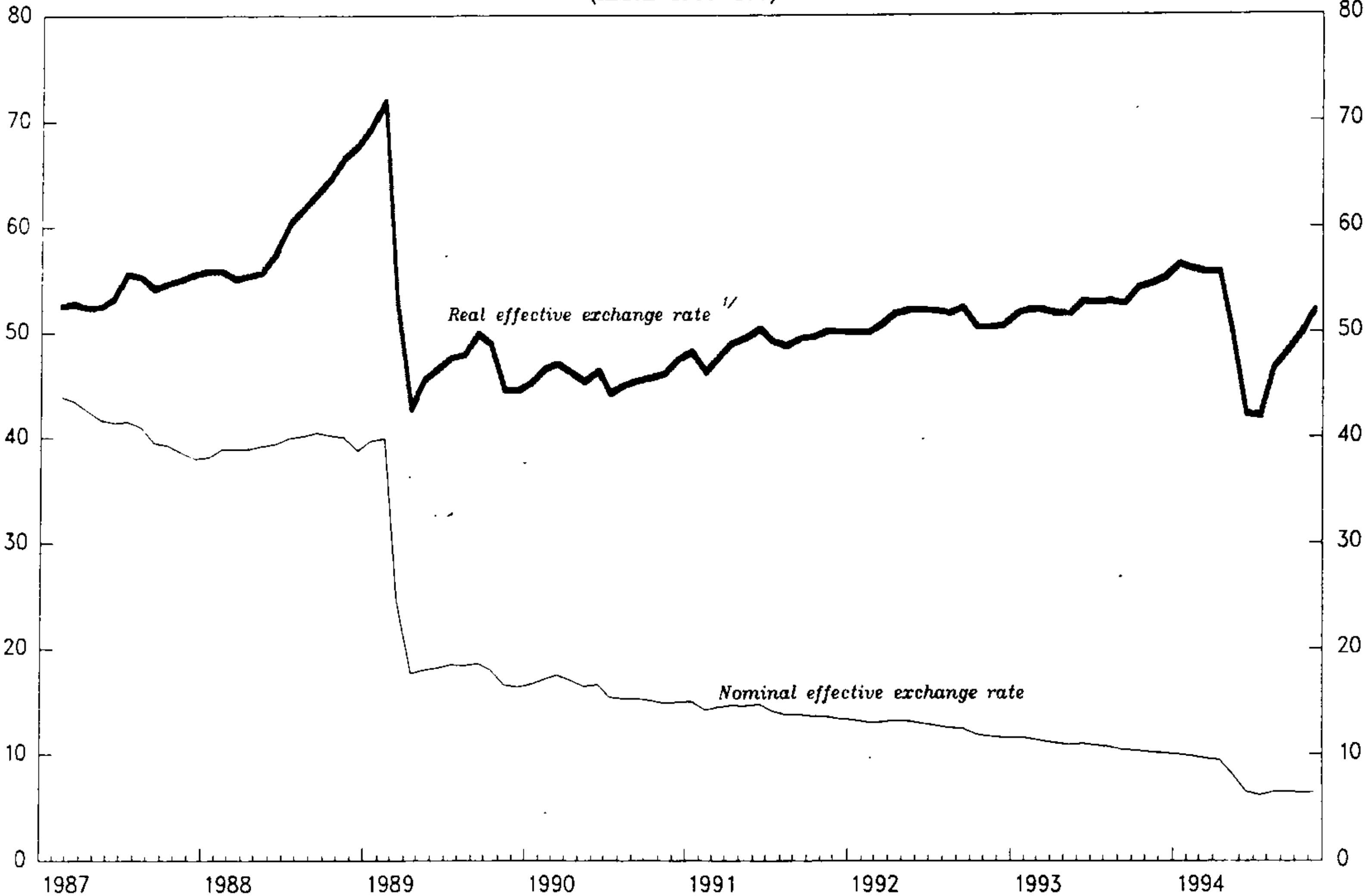
3/ The Central Bank was under substantial political pressure to lower interest rates during this period, culminating in the resignation of its President in April.

CHART 1

VENEZUELA

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES

(Index 1980=100)



Source: IMF, Information Notice System.

1/ Trade-weighted index of nominal exchange rate deflated by seasonally adjusted relative consumer prices. An increase (decrease) indicates appreciation (depreciation).

During the second half of 1994, monetary policy was eased sharply following the imposition of exchange controls. The recovery in net international reserves led to a large increase in bank liquidity and base money expanded by about 55 percent from July to December (64 percent for the year as a whole; Table 5). The Central Bank reduced its rediscount rate from 73 percent to 45 percent in July, and the yield on 91-day zero-coupon bonds dropped to an average of about 34 percent in the last five months of the year. Bank deposit rates fell to an average of about 29 percent during the third quarter of 1994. 1/ Reflecting the effects of sharply negative real interest rates, broad money (M2) is estimated to have declined in real terms by about 8 percent in 1994, following a 12 percent fall in 1993.

Price controls were introduced by the interim Government at the beginning of 1994 on a limited range of basic goods and these subsequently were broadened by the new Administration during the second half of 1994 to cover an estimated 10 percent of the CPI basket. However, these controls do not appear to have been fully binding. In August 1994 the authorities reduced electricity rates retroactively by canceling the monthly increases that had been implemented since March 1994 in line with the inflation adjustment factor in the pricing formula.

III. Policy Discussions and Prospects for 1995

Discussions with the authorities centered on the policies and outlook for 1995 and for the medium term, including the implications of the recently announced plan to seek substantial foreign investment in the oil sector. The authorities' broad objectives for 1995 were to reduce inflation to about 30 percent, halt the decline in economic activity, and attain balance of payments equilibrium. However, they were only prepared to implement limited revenue and expenditure measures. Instead, they were counting on large privatization proceeds and on sizable bond placements to finance the public sector deficit, meet amortization payments falling due, and clear arrears. As regards monetary policy, the authorities wanted to avoid a significant increase in interest rates, which in their view could jeopardize a recovery of economic activity.

The authorities indicated that exchange controls for current transactions could be lifted gradually in 1995 and that price controls could be removed once agreement had been reached with the private sector on voluntary price restraint. A fixed exchange rate regime was to be maintained for the time being.

1/ In late September, the Central Bank sought to limit the fall in bank deposit rates by increasing the minimum deposit rate to 10 percentage points below the yield on zero-coupon bonds, which implied a limit of 25 percentage points on maximum bank interest spreads. The maximum bank lending rate continued to be set at 15 percentage points above the zero-coupon bond rate.

The mission stressed that Venezuela was facing a very difficult economic situation. Based on the authorities' envisaged policies, the mission observed that one could not exclude the possibility of an acceleration of inflation and deterioration in the external accounts. In this context, the mission indicated that a substantially more ambitious program of stabilization and reform was required. Specifically, the mission recommended significantly stronger fiscal adjustment and monetary policy tightening than envisaged by the authorities. Only under such circumstances could one restore domestic and external confidence in policies, something that was required to reduce inflation and to allow for the removal of exchange controls, which were creating serious distortions in the economy. The mission also recommended measures to address the remaining weaknesses in the banking system. The policy discussions centered on those areas where there were major differences of opinion between the authorities and the staff.

1. Fiscal policy

The authorities felt that there were limits to the degree of fiscal adjustment that could be implemented in the short run. For this reason, they were proposing to rely on substantial privatization receipts and new borrowing to finance the deficit in 1995, cover amortization payments, and clear arrears. The main revenue measures planned for 1995 were an increase in the rate of the GSLT from 10 percent to 12 1/2 percent, and a new tax on financial transactions to replace the bank debits tax (that lapsed at end-1994). The authorities indicated that it was not feasible politically to raise gasoline prices at this time or to increase the GSLT rate to 15 percent as had been announced earlier. 1/ They hoped to make cuts of 5 percent in noninterest budgeted expenditures, but acknowledged that not all the debt-service and wage obligations for 1995 had been included in the budget, and that the fiscal program for 1995 would need to take account of these additional expenditures.

On the basis of the authorities' policies, and including all known expenditure obligations, the mission projected the overall public sector deficit at 6.1 percent of GDP (a deficit of 3.7 percent of GDP excluding the quasi-fiscal losses of the Central Bank). The mission indicated that, given the current outlook for external and domestic financing, a deficit of this magnitude could not be financed without substantial recourse to central bank credit or a further accumulation of arrears.

Public sector revenue was projected by the staff to decline from 31.5 percent of GDP in 1994 to 27.5 percent of GDP in 1995 under the authorities' program, primarily because of the fall in the operating surplus of the

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1/ An increase in gasoline prices to export opportunity cost (implying an increase of between four and fivefold) and the larger increase in the GSLT rate had been key features of an earlier program announced by the authorities in September 1994.

state petroleum company (PDVSA) caused by the real exchange rate appreciation that would result from maintenance of a fixed exchange rate. 1/ It was assumed that the new 0.5 percent tax on financial transactions would take effect in April, and that there would be some increase in revenue collection as a result of the efforts of the newly-created autonomous tax revenue service (SENIAT) to reduce evasion. The yield from the new measures in 1995 was projected to more than offset revenue losses stemming from the lapse of the bank debits tax and a further decline in domestic fuel tax revenues relative to GDP. The projections assumed that gasoline and diesel prices remain frozen in 1995. 2/

Public expenditures were projected by the staff to decline sharply from 46.9 percent of GDP in 1994 to 33.6 percent of GDP in 1995, mainly on the assumption that further outlays associated with the banking crisis will be confined to the recapitalization of banks that were intervened in 1994. These expenditures were assumed to be covered by FOGADE's projected receipts in 1995 (from liquidation of assets and further government transfers of about Bs 100 billion financed through the placements of bonds), such that no further recourse by FOGADE to central bank credit would be required. Interest obligations of the nonfinancial public sector would increase by about 0.6 percent of GDP. This increase would have been substantially larger were it not for the fact that a large part of the direct fiscal cost of the banking crisis in 1994 was financed by the Central Bank, 3/ and real interest rates were assumed to remain negative in 1995. The projections also assumed that the authorities would be successful in reducing discretionary expenditure by 5 percent from budgeted levels, and that there would be a further slight decline in the public sector wage bill in relation to GDP.

As regards the financing of the deficit, the authorities planned a major acceleration of the privatization program in 1995, including the sale of at least part of remaining government shares in the telephone company (CANTV), three electricity companies, and several of the enterprises operated by the Venezuelan Guyana Corporation (CVG). They hoped to obtain about US$1.4 billion (2 percent of GDP) in net receipts from privatization in 1995. Moreover, the authorities also envisaged making substantial recourse to the domestic bond market in 1995, including the placement of the above-mentioned bonds to finance the operations of FOGADE, and further large net placements of treasury notes. The authorities also expected to raise about Bs 180 billion (1.4 percent of GDP) through a placement in the domestic market of a U.S. dollar-denominated instrument backed by rights of

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1/ The staff projections are based on an average exchange rate of Bs 180 per U.S. dollar in line with the 1995 budget.

2/ Regular gasoline in Venezuela currently retails for Bs 22 or US$0.13 a gallon. The local currency price has been fixed since March 1992.

3/ Continued large quasi-fiscal losses of the Central Bank (cash basis) amounting to 2.4 percent of GDP were projected in 1995, compared with 2.5 percent in 1994 and almost none in the previous year.

future oil royalties in the domestic market that would be used to reduce FOGADE's debt to the Central Bank. Moreover, the authorities were planning to seek access to the international bond market, including through the possible issue of an instrument backed by rights to future oil royalties.

The mission pointed out that considerable doubts remained over Venezuela's creditworthiness, and that it was likely to be difficult to obtain the level of external and domestic financing envisaged by the authorities. Further, the issuing of bonds backed by rights to future oil royalties could turn out to be very costly and make it more difficult and expensive for the public sector to borrow in the future. The staff also considered that the privatization proceeds being counted upon by the authorities appeared to be very optimistic, particularly in light of the exchange and price controls. For this reason, the staff projected that the available foreign financing and privatization proceeds in 1995 would be considerably smaller than the level envisaged by the authorities. 1/ In these circumstances, the nonfinancial public sector would need to make substantial recourse to central bank financing and/or accumulate additional arrears in 1995.

2. Financial sector policies

The authorities felt that a large increase in nominal interest rates should be avoided at this time because this could jeopardize the prospects for an economic recovery. However, they indicated that the combination of the planned easing of exchange controls and the issue of domestic bonds to finance FOGADE's obligations should assist in reducing excess bank liquidity during the early months of 1995. To limit the adverse effects of negative real interest rates on savings, they planned to retain the current minimum deposit rate at 10 percentage points below the interest rate on zero-coupon bonds.

The mission noted that both lending and deposit rates were strongly negative in real terms, and that a failure to restore positive real interest rates in 1995 would lead to a further erosion of financial savings. These negative rates could also undermine the efforts to strengthen the banking sector, and they could jeopardize the authorities' efforts to reduce inflationary pressures. The staff's projections assumed that despite the price controls and the maintenance of a fixed exchange rate, inflation in 1995 would remain at a level similar to that recorded in the latter part of 1994. However, the staff noted that there was a real risk under current policies that inflation could accelerate further in 1995.

The authorities acknowledged that problems remained within the banking sector, but they were hopeful that the policy adopted during the second half

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1/ Negative net foreign financing--including privatization and the clearance of external arrears--of 3 percent of GDP was projected by the staff.

of 1994 of nationalizing insolvent banks would assist in restoring public confidence in the banking system and reduce the risk of new runs on banks. They have since requested further technical assistance from the Fund to help assess the financial condition of remaining banks and the preparation of a strategy to restore the health of the banking system. During 1995 the authorities planned to begin the process of liquidating the assets of those banks that were closed in 1994 and to pursue restructuring plans for those nationalized banks that remain in operation. They also hoped to make substantial progress toward the reprivatization of Banco Latino. Regarding FOGADE's debt to the Central Bank, the authorities were considering the possibility of settling part of this debt through the issue of a long-term low interest rate bond.

The mission noted that there was a significant risk that the longer-term cost of nationalizing and recapitalizing insolvent banks could exceed that of liquidating the troubled banks and repaying depositors up to the legal guarantee. A comprehensive strategy was needed to assess the financial condition of all remaining financial institutions; develop plans for immediate recapitalization, merger, or liquidation of insolvent banks; and to implement measures to strengthen banking supervision and to exercise surveillance over financial groups. In the latter connection, the mission underscored the need for the authorities to proceed promptly with their plans to conduct supervision on the basis of consolidated information on financial group activities. The mission also suggested that foreign participation in the banking sector should be encouraged and that any instrument issued to settle FOGADE's debt to the Central Bank should be at market interest rates.

3. External sector policies

The authorities felt that the current exchange rate of Bs 170 per U.S. dollar could be maintained, but left open the possibility of modifying the rate slightly, perhaps to achieve the average rate used in the 1995 budget of Bs 180 per U.S. dollar. They were neither willing to lift capital controls nor to return to a flexible exchange rate regime at this time because of concerns regarding the possibility of large capital outflows. They also were noncommittal regarding a timetable for liberalizing the controls on current account transactions.

The mission cautioned that although the bolivar did not seem significantly overvalued at the current exchange rate, the policy of maintaining a fixed exchange rate under the current inflationary conditions would quickly lead to a large real appreciation of the currency. Moreover, the staff suggested that the distortions associated with exchange controls would progressively increase over time. The mission also took the position that, in the context of adequate fiscal and credit policies, it was desirable to return to the implementation of a flexible exchange rate system given that the Venezuelan economy is heavily vulnerable to terms of trade shocks due to its dependence on oil revenues.

The authorities pointed out that trade barriers had not been increased in 1994, notwithstanding the balance of payments difficulties. In December 1994 Congress approved the treaty to include Mexico in the customs union already in place with Colombia and ratified the membership of Venezuela in the World Trade Organization.

On the basis of the authorities' current policy intentions, the staff projections envisaged a decline in the external current account surplus from 6.5 percent of GDP in 1994 to 3.8 percent of GDP in 1995 (Table 6). Oil export revenue would increase by almost US$900 million as a result of a further increase in production and higher prices, 1/ while growth in non-traditional exports would slow owing to the projected real currency appreciation. Imports were projected to increase by about 15 percent in U.S. dollar terms, on the assumption that the authorities carry out their plans to liberalize the exchange controls on current account transactions. Net capital flows still would be strongly negative in 1995, reflecting scheduled amortization and limited access to new external financing. 2/ On this basis, gross official reserves of the Central Bank (excluding gold holdings) were projected to decline to the equivalent of five months of imports and nonfactor services from about seven months at end-1994.

4. Other policy issues

The authorities felt that price controls had not led to significant distortions, as the controlled prices had been revised periodically to prevent shortages. In 1995 the authorities intended to seek an agreement with the private sector on a system of voluntary price restraint aimed at limiting increases in the prices of basic goods and services. Once such agreements were reached, they hoped to be able to eliminate price controls.

The authorities expressed concern about the effects of inflation and unemployment on the living conditions of the poor. They noted that the 1995 budget included an increase in spending on safety net programs, including measures to protect the real value of the monthly stipend for low-income students as well as other subsidies targeted to poor women and children. Also, the authorities had plans to increase financing for public housing projects and to provide debt relief to small businesses.

A commission was established in November to study existing severance payment rules and the social security system. The authorities were aware of the need to bring severance benefits down to realistic levels and indicated

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1/ An average oil export price of US$14 per barrel was assumed in 1995, compared with US$13.25 per barrel in 1994. This increase was slightly more conservative than that envisaged by the current WEO exercise.

2/ The size of net outflows would be lower than in 1994 on the assumption that exchange controls on capital flows would continue to have some impact on curbing capital flight, and on the basis of the expected increase in foreign direct investment in the oil sector (see below).

that labor unions might agree to the elimination of the retroactivity feature of severance payments in exchange for immediate wage increases. 1/ Also, the authorities indicated that they would seek ways to improve the actuarial base of the Venezuelan Social Security Institute (IVSS). The commission is due to report in February and the authorities were hopeful that the report would make recommendations that could serve as the basis for prompt action. The mission encouraged the authorities to reform the severance payments system, particularly in light of the large unfunded liabilities of the Government in this area, but urged caution regarding wage increases in light of the need to avoid a wage-price spiral.

IV. Alternative Scenario for 1995 and the Medium Term

The staff is of the view that with strong policies Venezuela would be able to achieve a relatively rapid turnaround in economic performance, as illustrated in the staff's medium-term scenario (Tables 7 and 8). Based on a more realistic assumption about bond financing and taking into consideration the need to avoid net central bank credit to the public sector, the staff estimated the public sector deficit should be held to about 1.5 percent of GDP in 1995. Such a reduction in the deficit could be attained by increasing the GSLT rate to 15 percent, by raising domestic fuel prices to export opportunity cost levels, and by exerting firmer expenditure control, provided that the return to a flexible exchange rate policy would contribute to avoid a large real appreciation of the currency. The staff scenario envisaged that there would be a further strengthening of public sector finances over the medium term that would result in a surplus of 3 percent of GDP by 2001.

In addition to a strengthening of revenue and expenditure measures, the scenario envisaged an immediate tightening in the stance of monetary policy to restore positive real interest rates, the lifting of exchange and price controls, and the return to a flexible exchange rate policy in 1995. The bolivar was assumed to depreciate in line with the difference between Venezuela's inflation and that of its trading partners. The aforementioned policies would allow the authorities to regain the confidence of the private sector, which would facilitate the attainment of planned goals for privatization. It was assumed that the proceeds from privatization would mainly be used to cover severance liabilities and reduce the public sector debt after 1995.

Oil exports were projected to increase from 2.4 million barrels a day in 1993 to 3.1 million barrels a day by 2002, and that international oil prices would be broadly in line with the assumptions of the WEO. It was assumed that the oil sector is opened to private investment in 1995 in line

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1/ The retroactive nature of the current severance payments system, and its cost for the public sector, is discussed in the recent economic developments paper to be issued shortly.

with the authorities' intentions. Private companies would be offered the opportunity to participate directly in exploration and the production of light and medium crude through profit-sharing contracts with PDVSA. The authorities envisage that these joint ventures would finance about US$17 billion of PDVSA's investment program of US$49 billion (in 1993 prices) over the period 1993-2002. However, the staff's medium-term scenario assumes a lower level of investment given the uncertainty associated with several of the projects, particularly regarding natural gas and extra heavy crude.

With the fiscal and credit tightening, and the recovery in the demand for money in real terms envisaged in the scenario, the 12-month rate of inflation would decline from about 70 percent at end-1994 to 30 percent at end-1995, and to single-digit levels beginning by 1998. The improvement in public sector savings would underpin a recovery of national savings of about 2.5 percentage points of GDP over the medium term, while investment would rise from 16.5 percent of GDP in 1995 to about 21 percent of GDP by 1998. Real GDP would be flat in 1995, but would recover strongly thereafter.

Despite increased oil exports, the external current account surplus would decline to less than 1 percent of GDP over the medium term, owing partly to large increases in imports associated with PDVSA's investment program. The capital account was projected to be in surplus through most of the projection period and gross international reserves (excluding gold holdings) would rise over time to about six months of imports of goods and nonfactor services. It was envisaged that a large reduction in public external debt could be achieved from about 59 percent of GDP at end-1994 to about 22 percent of GDP by 2002, as the public sector would make net repayments abroad.

There are risks in the medium-term outlook for Venezuela. The most obvious risk would be the failure to sufficiently tighten financial policies, in which case inflation could accelerate and the economy could continue to decline in the atmosphere of considerable financial market uncertainty. Beyond these risks, the costs associated with the banking crisis could be larger than envisaged currently, in which case a further strengthening of fiscal policies would be required. Also, the scenario is sensitive to the assumptions made regarding oil export prices and oil production. For example, if oil export prices were to be lower by US$1 a barrel, other things being equal, the current account balance would deteriorate by an average of almost 2 percentage points of GDP a year over the projection period.

V. Staff Appraisal

In 1994 there was a significant worsening in Venezuela's economic situation as indicated by a strong acceleration in inflation, a significant decline in output, and the accumulation of substantial external payments arrears. A difficult fiscal situation at the beginning of the year was aggravated by the emergence of a major banking crisis. The authorities did not respond to these developments with a sufficiently strong adjustment of financial policies, but rather they resorted to exchange restrictions, price controls, and the fixing of the exchange rate.

The authorities' program for 1995 does not address adequately the serious imbalances presently affecting the economy. In the fiscal area, the authorities are counting on privatization and financing that will be difficult to obtain in the absence of a basic correction in financial policies. Unless additional adjustment measures are taken, the authorities likely will face again the need to finance a large public sector deficit with central bank credit (with possible undesirable consequences for inflation and net international reserves) or through a further accumulation of external arrears.

There is an urgent need to frame a program to address Venezuela's economic problems in a comprehensive manner and lay the basis for sustained economic recovery. Such a program would need to include a lasting fiscal adjustment with front-loaded measures, a tightening of the monetary stance and a strengthening of the autonomy and capital of the Central Bank, and the liberalization of prices and the exchange market. Only under such circumstances, could one expect a restoration of private sector confidence necessary to stabilize the economy.

The public sector deficit should be limited to about 1.5 percent of GDP in 1995. In the revenue area, further efforts are needed to expand Venezuela's non-oil tax base that could include the raising of the rate of the general sales and luxury tax to 15 percent and the abolition of most exemptions to the income and sales taxes. Users' fees should also be increased, including those of universities. However, a tax on financial transactions should be avoided because of the distortions it would introduce.

The domestic pricing of fuel, in particular gasoline, has a key role to play in the adjustment effort. The current low level of gasoline prices implies a substantial loss of fiscal revenue and results in a serious misallocation of resources. The subsidy accruing to upper income earners is difficult to justify on equity grounds. At the same time, the elimination of these distortions would reduce incentives for smuggling and release gasoline for export. Gasoline prices need to be raised to their export opportunity level without delay and prices of all domestic fuels should henceforth be adjusted automatically in line with export prices and exchange rate movements.

Immediate action is needed to secure durable reductions in public sector expenditure. Specifically, the size of the public sector should be reduced by eliminating redundancies and increasing the scope of privatization. It also will be important to raise the efficiency of public expenditure, especially in the areas of health and education.

The Government's decision to reactivate the privatization program is welcome. This is particularly so if the decision is to include enterprises in the non-oil mineral sector that have incurred heavy losses. In addition, the opening of oil fields to joint ventures with foreign investors should be instrumental in developing further this important sector. Given the extent of current fiscal imbalances, privatization proceeds may need to be used to help finance the public sector deficit in 1995, but in subsequent years privatization revenue should be used primarily to reduce public sector debt, including severance liabilities.

It is important that the authorities carry out their intentions to clear external payments arrears. This measure would be a key element in the strategy to restore Venezuela's creditworthiness. The fiscal program for 1995 also will need to take fully into account all debt-service obligations falling due to avoid a new accumulation of arrears.

It is necessary to bring severance benefits down to a realistic level to improve the public finances and increase labor market efficiency, particularly in light of the recent increase in unemployment. The social security tax administration needs to be improved urgently to reduce evasion, and the structure of benefits needs to be reformed with a view to linking them more closely to individual contributions.

Monetary restraint will have an important role to play in helping to reduce inflation and safeguard the official international reserves. It is essential to restore positive real interest rates to arrest the decline of financial savings and facilitate the lifting of exchange controls. For this purpose, it will be important to eliminate interest rate controls and to continue to rely on open market operations to attain monetary targets. Direct or indirect credit by the Central Bank to the Government should be avoided. Moreover, a timetable should be established soon for repaying public sector debts to the Central Bank, especially those related to the banking crisis.

Any remaining cases of weaknesses in the banking system need to be resolved quickly to restore confidence in the banking system and ensure that the necessary tightening of credit conditions does not precipitate new bank failures. To limit taxpayer losses and avoid moral hazard, timely action is needed to liquidate insolvent banks and sell intervened institutions and related assets. A major effort is needed to improve bank supervision and the authorities should increase the resources devoted to this area.

Under the current inflationary conditions, the maintenance of a fixed exchange rate at the current level will imply a rapid erosion of competitiveness. There already are indications of an increasing spread between the official and black market exchange rates. It would be preferable to have the exchange rate determined by the market with the support of appropriately restrained fiscal and credit policies. Such a course of action would facilitate the early elimination of exchange controls.

Exchange and price controls are causing serious distortions in the economy and should be eliminated. The elimination of exchange controls need not lead to a renewal of capital outflows provided that it is accompanied by the adoption of strong fiscal and credit policies. Venezuela maintains exchange restrictions subject to Fund approval under Article VIII, Section 2(a), in the form of (i) limits on the allocation of foreign exchange for education, travel abroad, and family remittances, and on the remittances of profits from certain investments, and (ii) as evidenced by the existence of certain external payments arrears. In the absence of a clear timetable for the removal of these restrictions, the staff does not recommend approval of their retention by Venezuela at this time.

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

Table 1. Venezuela: Selected Economic and Financial Indicators

	1990	1991	1992	1993	Staff Est. 1994	Staff Proj. 1/ 1995
(Annual percentage change; unless otherwise specified)						
National income and prices						
GDP at constant prices	6.5	9.7	6.1	-0.4	-3.3	-2.0
Oil	14.0	10.2	-1.2	4.6	5.7	5.9
Non-oil	4.5	9.6	8.1	-1.7	-5.8	-4.5
GDP deflator	41.7	21.4	28.3	32.4	57.7	56.3
GDP deflator (non-oil)	32.4	32.3	30.4	36.6	60.0	64.8
Consumer prices (end of period)	36.5	31.0	31.9	45.9	70.8	60.5
External sector						
Exports, f.o.b. (in U.S. dollars)	35.1	-14.2	-6.5	0.2	11.8	6.9
Imports, f.o.b. (in U.S. dollars)	-6.5	48.8	25.5	-12.6	-27.5	15.3
Terms of trade	28.3	-31.5	-21.3	-8.7	-0.7	2.9
Public sector						
Total revenue	71.9	16.4	9.6	39.6	89.3 2/	33.0 3/
Total expenditure 4/	59.4	33.6	24.3	23.5	152.5 2/5/	9.1 3/5/
Money and credit						
Net domestic assets of the financial system 6/	14.8	12.5	27.2	34.9	58.7	53.9
Of which: net credit to public sector	14.4	-38.6	7.1	14.2	21.1	15.6
credit to private sector	13.5	21.3	19.6	7.1	25.0	27.6
Money and quasi-money (M2)	58.1	40.7	18.1	28.3	57.2	47.2
Interest rates on time deposits (average)	28.6	31.2	35.3	54.7	38.6	...
(End-year; index 1980 = 100)						
Exchange rates						
Real effective exchange rate 7/	47.5	50.1	50.7	55.2	52.1	...
Nominal effective exchange rate	15.0	13.4	11.6	10.1	6.5	...
(In percent of GDP)						
Public sector						
Total revenue	34.0	29.7	24.0	25.4	31.5 2/	27.5 3/
Total expenditure 4/	33.0	33.1	30.2	28.3	46.9 2/5/	33.6 3/5/
Current balance	13.3	9.5	5.4	6.8	5.9	3.8
Overall surplus or deficit (-)	1.1	-3.3	-6.3	-3.0	-15.4	-6.1
Nonfinancial public sector surplus or deficit (-)	1.1	-2.6	-6.1	-2.6	-12.9	-3.7
Foreign financing 8/	1.9	6.7	4.3	1.0	-1.0	-3.0
Domestic financing	-3.0	-4.1	1.8	1.6	13.9	6.7
Central government surplus or deficit 4/	-1.2	-1.3	-3.6	-3.4	-6.9	-8.3
Public external debt (medium- and long-term) 9/	58.6	55.3	52.5	55.8	58.9	42.3
Public domestic debt 10/	11.2	5.1	4.5	5.2	17.0	14.4
Gross domestic investment	10.2	18.7	23.7	18.7	14.2	14.4
Gross national savings	27.3	22.0	17.5	15.0	20.7	18.2
External current account (deficit -)	17.1	3.3	-6.2	-3.7	6.5	3.8
(In billions of U.S. dollars; unless otherwise specified)						
Overall balance of payments	2.3	2.9	-1.2	-0.5	-1.6	-0.2
Public external debt (medium- and long-term)	28.4	29.6	31.7	33.4	32.9	30.6
Gross operational reserves of the BCV (months of imports of goods and nonfactor services)	9.3	8.5	6.0	6.3	7.1	4.9
Oil export price (U.S. dollars per barrel)	20.3	15.9	14.9	13.3	13.3	14.0
(In percent of exports of goods and nonfactor services)						
Scheduled public external debt service ratio	26.0	20.0	22.0	31.5	25.3	26.0
Interest payments	14.3	13.4	15.2	14.5	13.0	13.1
Amortization	11.7	6.6	6.8	17.0	12.3	12.9

Sources: Venezuelan authorities; IFS; and Fund staff estimates and projections.

1/ Staff projections based on authorities' policies and assuming that any potential fiscal gap is closed with central bank financing.
2/ Includes a transfer of Bs 293 billion (3.5 percent of GDP) from the Central Government to FOGADE.
3/ Includes a transfer of Bs 280 billion (2.2 percent of GDP) from the Central Government to FOGADE.
4/ Includes the operating losses of the Central Bank and extrabudgetary expenditure.
5/ Includes FOGADE's net lending to the banking system.
6/ In relation to liabilities to the private sector at the beginning of the period.
7/ Increase in the index shows appreciation of the bolivar. Figure for 1994 corresponds to end-November.
8/ Includes privatization revenue.
9/ Held by nonresidents; includes liabilities to the Fund.
10/ Includes debt of the Central Bank.

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

	1990	1991	1992	1993	Staff Est. 1994	Staff Proj. 2/ 1995
(In billions of bolivares)						
Total revenue 3/	775.9	903.3	990.3	1,382.1	2,616.5	3,480.2
Oil company surplus	588.5	625.7	628.5	839.1	1,288.1	1,671.6
Of which: domestic sales	41.1	59.2	69.7	85.1	99.6	109.4
Surpluses of enterprises	44.9	61.5	54.0	40.2	89.3	138.2
Other	142.5	216.1	307.8	502.8	1,239.1 4/	1,670.4 5/
Total expenditure	751.9	1,004.8	1,248.9	1,542.7	3,894.8	4,251.0
Current expenditure	467.8	601.8	759.0	998.1	1,673.3	2,592.5
Salaries	99.2	139.7	195.7	262.1	371.1	548.9
Goods and services	30.5	41.7	53.7	73.1	88.3	107.8
Interest payments	110.3	124.1	203.4	224.3	467.0	788.9
Foreign	91.1	108.6	162.6	183.4	314.0	400.6
Domestic	19.2	15.5	40.8	40.9	153.0	388.3
Restructuring costs	--	14.7	16.8	49.9	31.8	35.6
Other 6/	227.9	281.5	289.4	388.7	715.1	1,111.3
Capital expenditure and net lending	284.1	403.0	489.9	544.6	2,221.5	1,658.5
Fixed capital formation	200.6	288.0	395.4	437.0	632.3	902.9
Other	83.5	115.0	94.5	107.6	1,589.2 4/	755.6 5/
Current account balance	303.6	288.4	224.0	367.9	491.9	480.7
Overall balance	24.0	-101.5	-258.6	-160.6	-1,278.3	-770.8
Financing	-24.0	101.5	258.6	160.6	1,278.3	770.8
External	44.4	81.5	181.3	55.4	-84.3	-393.4
Domestic	-68.4	-103.3	77.3	105.2	1,362.6	1,128.2
Privatization	--	123.3	--	--	--	36.0
(In percent of GDP)						
Total revenue 3/	34.0	29.7	24.0	25.4	31.5	27.5
Oil company surplus	25.8	20.6	15.2	15.4	15.5	13.2
Of which: domestic sales	1.8	1.9	1.7	1.6	1.2	0.9
Surpluses of enterprises	2.0	2.0	1.3	0.7	1.1	1.1
Other	6.2	7.1	7.5	9.3	14.9 4/	13.2 5/
Total expenditure	33.0	33.1	30.2	28.3	46.9	33.6
Current expenditure	20.5	19.8	18.4	18.3	20.1	20.5
Salaries	4.4	4.6	4.7	4.8	4.5	4.3
Goods and services	1.3	1.4	1.3	1.3	1.1	0.9
Interest payments	4.8	4.1	4.9	4.1	5.6	6.2
Foreign	4.0	3.6	3.9	3.4	3.8	3.2
Domestic	0.8	0.5	1.0	0.7	1.8	3.0
Restructuring costs	--	0.5	0.4	0.9	0.4	0.3
Other 6/	10.0	9.3	7.1	7.2	8.5	8.8
Capital expenditure and net lending	12.5	13.3	11.9	10.0	26.7	13.1
Fixed capital formation	8.8	9.5	9.6	8.0	7.6	7.1
Other	3.7	3.8	2.3	2.0	19.1 4/	6.0 5/
Current account balance	13.3	9.5	5.4	6.8	5.9	3.8
Overall balance	1.1	-3.3	-6.3	-3.0	-15.4	-6.1
Financing	-1.1	3.3	6.3	3.0	15.4	6.1
External	1.9	2.7	4.3	1.0	-1.0	-3.1
Domestic	-3.0	-3.4	2.0	2.0	16.4	9.1
Privatization	--	4.0	--	--	--	0.1
Memorandum items						
Non-oil surplus/deficit	-24.7	-23.9	-21.5	-18.4	-30.9	-19.3
Military expenditure	1.4	1.7	1.7	2.0	2.4	1.4

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

1/ Includes the Central Government, the state oil company (PDVSA), other public enterprises, the social security institute (IVSS), the investment fund (FIV), the deposit insurance agency (FOGADE), and the operating balance of the Central Bank of Venezuela.

2/ Staff projections based on authorities' policies and assuming any potential fiscal gap is closed with central bank financing.

3/ Excludes privatization proceeds.

4/ Includes a transfer of Bs 293 billion (3.5 percent of GDP) from the Central Government to FOGADE.

5/ Includes a transfer of Bs 280 billion (2.2 percent of GDP) from the Central Government to FOGADE.

6/ Includes the operating losses of the Central Bank of Venezuela.

Table 3. Venezuela: Central Government Operations

	1990	1991	1992	1993	Staff Est. 1994	Staff Proj. 1/ 1995
(In billions of bolivares)						
Total revenue 2/	534.3	709.0	727.5	911.6	1,530.9	2,098.2
Petroleum sector	425.8	556.3	488.3	541.3	744.6	941.3
Nonpetroleum income taxes	37.8	47.3	64.8	114.5	149.4	255.7
Import taxes	33.0	59.5	83.3	100.4	129.9	184.1
Value-added/general sales and luxury tax	--	--	--	36.1	253.0	467.4
Other	37.6	45.9	91.1	119.1	254.0	249.7
Expenditure and net lending	561.3	748.4	876.4	1,094.6	2,104.7	3,150.5
Current expenditure	435.0	552.2	658.8	836.2	1,508.0	2,349.3
Salaries	92.3	129.9	185.0	248.3	354.0	523.4
Goods and services	22.9	31.0	40.8	52.8	63.0	70.5
Interest payments	75.9	104.6	152.8	167.6	385.9	694.4
Domestic	16.1	15.0	38.9	37.6	147.4	386.2
Foreign	59.8	89.6	113.9	130.0	238.5	308.2
Transfers	183.3	230.0	273.1	337.4	436.3	748.7
Of which: direct social grants	15.7	29.6	38.8	47.9	28.6	68.5
Exchange and operating losses 3/	45.7	51.0	-0.8	16.3	205.7	298.8
Other	14.9	5.7	7.9	13.8	63.1	13.5
Capital expenditure	126.2	196.2	217.6	258.4	596.7	801.2
Fixed capital formation	17.1	37.6	48.0	55.3	52.1	122.9
Other	109.1	158.7	169.6	203.1	544.6	678.3
Current balance	99.3	156.8	68.7	66.0	-88.9	-301.2
Overall balance	-27.0	-39.5	-148.9	-183.0	-573.9	-1,052.4
Financing	27.0	39.5	148.9	183.0	573.9	1,052.4
External	11.6	48.9	26.8	50.7	7.0	-237.0
Domestic	15.4	-132.6	122.1	132.3	564.9	1,289.4
Privatization	--	123.2	--	--	2.0	--
(In percent of GDP)						
Total revenue 2/	23.4	23.3	17.6	16.7	18.4	16.6
Petroleum sector	18.7	18.3	11.8	9.9	9.0	7.5
Nonpetroleum income taxes	1.7	1.6	1.6	2.1	1.8	2.0
Import taxes	1.4	2.0	2.0	1.8	1.6	1.5
Value-added/general sales and luxury tax	--	--	--	0.7	3.0	3.7
Other	1.6	1.4	2.2	2.2	3.0	1.9
Expenditure and net lending	24.6	24.6	21.2	20.1	25.3	24.9
Current expenditure	19.1	18.2	15.9	15.3	18.1	18.6
Salaries	4.1	4.3	4.5	4.6	4.3	4.1
Goods and services	1.0	1.0	1.0	0.9	0.8	0.6
Interest payments	3.3	3.4	3.7	3.1	4.6	5.5
Domestic	0.7	0.5	0.9	0.7	1.8	3.1
Foreign	2.6	3.0	2.7	2.4	2.5	2.4
Transfers	8.0	7.6	6.6	6.2	5.2	5.9
Of which: direct social grants	0.7	1.0	0.9	0.9	0.3	0.5
Exchange and operating losses 3/	2.0	1.7	--	0.3	2.5	2.4
Other	0.7	0.2	0.1	0.2	0.7	0.1
Capital expenditure	5.5	6.5	5.3	4.7	7.2	6.3
Fixed capital formation	0.8	1.2	1.1	1.0	0.6	1.0
Other	4.7	5.3	4.1	3.6	6.6	5.3
Current balance	4.4	5.2	1.7	1.2	-1.1	-2.4
Overall balance	-1.2	-1.3	-3.6	-3.4	-6.9	-8.3
Financing	1.2	1.3	3.6	3.4	6.9	8.3
External	0.5	1.6	0.7	0.9	0.1	-1.9
Domestic	0.7	-4.4	2.9	2.5	6.8	10.2
Privatization	--	4.1	--	--	--	--

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

1/ Staff projections based on authorities' policies and assuming that any potential fiscal gap is closed with central bank financing.
2/ Excludes privatization proceeds.
3/ Includes the operating losses of the Central Bank of Venezuela.

Table 4. Venezuela: Operations of the State Petroleum Company (PDVSA)

	1990	1991	1992	1993	Staff Est. 1994	Staff Proj. 1/ 1995
	(In billions of bolivares)					
Current revenue	685.9	785.0	871.3	1,112.8	1,809.9	2,369.9
Operating revenue	684.6	783.1	869.9	1,112.1	1,808.4	2,368.1
Domestic	41.1	59.2	69.7	85.1	99.6	109.4
Foreign	643.5	723.9	800.2	1,027.0	1,708.8	2,258.7
Interest and dividends	1.3	1.9	1.4	0.8	1.5	1.8
Current expenditure	521.9	718.7	763.3	848.4	1,312.0	1,723.1
Operating expenditure	96.1	157.4	241.4	273.0	520.3	696.4
Salaries	28.1	48.2	49.8	58.5	108.7	162.0
Goods and services	67.3	108.5	191.6	214.5	411.6	534.4
Other	0.7	0.6	--	--	--	--
Royalties	111.1	141.9	146.9	174.4	300.0	322.6
Income tax	314.7	414.4	341.4	367.1	444.6	618.7
Transfers	--	--	--	--	--	33.9
Interest	--	5.0	33.6	34.0	47.1	51.5
Operating surplus	588.5	625.7	628.5	839.1	1,288.1	1,671.6
Capital expenditure	103.2	168.2	222.1	268.3	459.1	594.6
Fixed capital formation	89.2	163.9	228.0	283.8	449.1	609.2
Change in stocks	14.0	4.3	-5.9	-15.5	1.0	-14.6
Overall balance	60.8	-102.0	-114.1	-3.9	38.8	52.2
	(In percent of GDP)					
Current revenue	30.1	25.8	21.1	20.4	21.8	18.8
Operating revenue	30.0	25.8	21.1	20.4	21.8	18.7
Domestic	1.8	1.9	1.7	1.6	1.2	0.9
Foreign	28.2	23.8	19.4	18.8	20.6	17.9
Interest and dividends	0.1	0.1	--	--	--	--
Current expenditure	22.9	23.7	18.5	15.6	15.8	13.6
Operating expenditure	4.2	5.2	5.8	5.0	6.3	5.5
Salaries	1.2	1.6	1.2	1.1	1.3	1.3
Goods and services	3.0	3.6	4.6	3.9	5.0	4.2
Other	--	--	--	--	--	--
Royalties	4.9	4.7	3.6	3.2	3.6	2.6
Income tax	13.8	13.6	8.3	6.7	5.3	4.9
Transfers	--	--	--	--	--	0.3
Interest	--	0.2	0.8	0.6	0.6	0.4
Operating surplus	25.8	20.6	15.2	15.4	15.5	13.2
Capital expenditure	4.5	5.5	5.4	4.9	5.5	4.7
Fixed capital formation	3.9	5.4	5.5	5.2	5.4	4.8
Change in stocks	0.6	0.1	-0.1	-0.3	0.1	-0.1
Overall balance	2.7	-3.4	-2.8	-0.1	0.5	0.4

Sources: Petróleos de Venezuela S.A.; Central Bank of Venezuela; and Fund staff estimates and projections.

1/ Staff projections based on authorities' policies.

Table 5. Venezuela: Summary Accounts of the Financial System

	US$1 = Bs 90.5				US$1 = Bs 170.0	Staff Est.	Proj. 1/
	1990	1991	1992	1993	1993	1994	1995
(End of period stocks; billions of bolivares)							
I. Central Bank							
Net international reserves	680.0	928.9	830.9	753.3	1,415.1	1,227.6	1,057.6
Net domestic assets	-518.9	-606.0	-456.3	-340.5	-1,002.2	-552.2	-17.2
Net credit to the public sector	64.1	-231.4	-130.2	-76.4	-90.5	592.5	947.9
Central Government	122.0	-79.7	-27.1	-64.3	-64.3	-147.3	431.5
Rest of the public sector	-57.9	-151.7	-103.1	-12.1	-26.2	739.8	516.4
Zero-coupon bonds	-100.0	-49.6	-52.8	-70.9	-70.9	-745.0	-843.0
Credit to financial system	10.8	6.7	3.7	41.2	41.2	16.9	-2.0
Other items (net)	-493.7	-331.7	-277.0	-234.4	-882.0	-416.6	-120.1
Base money	161.2	322.9	374.6	412.9	412.9	675.4	1,040.4
II. Financial System							
Net foreign assets	783.0	1,023.5	935.5	862.1	1,619.5	1,525.4	1,355.4
Net domestic assets	41.6	144.8	462.0	950.3	198.8	1,265.6	2,768.9
Net credit to the public sector	62.1	-255.8	-173.0	26.1	60.0	435.0	878.6
Credit to the private sector	508.1	683.5	912.3	1,011.8	1,047.2	1,510.0	2,270.7
Other items (net)	-528.6	-282.8	-277.4	-87.5	-908.5	-679.4	-380.5
Liabilities to the private sector	824.6	1,168.3	1,397.5	1,812.4	1,818.2	2,791.0	4,124.3
(Annual percentage change)							
I. Central Bank 2/							
Net domestic assets	-136.1	-54.0	46.4	30.9		109.0	79.2
Net credit to the public sector	74.0	-183.3	31.5	17.1		165.6	52.6
Zero-coupon bonds	-97.4	31.1	-1.0	-4.8		-163.3	-14.5
Credit to financial system	-11.5	-2.5	-0.9	10.0		-5.9	-2.8
Other items (net)	-101.0	100.5	16.8	8.6		112.5	43.9
Base money	65.0	100.3	16.0	10.2		63.6	54.0
II. Financial System 3/							
Net domestic assets	14.8	12.5	27.2	34.9		58.7	53.9
Net credit to the public sector	14.4	-38.6	7.1	15.0		20.7	15.9
Credit to the private sector	13.5	21.3	19.6	7.1		25.5	27.3
Other items (net)	-13.1	29.8	0.4	12.8		12.6	10.7
Liabilities to the private sector	57.2	41.7	19.6	29.7		53.5	47.8
Memorandum items							
Financial system							
Net credit to the public sector (annual flow as a percent of GDP)	3.3	-10.5 4/	5.5	3.8		4.5	3.5
Money and quasi-money (M2) (annual percentage change)	58.1	40.7	18.0	28.3		57.2	47.2
Credit to private sector (annual percentage change)	16.1	34.5	33.5	10.9		44.2	50.4
Nominal GDP (in billions of bolivares)	2,279.3	3,037.5	4,131.5	5,449.1		8,310.7	12,633.3

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

1/ Staff projections based on authorities' policies and assuming that potential fiscal gap is closed with central bank financing.
2/ In relation to base money at the beginning of the period. Excluding the effect of exchange rate variations.
3/ In relation to liabilities to the private sector at the beginning of the period. Excluding the effect of exchange rate variations.
4/ Excludes the impact of the write off of central government debts related to the settlement of exchange rate guarantees.

Table 6. Venezuela: Summary Balance of Payments

(In billions of U.S. dollars; unless otherwise indicated)

	1990	1991	1992	1993	Staff Est. 1994	Staff Proj. 1/ 1995
Current account	8.3	1.7	-3.8	-2.2	3.6	2.7
Exports, f.o.b	17.4	15.0	14.0	14.0	15.7	16.8
Of which: petroleum	13.9	12.1	11.0	10.4	11.1	12.0
Imports, f.o.b.	-6.8	-10.1	-12.7	-11.1	-8.1	-9.3
Interest payments	-3.2	-2.5	-2.8	-2.7	-2.8	-3.0
Other (net)	0.8	-0.6	-2.2	-2.4	-1.2	-1.7
Capital account	-6.0	1.2	2.5	1.7	-5.2	-3.0
Direct investment (net)	0.1	1.8	0.4	-0.1	0.2	0.5
Long-term capital	-2.0	0.7	2.5	2.5	-1.7	-1.3
Public sector 2/	-2.3	1.2	2.2	2.2	-1.0	-0.9
Disbursements	2.2	2.3	3.2	4.5	1.0	0.8
Amortization 3/	-2.0	-1.0	-0.9	-2.4	-1.9	-1.9
Other	-2.5	-0.2	-0.2	--	--	0.2
Private sector (net)	0.3	-0.4	0.3	0.3	-0.6	-0.4
Short-term capital	-4.2	-1.3	-0.4	-0.7	-3.7	-2.1
Public	-1.1	1.3	0.9	-1.0	-0.9	-0.3
Private	-3.3	-2.0	-1.3	0.2	-2.8	-1.9
Of which: counterpart private interest	-0.6	-1.0	-0.7	-0.1	-0.7	-1.2
other 4/	-2.7	-1.0	-0.6	0.3	-2.1	-0.7
Overall balance	2.3	2.9	-1.2	-0.5	-1.6	-0.2
Counterpart valuation change	-0.1	--	--	-0.1	-0.1	--
Net international reserves (increase -)	-2.2	-3.2	1.2	0.7	1.1	1.0
Gross reserves	-4.4	-2.7	1.2	0.2	1.2	1.4
IMF (net)	2.0	0.2	-0.3	-0.3	-0.1	-0.4
Other reserve liabilities	0.2	-0.8	0.3	0.8	--	--
Arrears (increase +)	--	0.3	0.1	-0.1	0.6	-0.8
Memorandum items						
Current account (percent of GDP)	17.1	3.3	-6.2	-3.7	6.5	3.8
Non-oil real GDP (percent change)	4.5	9.6	8.9	-2.3	-5.9	-1.9
Non-oil exports (percent volume change)	0.1	-0.2	7.6	16.5	17.4	1.4
Import volume (percent change)	2.4	25.2	4.8	-13.9	-28.8	13.1
Oil price (US$/barrel)	20.5	15.9	14.9	13.3	13.3	14.0
Net international reserves (billions of U.S. dollars)	7.8	11.0	9.9	9.2	8.1	7.1
Gross operational reserves (billions of U.S. dollars)	7.4	9.7	8.6	8.3	7.1	5.7
(months of imports)	9.3	8.5	6.0	6.3	7.1	4.9
Total external debt (billions of U.S. dollars)	33.8	35.3	38.1	39.4	38.0	35.0
(percent of GDP)	69.9	66.1	63.1	65.9	68.0	48.5
Debt service (billions of U.S. dollars) 5/	5.6	4.2	4.5	6.1	5.8	6.1
(percent of exports of goods and nonfactor services)	29.8	25.8	29.0	39.3	33.1	33.1
Secondary market price for bank loans 6/ (end of period)	56.94	71.50	54.5	68.9	45.7	...
Six-month LIBOR (percent per annum)	8.4	6.1	3.9	3.4	5.1	7.5

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

1/ Staff projections based on authorities' policies and assuming that potential fiscal gap is closed with central bank financing.
2/ Includes PDVSA.
3/ Includes the rollover of principal on eligible bank debt in 1990 and the effects of the 1990 bank financing agreement in 1991.
4/ Includes imports financing, accumulation of arrears an private sector financial debt, and errors and omissions in the case of historical data.
5/ On an accrual basis (1991 incorporates the effect of the 1990 bank financing agreement). Amortization includes repayments to the Fund.
6/ Average of bid and offer prices as of end-December. The price for 1994 is as of December 19.

Table 7. Venezuela: Medium-Term Selected Economic and Financial Indicators

	1995	1996	1997	1998	1999	2000	2001	2002
			Projected					
(Annual percentage change; unless otherwise specified)								
National income and prices								
GDP at constant prices	--	3.7	4.0	4.5	4.5	4.5	4.0	4.0
Oil	5.9	7.6	6.0	4.4	2.7	1.6	0.1	0.2
Non-oil	-1.9	2.4	3.3	4.5	5.2	5.6	5.3	5.3
GDP deflator	46.8	19.1	11.9	8.8	6.9	5.1	4.2	4.2
GDP deflator (non-oil)	49.3	19.0	12.3	8.9	6.9	4.9	4.0	4.0
Consumer prices (end of period)	30.1	15.0	10.0	8.0	6.0	4.0	4.0	4.0
Public sector								
Total revenue	59.9	22.7	18.4	6.5	11.2	6.4	6.8	5.3
Total expenditure 1/	11.9	14.1	15.2	5.9	9.7	4.6	5.1	4.8
Money and credit								
Net domestic assets of the financial system 2/	37.0	19.3	12.5	9.5	9.7	5.9	4.1	5.2
Of which: net credit to public sector	-8.5	-17.6	-11.1	-2.2	-1.8	-5.1	-2.2	-3.0
credit to private sector	33.5	28.6	20.3	11.5	12.2	10.1	6.3	8.5
Money and quasi-money (M2)	36.4	25.6	17.9	12.8	10.8	8.6	8.2	8.2
Velocity (GDP relative to average M2)	3.9	3.7	3.5	3.5	3.5	3.5	3.5	3.5
(In percent of GDP)								
Public sector								
Total revenue	34.6	34.4	35.0	32.9	32.7	31.7	31.2	30.3
Total expenditure 1/	36.0	33.3	33.0	30.8	30.2	28.8	27.9	27.0
Current Balance	9.9	11.7	13.5	13.6	14.1	13.9	13.9	14.2
Overall surplus or deficit (-)	-1.4	1.1	2.0	2.1	2.5	2.9	3.3	3.3
Primary surplus or deficit	5.8	7.3	7.8	7.3	7.0	6.7	6.5	6.2
Foreign financing 3/	-1.6	0.6	-0.5	-1.1	-1.8	-1.7	-2.1	-2.0
Domestic financing	3.0	-1.7	-1.5	-1.0	-0.7	-1.2	-1.2	-1.3
Public domestic debt	11.9	9.3	9.9	10.1	9.0	7.6	7.8	7.2
Public external debt	50.6	47.9	43.8	39.0	34.3	29.9	25.9	22.4
Central government surplus or deficit	-5.3	-2.2	-1.0	1.0	1.1	2.0	2.1	2.6
Gross domestic investment	16.5	18.2	19.8	20.6	21.0	20.3	21.8	23.2
Gross national savings	19.1	19.6	21.2	21.4	22.3	21.9	22.7	23.4
(In billions of U.S. dollars; unless otherwise specified)								
Current account	1.6	0.9	1.0	0.6	1.0	1.4	0.8	0.2
Exports, f.o.b	17.0	18.4	20.1	21.2	23.0	24.9	26.0	26.8
Of which: PDVSA	12.0	13.1	14.3	14.9	15.8	16.5	16.9	17.2
Imports, f.o.b.	-10.3	-11.4	-12.5	-13.6	-14.6	-15.9	-17.7	-18.9
Interest payments	-3.1	-3.3	-3.4	-3.4	-3.4	-3.3	-3.3	-3.4
Other (net)	-2.0	-2.8	-3.2	-3.6	-4.0	-4.3	-4.2	-4.3
Capital account	-0.8	0.5	0.5	0.5	-0.6	-0.2	1.1	1.3
Direct investment	1.5	1.3	1.5	1.7	1.1	1.2	1.5	1.6
Of which: oil sector	0.2	0.3	0.5	0.9	0.5	0.5	0.7	0.7

Table 7. Venezuela: Medium-Term Selected Economic and Financial Indicators (Concluded)

				Projected				
	1995	1996	1997	1998	1999	2000	2001	2002
(In billions of U.S. dollars; unless otherwise specified)								
Long-term capital	-0.6	0.4	0.6	0.3	-0.1	0.2	0.9	1.0
Public sector	-0.6	-0.1	-0.5	-0.8	-1.1	-1.3	-1.8	-1.8
Disbursements	1.3	2.3	2.1	2.2	1.9	2.1	1.8	1.9
Amortization	-2.2	-1.9	-2.4	-3.0	-3.0	-3.4	-3.5	-3.6
Other	0.2	-0.5	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Private sector (net)	--	0.5	1.1	1.1	1.0	1.5	2.7	2.8
Of which: oil sector								
Short-term capital	-1.7	-1.3	-1.6	-1.4	-1.6	-1.6	-1.3	-1.4
Public	-0.3	-0.2	-0.3	-0.1	-0.2	-0.1	-0.1	--
Private	-1.5	-1.1	-1.3	-1.3	-1.4	-1.5	-1.2	-1.3
Overall balance	0.8	1.4	1.5	1.1	0.4	1.2	1.9	15
Net international reserves (increase -)	--	-1.4	-1.5	-1.1	-0.4	-1.2	-1.9	-1.5
Gross reserves	*0.4*	*-0.9*	*-1.0*	*-0.7*	*--*	*-0.8*	-1.9	-1.5
IMF (net)	-0.4	-0.5	-0.5	-0.5	-0.4	-0.3	--	--
Arrears (increase +)	-0.8	--	--	--	--	--	--	--
Memorandum items								
Current account (percent of GDP)	2.6	1.4	1.4	0.8	1.3	1.6	0.9	0.2
Oil price (US$/barrel)	14.0	14.1	14.3	14.5	14.8	15.0	15.3	15.5
Six-month LIBOR (percent per annum)	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
BCV gross operational reserves (months of imports of goods and nonfactor services)	5.2	5.4	5.6	5.6	5.2	5.3	5.7	6.1
Total external debt 4/ (percent of GDP)	58.7	56.7	53.7	49.8	45.8	42.3	40.6	39.1
Scheduled external public debt service (percent of exports of goods and nonfactor services)	26.7	25.3	25.5	26.5	23.8	22.7	20.8	19.9

Sources: Venezuelan authorities; and Fund staff estimates.

1/ Includes the operating losses of the Central Bank.
2/ In relation to the liabilities to the private sector at the beginning of the period.
3/ Includes privatization.
4/ Includes private sector debt.

Table 8. Venezuela: Indicators of Financial Obligations to the Fund

	Projections						
	1994	1995	1996	1997	1998	1999	2000
Total obligations (in millions of SDRs)	240	404	412	394	389	314	221
Charges	99	100	83	65	60	27	
12							
Repurchases	141	304	329	329	329	287	209
Debt to IMF							
In billions of U.S. dollars	2.637	2.193	1.715	1.238	.761	.343	.036
In percent of GDP	4.7	3.6	2.7	1.8	1.0	0.4	--
In percent of exports of goods and services	15.2	11.7	8.7	5.7	3.3	1.4	0.1
In percent of gross reserves	21.4	18.5	13.5	9.0	5.3	2.3	0.2
In percent of total public debt	6.9	6.1	4.7	3.4	2.1	1.0	0.1
Debt service to IMF							
In billions of U.S. dollars	.343	.589	.600	.573	.568	.460	.325
In percent of exports of goods and services	2.0	3.1	3.0	2.7	2.5	1.9	1.2
In percent of total public debt service	7.6	11.3	11.9	10.4	9.0	7.5	5.1

Source: Fund staff estimates and projections.

Venezuela--Fund Relations
(As of December 31, 1994)

I. Membership Status:

Joined: December 30, 1946.
Status: Article VIII.

II. General Resources Account:	SDR Million	Percent of Quota
Quota	1,951.30	100.0
Fund holdings of currency	3,616.51	185.3
Reserve position in Fund	144.95	7.4

III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	316.89	100.0
Holdings	316.94	100.0

IV. Outstanding Purchases and Loans:	SDR Million	Percent of Quota
Extended arrangement	1,810.16	92.8

V. Financial Arrangements:

	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR Million)
EFF	6/23/89	3/22/93	3,857.10	2,005.60

VI. Projected Obligations to the Fund (SDR million).

(Based on existing use of resources and present holdings of SDRs):

	Overdue	Projections				
	12/31/94	1995	1996	1997	1998	1999
Principal	--	304.2	328.5	328.5	328.5	286.6
Charges/interest	--	101.8	84.4	65.1	45.7	26.9
Total	--	406.0	412.9	393.6	374.2	313.5

VII. Exchange Rate Arrangements:

In April 1993 the authorities adopted a crawling peg regime allowing the bolivar to move every business day by an amount ranging between Bs 0.10 and Bs 0.15 per U.S. dollar. On April 27, 1994 the authorities abandoned the crawling peg regime and allowed the bolivar to depreciate by 10.5 percent through May 10. On May 4 the authorities introduced a system of daily foreign exchange auctions, under which limits were placed on the amounts bid (in relation to successful bids in the previous day's auction), the BCV determined a reference exchange rate (based on a weighted average of the bids, excluding the lowest and highest rates), and participants in the auctions were required to sell the foreign exchange purchased from the BCV at the reference rate plus Bs 0.2. A parallel market developed rapidly in response to the introduction of this system and, on May 24, the authorities eliminated the restrictions on the amounts bid and the rate at which the foreign exchange purchased in the auctions could be sold and moved to a Dutch auction system. These changes were successful in eliminating the parallel market but the exchange rate continued to depreciate sharply from Bs 166 per U.S. dollar at end-May to close to Bs 200 per U.S. dollar in late June. On June 27 the authorities closed the foreign exchange market and subsequently introduced a fixed exchange rate of Bs 170 per U.S. dollar and a comprehensive system of exchange controls covering all current and capital account transactions.

VIII. Article IV Consultation:

The 1993 Article IV consultation was concluded by the Executive Board on March 14, 1994 (SM/94/45). Venezuela is on the standard 12-month Article IV consultation cycle.

IX. Technical Assistance:

Department	Dates	Purpose
FAD	May 1992	Advice on the value-added tax (VAT) and the gross assets tax (at Fund headquarters).
	September-November 1993	Review the VAT law and advice on its implementation.
	December 1993-June 1994	Advice on the implementation of the VAT (by expert on six-month assignment).
	January 1994	Advice on tax administration (by FAD staff member accompanying the WHD staff visit).

MAE	October 1992	Discuss issues in monetary management and accounting treatment of foreign exchange operations.
	February-March 1993	Review progress on monetary and exchange rate management and advice on the implementation of the new Central Bank Law.
	July 1993	Assist in defining prudential regulations concerning banks' foreign exchange positions.
	October-November 1993	Review progress on financial sector reform (by MAE staff member accompanying the 1993 Article IV consultation mission).
	June-July 1994	Advice on a strategy to address the banking crisis.
RES	August 1992, February, March, July, and November 1993; and March 1994	Advice on monetary management.

X. Resident Representative: None.

Venezuela--Relations with the World Bank Group

Venezuela regained eligibility for World Bank lending in December 1986 as a result of the decline in per capita income in U.S. dollar terms during the preceding years. The Bank supported the reforms implemented during 1989-90 with five structural adjustment loans valued at US$1.6 billion. Bank loans targeted debt reduction and financial sector and trade policy reforms. The loans also supported policies to advance privatization and rationalize public investment.

A transition from adjustment lending to policy-based investment lending began with a late 1990 social development and nutrition loan (US$100 million) that addressed the Bank's priority poverty alleviation concerns. One year later an agricultural sector loan (US$300 million) was approved. In 1992 six more sector loans were approved in the areas of Judicial Infrastructure Reform (US$30 million), Low-Income Barrios Improvement (US$40 million), Student Loan Reform (US$58 million), Endemic Disease (US$94 million), National Parks Management (US$55 million), and Highways Management (US$150 million). In 1993 two loans were approved: Basic Education (US$89.4 million) and Urban Transport (US$100 million). In 1994 one loan was approved: Health Sector Reform (US$54 million). Gross disbursements since 1989 total US$1,502 million through 1994.

During the period 1987-94, the IFC made total investment commitments of US$486 million.

Venezuela--Statistical Issues

1. Outstanding statistical issues

a. General

Venezuela's macroeconomic statistics suffer from shortcomings in most sectors that hinder the analysis of economic developments. For this reason, Venezuela has been chosen as a pilot project in order to improve the country operational database and to promote data harmonization within the Fund. The project will be launched with an STA multitopic assessment mission scheduled for March 1995 to help the authorities develop a comprehensive plan for improving the statistical database.

b. Real sector

Although data are reported to STA on a timely and frequent basis, employment, wage, and petroleum production statistics have not been reported for 1993 and 1994.

c. Government finance

Monthly data reported for IFS are current through April 1994 and cover the operations of the budgetary central government only. Annual data included in the GFS database are current through 1993 (preliminary) and correspond to a consolidation of the budgetary central government and social security funds. Since 1987, annual data are based on data reported to WHD for the "reduced public sector" which cover the budgetary central government, the Venezuelan Social Security Institute, three nonbank financial institutions, and some key nonfinancial public enterprises. This source does not include any data on the operations of decentralized agencies of the central government and of local governments.

d. Monetary accounts

Monetary statistics are reported by the Central Bank of Venezuela for publication in IFS in a current and timely manner. Data reported by banks are weak due to the banks' inadequate accounting and reporting standards. To partially address these problems, the Superintendency of Banks has prepared a draft of a new plan of accounts for financial institutions.

2. Technical assistance missions in statistics (1991-present)

Subject	Dates
Money and Banking	January 1992
Multitopic (planned)	March 1995