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Statement by Mr. Torres on Venezuela
Executive Board Meeting
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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. The political developments this year have made it difficult to implement the Government's economic program. The authorities 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 to the country.

This year has been a very difficult one for Venezuela. Non-economic factors have slowed down the pace of the economic reform program initiated in 1989. Failed military coup attempts in February and November are the most significant events but not the only expression 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 members of the economic cabinet that were appointed in March were and continue to be supportive of the economic reform program initiated in 1989.

Background

In 1989 the new government launched a global and comprehensive economic reform program that was a major departure in its conception and philosophy from the predominant economic culture and the beliefs of the main political parties and social leaders. The program was an answer to short-term as well as to structural problems that had been developing during decades of an economy based on the distribution of oil-rents. The plan contained three main elements: a) a macroeconomic adjustment program; b) a structural reform program; and c) a set of social program aimed at softening the burden of the economic adjustment program among the poor.

The macroeconomic adjustment included: the establishment of a unified and flexible exchange rate system, liberalized prices and interest rates, the elimination of general subsidies and tax exemptions, restructured external debt, and it increased prices of 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, a fiscal reform--

basically the approval by Congress of the value added tax, a new tax code, and a new income tax law--, and a financial reform.

The package of social programs included direct transfers to the poorest groups of the population in the form of cash, food and school supplies, among others. These programs amounted to the equivalent of 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 of them have been completed ahead 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 approval of the value added tax and the laws that constitute the core of the financial reform. These reforms require congressional approval which is beyond the control of the Administration.

The adjustment effort which was initiated in 1989 took only one year to start yielding positive results. After a significant decline of GDP in 1989 of about 9 percent 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 would grow to 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 in the same period. Net official international reserves have recovered substantially from US$5.8 billion in 1988 to US$10 billion in 1992. The annual inflation rate declined from 80 percent in 1989 to 36.5 percent in 1990, 31 percent in 1991 and is projected to reach 33 percent in 1992. This year is the first one of the adjustment program in which the inflation rate has not declined, a fact that is of great concern to my authorities.

Fiscal Policy

As important progress was made in other areas of the reform program, the fiscal problem has become the number one economic problem of Venezuela. The fiscal deficit amounted to 3.5 percent of GPD 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 expenditure in the last quarter of the year.

Five factors have contributed to the 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 VAT 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 their first full year of implementation. Third, the execution of the investment program of PDVSA, the state oil company. This investment is extremely important to keep an efficient oil production structure and to expand oil output capacity, and is 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 at the present moment. Fourth, because of the political situation, the adjustment of some prices of public goods and services, such as gasoline, had to be stopped at a level that by 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 expenditure has declined in relation to GDP to a level beyond which is difficult to cut further without risking an institutional collapse in vital areas like health or educational infrastructure. It is also important to say that in the 1992 budget there was an important amount of resources allocated for 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 to borrow with government guarantee and increases considerably the requirements then have to meet before they acquire debt. It also prohibits the financing of extra-budgetary expenditures. The same law is supposed to introduce greater fiscal discipline as the Government will be allowed to ask for congressional authorization of new credits only once a year 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. Finally, I would like to mention that Congress is expected to call for extraordinary sessions to start January 12 to continue the discussion of the proposed new taxes which were both approved by the Financial Commission of the Congress last November.

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

The privatization program is being reactivated again. A list of important enterprises are scheduled for divestiture in the coming months. Electricity plants, sugar mills, manufacturing plants, hotels and others assets are in 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. Educational and health services are the first ones to be decentralized on this new basis. Because of this, decentralization will also reduce the central government's fiscal burden.

Monetary Policy and financial reform

Developments in monetary policy in 1991 and 1992 have been greatly affected by fiscal events. In 1991, the CBV 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 magnitudes involved in open market operations, there was a sharp increase in interest rates and in the quasi-fiscal losses at the CBV. 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, the political developments have contributed to a sharp decline in the real demand for money this year. Under these circumstances, in order to maintain price pressures under control and to cope with speculative attacks against the bolivar, the CBV tightened credit with determination. At the same time, however, the CBV had to conduct monetary policy in a manner that would be consistent with a realistic structure of interest rates and 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 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 the financial reform, the CBV law amendment was approved by Congress in late November. According to the CBV law 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 strengthened. Other important features of the amendment to the law include the prohibition for the monetary authority to provide direct financing to the Government and the restriction of lending activities of the Central Bank to short term operations.

The other laws that are part of the financial reform are supposed 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. They also will contribute to the developments of capital markets and of new financial instruments. The system will be more transparent and competitive, and foreign investment will be permitted.

Exchange rate policy and balance of payments developments

The CBV 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 CBV 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 to about 6 percent of GDP in 1992. This has been the result of the previously mentioned decline in prices of oil and 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 going back to normal. Just before the November coup attempt the bolivar was trading at 78.35 per US dollar; today the current exchange rate is about Bs 78.80 per US dollar showing no noticeable deterioration. This stability has been produced without any significant intervention on the part of CBV. Interest rates have also been maintained at the same level and there is no pressure to raise them.

Price and wage policy

After the coup attempt in February of this year, tariff adjustments of some public goods and services such as water, electricity and gasoline were stopped and administrative controls on the prices of seven privately produced goods were imposed. Nevertheless, the Government made it clear that there will not be a return to a general system of price control, and that these 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 after 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 US$80 to US$120. While my authorities are very concerned about the level of inflation, they are also concerned with the disequilibrium in the income distribution.

As a general conclusion, 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 non-inflationary economic growth.

Some Lessons to be Learnt

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 learnt from the venezuelan experience as this experience refers to one in which an economic reform program has been --literally speaking-- under fire.

1. An economic reform program is not enough to reform the economy. No matters how global and comprehensive an 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 matters how much deteriorated the present economic situation is or has been. These supports have to be built up as part of the reforms itself.

To build political support, the government has to create an alliance of all those forces that favors the change and make them act permanent and aggressively. It is a mistake to expect the reforms to convince slowly and passively all people about its benefits. Once the reforms come into scene so does the counter reform. The counter reform is usually well organized and equipped as it is integrated by those sectors that have enjoyed many privileges for a long time.

To build public opinion support, the government has to do 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 are going to be in the future.

2. In designing a reform economic program, the role to play for each actor must be clearly defined and --ideally-- responsibilities differentiated.

In the phase of formulating the reform program, the government acquires the compromise internally and externally of implementing a list of measures that sometimes requires the participation of others institutional actors --like the Congress-- on which government has not control. If this support does not come, the government is the one to blame for the reform's lack of success.

So it might be much more convenient for the government and also for international institutions like the Fund to differentiate compromises and responsibilities. If government explains to the people that an economic reform program is to be launched and that it requires certain compromises of other social institutions it might be in a better position to press for the reforms. For the international institutions it also might help to asses the feasibility of the different reforms proposed.

3. In judging an economic reform program, the speed and the direction of changes must be differentiated.

When it comes to evaluate an economic reform program, there is a big temptation to judge it exclusively or mostly in terms of the quantitative performance criteria: rate of inflation, fiscal deficit, rate of growth etc. Although important qualitative criteria might have been defined at the beginning of the program, nevertheless, it is left in a very 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 on this only base. Elements such as the changes in the incentive structure for the allocation of resources or modifications in the structure of public spending should be equally valuated.

4. 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 opposite, the implementation of a social program may take months and even years. So by the time the compensatory programs start yielding significative effects there might be excessive social unrest. Because of this, governments should be encouraged to strengthen as much as possible its planning and managerial capacity in the social area in order to deal successfully with the social programs before the economic reforms are launched.