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October 19, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Venezuela - Staff Report for the 1987 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1987 Article IV consultation with Venezuela, which will be brought to the agenda for discussion on a date to be announced.

Mr. Cardemil (ext. 7162) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

VENEZUELA

Staff Report for the 1987 Article IV Consultation

Prepared by the Staff Representatives for the 1987
Consultation with Venezuela

Approved by S.T. Beza and S. Kanesa-Thasan

October 16, 1987

I. Introduction

The 1987 Article IV consultation discussions with Venezuela took place in Caracas during the period June 16-July 6, 1987 and continued during September 14-18, 1987. 1/ The discussions also reviewed the authorities' 1987 Quantified Economic Program (QEP) and prospects for 1988.

Representatives of Venezuela in the discussions included the Minister of Finance and the President of the Central Bank; the Minister Secretary of the President; the Ministers of Agriculture, Development, Planning, the Venezuela Investment Fund, and the Guayana Corporation; the Director of the Budget, and other senior officials. The staff representatives in one or both visits were Messrs. Hardy (Head), Elson, Cardemil and Ms. Carkovic (all WHD), Messrs. Fajgenbaum and Rodlauer (both ETR), Ms. Cheasty (FAD), and Mrs. Orpin (Secretary-WHD). Mrs. Filardo, Alternate Executive Director for Venezuela, participated in the policy discussions.

The last Article IV consultation was concluded by the Executive Board on July 25, 1986 (EBM/86/121, SM/86/152, and SM/86/153). The 1986 midyear Article IV consultation (SM/87/22) was concluded by the Executive Board on March 2, 1987. This is the fifth report prepared under the enhanced surveillance procedure approved for Venezuela by the Executive Board on May 30, 1985. The Staff Report for the 1986 Article IV consultation and that for the 1986 mid-year consultation were distributed to creditor commercial banks by the Venezuelan authorities.

1/ Venezuela accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement on July 1, 1976. Relations with the Fund and with the World Bank are described in Attachment I.

II. Background

1. Developments prior to 1986

In Venezuela, the oil sector provides 85-90 percent of export receipts, accounts for some two thirds of public sector revenues, and contributes around 20 percent of GDP. During the 1980s, the country has been struggling to adjust to a decline in oil exports from more than US$19 billion in 1981 to only US$7 billion in 1986, almost entirely due to lower prices. During this period Venezuela's terms of trade deteriorated by 50 percent, equivalent to a decline of 14 percent of real GDP. At the same time, Venezuela also lost most of its access to bank financing from abroad.

In 1982 pursuit of policies that raised domestic demand, the downturn in oil prices, and the drying up of the international credit market combined to cause a major balance of payments crisis, reflected in an unprecedentedly large external payments deficit of US$8 1/2 billion. During the period 1983-85 the authorities adopted a set of policies designed to reduce domestic demand and stimulate exports and import substitution; the policies included a cutback in public capital outlays, successive devaluations of the bolivar through a multi-tier exchange system 1/ and the introduction of comprehensive exchange, import, and price controls. Interest rates remained market determined until 1984 when they were put under administrative control. A social pact between labor and business representatives in 1984-85 ensured wage restraint in exchange for commitments to increase employment and greater fringe benefits.

These measures led to significant improvements in the public finances and in the external position in 1983-85, despite the continuing weakness of the international oil market. The public sector shifted from a large deficit in 1982 to a surplus averaging more than 5 percent of GDP in 1984-85, and the external current account yielded a surplus averaging nearly US$4 billion (7 3/4 percent of GDP) as imports and nonfactor service payments fell by more than one half. This strong current account performance allowed Venezuela to reduce outstanding public and private external debt during 1983-85 by US$3 billion to about US$33 billion, and to raise net official reserves by US$4 billion to US$15 1/2 billion, the equivalent of more than two years of imports. However, some US$3 billion of arrears on private sector debt service remained at the end of 1985.

A major element in the reduction of aggregate expenditure in 1983-85 was a decline of investment, which fell from 26 percent of GDP in 1982 to less than 15 percent of GDP on average in the following three

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1/ During 1983-85 the cumulative depreciation of the bolivar amounted to 37 percent in nominal effective terms and 14 percent in real effective terms.

years. Public investment was cut from close to 20 percent of GDP in 1982 to 9 1/2 percent of GDP, while private investment stagnated following a sharp decline in 1982 (Table 1). Consumption expenditure declined by 9 percent in real terms from 1982 to 1985, with per capita consumption falling by about 16 percent. Even though agricultural production grew strongly, output in the nonpetroleum sector fell by a cumulative 7 percent, and unemployment rose from 7 percent of the labor force in 1982 to 13 percent in 1985. Corrective price adjustments and the pass-through of the depreciation of the bolivar resulted in a temporary acceleration of price increases (as measured by the CPI) to 15 1/2 percent in 1984, but the inflation rate fell back to 9 percent in 1985.

2. Developments in 1986-87

Faced with a prolonged decline in real GDP and rising unemployment, toward the end of 1985 the authorities decided to shift financial policies to stimulate aggregate demand. Public investment was increased under a special three-year investment plan, credit policies were eased, and a 12 1/2 percent average wage increase was decreed for public and private sector workers not covered by collective bargaining agreements, the first such increase since 1980. This shift in policy was maintained despite the collapse of oil prices in early 1986, which resulted in a loss of US$5 1/2 billion in export earnings and public sector revenues (the drop in earnings was equivalent to more than 12 percent of GDP). The authorities sought to moderate the impact on the balance of payments and inflation by further tightening import and price controls. Thus, although output recovered strongly in 1986 (real GDP of the nonpetroleum sector rose by over 5 percent, with a particularly sharp rebound in construction) and unemployment declined, substantial domestic and external imbalances emerged. The overall public finances moved from a surplus of 5 3/4 percent of GDP in 1985 to a deficit of 6 3/4 percent of GDP in 1986 (Table 2), the increase in bank credit accelerated to more than 30 percent (Table 3), and inflationary pressures intensified as wholesale prices rose by 19 percent, although price controls held the increase in the consumer price index to less than 13 percent. In addition, the spread between the controlled and free exchange rates widened significantly, with the bolivar in the free exchange market depreciating to about Bs 25 per U.S. dollar in the second half of 1986, compared with the controlled rate of Bs 7.50 per U.S. dollar. With the acceleration of inflation, real interest rates turned negative as the ceiling on the commercial banks' lending rate was kept at 13 percent, the preferential rate for agricultural credit at 8 1/2 percent, and the maximum time deposit rate at 9 percent.

Even though import controls were tightened, the external current account shifted from a surplus of US$3 billion (6 percent of GDP) in 1985 to a deficit of more than US$2 billion (4 1/2 percent of GDP) in 1986. Despite the introduction of a 120-day import financing

Table 1. Venezuela: Selected Macroeconomic Indicators

	Average 1979-81	1982	1983	1984	1985	Prel. 1986	Proj. 1987
			(Annual percentage change)				
Real GDP	-0.3	0.7	-5.6	-1.3	0.3	5.2	2.8
Petroleum	-1.1	-7.2	-4.7	0.3	-3.4	5.3	--
Nonpetroleum	-0.2	1.4	-5.7	-1.5	0.6	5.2	3.0
Real GDP adjusted for terms of trade 1/	1.6 2/	-1.8	-6.9	-0.2	0.1	-8.1	6.8
Nominal GDP	19.1	2.1	-0.3	19.7	7.1	8.5	29.0
Petroleum	31.9	-16.3	-9.9	51.6	-5.9	-25.7	20.0
Nonpetroleum	15.8	8.9	2.5	11.6	11.5	18.4	30.6
Caracas consumer price index (end of period)	16.9	7.7	7.5	15.5	9.1	12.7	38.0
Wholesale price index (end of period)	14.6	6.2	10.8	23.8	12.9	18.8	50.0
Unemployment rate (in percent)	5.8	7.1	10.0	12.9	13.1	11.0	10.0
			(In percent of GDP)				
Gross domestic expenditures (at current prices)	95.3	102.5	89.7	87.1	89.3	101.1	97.9
Consumption	68.9	76.6	78.0	72.4	74.7	80.6	79.1
Investment 3/	26.4	25.8	11.7	14.8	14.7	20.3	18.8
Public	14.0	18.7	14.4	8.0	9.5	12.5	...
Private	12.4	7.1	-2.8	6.8	5.2	7.8	...
Gross national savings	28.3	21.1	17.6	24.0	20.8	15.8	17.7
Public	16.3	11.8	11.1	18.4	15.5	11.1	...
Private	12.0	9.3	6.5	5.6	5.4	4.7	...
Foreign savings	-1.9	4.8	-5.9	-9.3	-6.2	4.6	1.1

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

1/ Base year 1980.
2/ 1981 only.
3/ Includes change in inventories.

Table 2. Venezuela: Consolidated Reduced Public Sector 1/

	1983	1984	1985	1986	Est. 1987	Proj. 1988
	(In billions of bolivares)					
Total revenue	87.4	127.6	141.2	115.6	171.1	193.1
Oil revenue	51.0	77.0	74.3	49.8	97.6	120.4
Exchange profits (net)	10.1	13.2	18.0	7.0	--	—
Other revenue	23.5	26.8	37.5	45.2	62.4	62.1
NPE surpluses	2.8	10.6	11.4	13.6	11.1	10.6
Total expenditure	102.0	112.0	120.1	142.8	204.0	218.7
Current	54.6	70.5	74.8	71.7	118.9	117.8
of which: exchange losses (net)	(--)	(--)	(--)	(--)	(11.9)	(1.8)
Capital and lending 2/	47.4	41.4	45.3	71.1	85.1	101.0
Overall surplus/deficit	-14.6	15.6	21.1	-27.2	-32.9	-25.6
Financing	14.6	-15.6	-21.1	27.2	32.9	25.6
External 3/	-4.0	-6.4	-7.0	-4.6	-1.3 3/	-17.8
Domestic banks	6.0	-16.4	-7.7	30.1)	11.2 4/	-1.8 4/
Domestic nonbanks	12.6	7.2	-6.4	1.7)	3.0	2.0
Financing gap	--	--	--	--	20.0	43.2
Of which: new money 5/					12.8	29.0
	(In percent of GDP)					
Total revenue	30.1	36.7	38.0	28.6	32.8	31.1
Oil	17.6	22.2	20.0	12.3	18.7	19.4
Exchange profits (net)	3.5	3.8	4.8	1.7	--	—
Other	8.1	7.7	10.1	11.2	12.0	10.0
NPE surpluses	1.0	3.1	3.1	3.4	2.1	1.7
Total expenditure	35.1	32.2	32.3	35.4	39.2	35.2
Current	18.8	20.3	20.1	17.8	22.8	19.0
of which: exchange losses (net)	(--)	(--)	(--)	(--)	(2.3)	(0.3)
Capital	16.3	11.9	12.2	17.6	16.3	16.3
Surplus/deficit	-5.0	4.5	5.7	-6.7	-6.3	-4.1

Sources: Central Bank of Venezuela; Central Office of the Budget (OCEPRE); and Fund staff estimates.

1/ Comprises operations of the Central Government (including extrabudgetary operations), the Venezuelan Investment Fund (VIF), the National Petroleum Company, the nonfinancial public enterprises, and the Exchange Differentials Compensation Funds (FOCOCAM/FICAM).
2/ Excludes transfer of government bonds (under Ley Habilitante) to banks.
3/ Includes change in international reserves of the VIF (US$0.4 billion loss in 1987).
4/ Consistent with monetary projections of the 1987 QEP and the authorities' targets for 1988.
5/ Authorities' targets on additional gross external borrowing: US$0.9 billion in 1987 and US$2 billion in 1988.

Table 3. Venezuela: Summary Accounts of the Banking System

	1983	1984	1985	1986	April 86–March 87	QEP 1987 1/2/	1988 1/
	(Annual flows in billions of bolivares)						
Net foreign assets	8.9	13.0	9.1	-27.6	-27.9	-15.5	--
Net domestic assets 3/	20.4	2.0	10.1	68.3	79.6	63.3	53.5
Net credit to public sector	6.3	-16.4	-8.1	30.0	45.7	...	...
Credit to private sector	5.3	15.7	17.2)	36.4	43.0	...	...
Other 3/	8.8	2.7	1.0)	1.9	-9.1	...	...
Medium- and long-term foreign liabilities	0.5	1.7	4.3	0.2	1.3	--	—
Liabilities to private sector	28.8	13.3	14.9	40.5	50.4	47.8	53.5
Of which: money and quasi-money	25.4	12.8	17.7	38.2	47.8	46.0	...
	(Annual percentage change in relation to liabilities to private sector at the beginning of the period)						
Net domestic assets 3/	12.4	1.0	4.9	30.9	36.0	23.9	17.0
Net credit to public sector	3.8	-8.5	-3.9	13.6	20.7	...	...
Credit to private sector	3.2	8.1	8.3	16.4	19.5	...	...
Liabilities to private sector	17.6	6.9	7.2	18.3	22.8	18.0	17.0
	(Flows as percent of GDP)						
Net domestic assets 3/	7.0	0.6	2.7	16.9	18.3	12.1	8.6
Net credit to public sector	2.2	-4.7	-2.2	7.4	10.6	...	...
Credit to private sector	1.8	4.5	4.6	9.0	9.9	...	...
Liabilities to private sector	9.9	3.8	4.0	10.0	11.6	9.2	8.6
Money and quasi-money	8.7	3.7	4.8	9.5	11.0	8.8	...
Memorandum items							
Liabilities to private sector (in billions of bolivares)	193.0	206.3	221.3	261.7	271.1	313.2 4/	366.5 4/
Money and quasi-money (annual percentage change)	17.5	7.2	9.0	17.9	22.4	18.0	17.0
Excess reserves held by commercial banks (in billions of bolivares)	8.3	2.3	5.2	1.8	1.7	...	...

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

1/ From the Quantified Economic Program for 1987 and the authorities' main targets for 1988.
2/ Foreign assets and liabilities are valued at Bs 14.50 per U.S. dollar.
3/ Includes counterpart unrequited foreign exchange and valuation adjustments.
4/ Staff estimates; the QEP uses a more restrictive coverage of broad money stock.

requirement there was a weakening in the capital account in 1986, and international reserves declined by close to US$4 billion, ending the year at about US$11 1/2 billion (Table 4).

The large reserve loss and the growing imbalances in the economy led the authorities at the end of 1986 to adopt a new package of measures relating to the exchange system, wages and prices, the public finances, and private debt service. The measures included a substantial devaluation of the bolivar in the controlled exchange market. Most current transactions were shifted to a new rate of Bs 14.50 per U.S. dollar, including transactions that were previously in the free market (such as nontraditional exports and certain imports), leaving only imports without official foreign exchange permits, tourism and private nonregistered capital flows in the free market. Those exports previously in the free market were given an increased fiscal incentive 1/ and imports previously in the free market were made subject to a special tariff surcharge. At the same time, "essential imports" 2/ (20-25 percent of total imports), as well as the transactions of the petroleum sector, were left at the preferential rate of Bs 7.50 per U.S. dollar.

These changes involved a weighted average depreciation of some 28 percent in December 1986, reducing the value of the bolivar in real effective terms to the level prevailing in the mid-1970s. However, this depreciation has been partially reversed during 1987 with the subsequent acceleration in domestic inflation. Thus, despite the transfer of some import items from the Bs 7.50 per U.S. dollar rate to the Bs 14.50 per U.S. dollar rate, the bolivar appreciated in real effective terms by about 10 percent during the first half of 1987 (Chart 1).

As part of the end-1986 package, the Government also raised minimum wages (affecting about one third of the working population) by 25-33 percent, increased wages of certain public employees, decreed higher fringe benefits for private sector workers and placed a temporary price freeze on some 110 commodity groups. It also took steps to eliminate controls on new private investment projects and to reduce the coverage of rent control on housing. These measures were followed in April 1987 by a further wage increase in the form of a compensatory bonus which effectively raised wages for 1987 by 20-30 percent for both the public and private sectors. Also, a special additional wage adjustment was granted to all teaching staff, while enterprises were forbidden to dismiss workers for six months. Also, agricultural support

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1/ This incentive takes the form of a subsidy which varies according to an estimated domestic value added. With the increased subsidy the average exchange rate for exports is currently about Bs 18 per U.S. dollar, which is only slightly lower than the Bs 19-20 per U.S. dollar effective rate for exports prior to the December 1986 measures.

2/ Imports of food, medicines, and inputs for the agricultural sector, textiles and footwear, and paper products.

Table 4. Venezuela: Summary Balance of Payments

(In billions of U.S. dollars)

	1982	1983	1984	1985	Prel. 1986	Est. 1/ 1987	Proj. 2/ 1988
Current account	-3.2	3.4	4.8	3.0	-2.1	-0.4	-0.1
Trade balance	3.9	8.1	8.7	6.8	0.8	2.0	2.7
Exports, f.o.b.	16.5	14.9	16.0	14.2	8.6	10.1	10.7
Of which: petroleum	15.7	13.9	14.8	12.9	7.2	9.0	9.4
Imports, f.o.b.	-12.6	-6.8	-7.3	-7.4	-7.8	-8.0	-8.0
Nonfactor services (net)	-5.0	-1.9	-1.8	-1.4	1.2	-1.0	-1.0
Freight and insurance	-1.0	-0.6	-0.4	-0.6	-0.6	-0.6	0.6
Travel	-2.5	-0.6	-0.6	-0.1	-0.1	-0.1	--
Other	-1.5	-0.7	-0.8	-0.6	-0.5	-0.3	-0.4
Investment income (net)	-1.5	-2.6	-1.9	-2.2	-1.5	-1.5	-1.8
Of which: interest payments accrued	-3.7	-4.2	-3.8	-4.0	-3.1	-2.5	-2.7
Transfers (net)	-0.6	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Capital account	-3.6	-5.9	-4.0	-2.4	-3.1	-1.2	-1.6
Medium- and long-term capital	2.3	-1.8	-2.5	-2.4	-3.3	-1.1	-1.4
Public sector debt (net)	1.4	0.5	-1.0	-0.8	-1.1	-0.6	-1.1
Disbursement	3.4	1.5	0.5	0.2	0.2	-0.3	0.1
Amortization	-2.0	-1.0	-1.4	-1.0	-1.4	-0.9	-1.2
Scheduled	-2.0	-2.9	-3.4	-4.4	-2.4	-2.3	...
Refinanced	--	1.9 3/	2.0 3/	3.5	1.0	1.4	...
Other public sector	0.7	-0.3	-0.2	-0.1	-0.5	--	--
Private sector	0.2	-1.9	-1.7	-1.7	-1.7	-0.4	-0.3
Direct investment	0.3	0.1	--	0.1	--	0.1	0.2
Other	-0.2	-2.0	-1.8	-1.7	-1.7	-0.5	-0.5
Short-term capital	-5.9	-4.2	-1.5	--	0.2	-0.1	-0.2
Net errors and omissions	-1.9	-0.3	0.7	0.2	0.4	--	--
Overall balance	-8.7	-2.8	1.6	0.9	-4.8	-1.6	-1.7
Valuation change	--	-0.2	--	0.1	0.1	--	--
Financing	8.7	3.0	-1.6	-0.9	4.7	0.7	-0.3
Net international reserves (increase -)	8.3	-0.3	-1.9	-1.8	3.8	1.5 4/	-- 4/
Change in arrears (excluding refinancing)	0.4	3.3	0.3	0.8	0.9	-0.8	-0.3
Financing gap	--	--	--	--	--	0.9	2.0
Memorandum item							
Arrears rescheduling (-)	--	--	--	-2.3	-1.0	-1.9	...

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

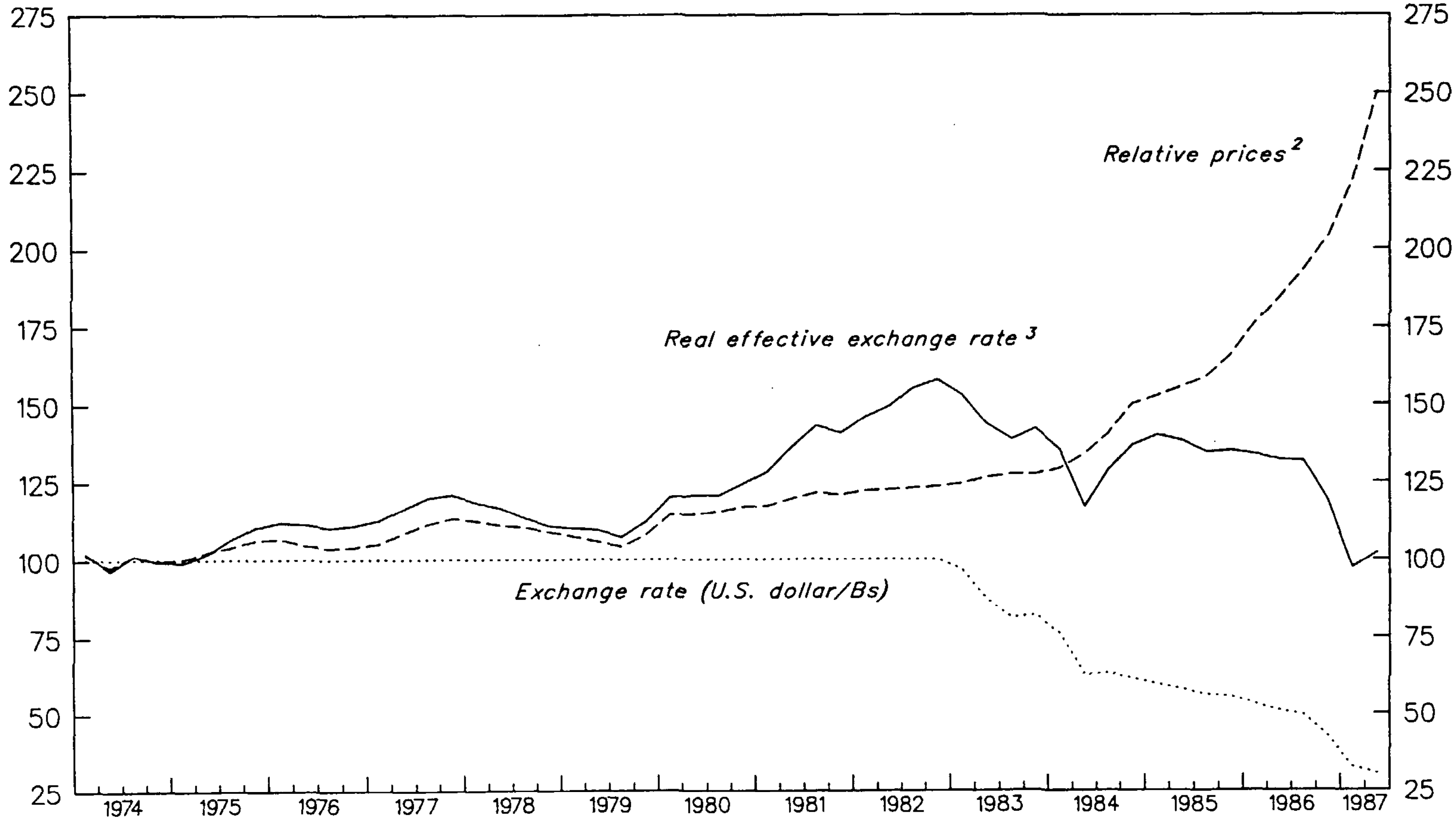
1/ In this column, the QEP's projections have been adjusted for imports through the free exchange market as well as for imports of public enterprises financed directly by suppliers' credits from abroad; in addition, adjustments have been made to interest payments and private sector amortization payments in line with the latest developments in international interest rates and progress in the regularization of private debts.
2/ Staff projections.
3/ Rollover of medium- and long-term debt to financial institutions.
4/ Government targets.

CHART 1

VENEZUELA

EXCHANGE RATE DEVELOPMENTS [1]

(1974=100)



Source: Staff calculations.

1 Weighted by 1980 import shares of principal trading partners. A decrease in the index represents a depreciation. Since February 1983 weighted averages of multiple exchange rates are used.

2 Index of Venezuelan home goods prices divided by index of partner countries export unit value.

3 Based on relative prices (footnote 2) in a common currency

prices were raised by an average of about 30 percent and the authorities announced increases in various subsidies and a further boost in public investment. During the months of April-July consumer prices were allowed to adjust to the increases in costs that had taken place and the inflation rate reached 4-5 percent a month before dropping back to 0.8 percent in August. By August 1987, the 12-month rates of increase in consumer and wholesale prices had accelerated to 33 percent and 50 percent, respectively.

In September the Ministry of Development modified the system of price regulation placing all commodity prices in one of three categories: (a) those whose adjustment require prior approval of the Ministry of Development (85 items of essential commodities)--the prices of these items also were frozen until end-1987; (b) those whose adjustment require prior approval of a special price commission (CONACOPRESA) of business and labor representatives (43 items); and (c) those whose adjustment was to be automatically approved after prior notification to the Ministry of Development, provided the Ministry does not object within 30 days.

Domestic credit rose by 36 percent in the year ended March 1987, boosted by large-scale domestic financing of the public sector and an upsurge in the demand for credit by the private sector. Controlled interest rates became highly negative in real terms and the value of the bolivar in the free exchange market, which had tended to rise immediately following the December measures, depreciated again in May-September to between Bs 30 and Bs 33 per U.S. dollar, a spread of more than 100 percent over the controlled rate. At the same time, the growth in output appears to have slackened and unemployment remained around 10 percent of the labor force.

Net official reserves fell by US$0.7 billion in the first eight months of 1987 as non-oil exports dropped by around 15 percent while imports declined by about 7 percent. The poor performance of non-oil exports seems to have reflected buoyant domestic demand for products such as steel, aluminum, and cement, while the decline in imports resulted from the tightening of exchange controls during the first half of the year and the impact of devaluation. Tight import controls in the official market has led to the channeling of some imports through the free exchange market; imports through this channel are projected at more than US$700 million (10 percent of total imports) in 1987.

3. External debt and debt rescheduling

Total public and private external debt at the end of 1986 was about US$32 billion (70 percent of GDP or 335 percent of exports of goods and nonfactor services), and total debt service in 1986 amounted to 65 percent of exports of goods and nonfactor services. In 1987, as a result of revised amortization schedules of both public and private debt and the partial recovery of oil exports, the debt service ratio is expected to decline to around 36 percent (Table 5).

Negotiations for a multi-year rescheduling of Venezuela's US$21 billion of public and publicly guaranteed external debt with foreign commercial banks (MYRA) were concluded in early 1986 and became effective in October 1986. The MYRA covered the 1983-88 maturities and extended the repayment period through 1997. A downpayment of US$750 million was paid in late 1986 and early 1987. Late in 1986 the authorities reopened negotiations on the MYRA and reached a preliminary agreement with the Advisory Committee of commercial banks in February 1987 which would reduce amortization payments for the period 1987-96 (a reduction of US$2 billion during 1987-89), extend the repayment period through 1999, lower the spread over LIBOR from 1 1/8 to 7/8 percentage points, and allow debt-to-equity conversions. The new agreement was formally signed by Venezuela in September and is expected to be ratified by the banks before the end of 1987.

The normalization of private sector external debt servicing is expected to be virtually completed by end-1987 or early 1988. The authorities had initiated in 1983 a process of registration of private sector debt through the Exchange Control Agency (RECADI) for the purpose of determining access to foreign exchange at preferential rates for debt servicing. After a slow registration process that led to a significant accumulation of private sector debt arrears, registration was completed in the first half of 1986. New regulations announced at the end of 1986 required that some US$5 1/4 billion of private debt be restructured into backloaded, eight-year obligations carrying a maximum interest rate of LIBOR plus 1 1/4 percentage points; debtors were permitted to purchase foreign exchange at Bs 7.50 per U.S. dollar plus a premium of Bs 3-4.5 per U.S. dollar of registered debt for debt service during the eight-year repayment period. The staff estimates that this exchange guarantee scheme involves an implicit exchange subsidy of at least 1/2 percent of GDP a year over the next eight years. State enterprises, whose debts were rescheduled over a 13-year period under the MYRA, can obtain exchange cover by paying a premium of Bs 3.5-4.75 per U.S. dollar of debt for debt service. In addition, about US$1 billion of private debts remained repayable in 1987 at the preferential rates of Bs 4.30 per U.S. dollar or Bs 7.50 per U.S. dollar, and trade credits outstanding as of December 8, 1986 (about US$1 1/4 billion) were also given access to the rate of Bs 7.50 per U.S. dollar. As a result, exchange subsidies for debt servicing will be as much as 3 1/2 percent of GDP in 1987, but would drop back to less than 1 percent of GDP in 1988.

III. Summary of Discussions

The discussions with the authorities focused on the balance of payments outlook and the financing needs of Venezuela over the next few years, on the stance of demand management and external policies, and on

Table 5. Venezuela: External Debt

(In millions of U.S. dollars)

	1982	1983	1984	1985	Prel. 1986	Proj. 1987
Total debt (year-end)	35,817	35,347	33,387	32,932	31,786	30,744
Public sector	28,000	28,350	26,517	25,733	24,486	24,125 1/
Medium- and long-term	...	18,912	17,737	25,733	24,486	24,062
To official creditors	...	522	489	387	265	...
To private creditors	...	18,390	17,248	25,346	24,221	...
Financial institutions	...	16,393	15,428	23,540	22,783	...
Other	...	1,997	1,820	1,807	1,438	...
Short-term	...	9,438	8,780	--	--	...
Private sector 2/	7,817	6,997	6,870	7,199	7,300	6,619
Financial institutions	4,946	4,407	4,324	4,674	5,000	4,705
Other	2,871	2,590	2,546	2,525	2,300	1,914
Debt service 3/	6,526	7,435	7,008	6,684	6,212	3,916
Amortization	2,832	3,513	3,249	2,725	3,096	1,423
Public sector 4/	2,032	945	1,433	1,009	1,380	932
Private sector 5/	800	2,568	1,816	1,716	1,716	491
Interest	3,694	3,922	3,759	3,959	3,116	2,493
Public sector	2,981	2,949	2,773	3,240	2,616	2,012
Private sector	713	973	986	719	500	481
Stock of arrears	825	4,134	4,445	3,007	2,889	324
Public	825	945	--	--	--	--
Interest	400	175	--	--	--	--
Principal 5/	425	770	--	--	--	--
Private	...	2,479	4,105	3,007	2,889	324
Interest	...	730	667	177	--	--
Principal 5/	...	1,749	3,438	2,830	2,889	324
Commercial arrears	--	710	340	--	--	--
Memorandum item						
Debt service ratio (percent) 6/	37.1	46.4	41.7	44.5	65.5	35.7

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

1/ Includes US$271 million loan from the Fondo Andino de Reserva but excludes new borrowing to close the balance of payments gap for 1987.
2/ Net debt (i.e., excludes US$1,733 million of nonregistered debt, that were matched by assets held abroad).
3/ Excluding the rollover of short-term debt, but including interest on short-term debt.
4/ After renegotiation of rescheduling agreement.
5/ Includes arrears incurred on medium- and long-term debt.
6/ In relation to exports of goods and nonfactor services.

the prospects for reducing inflation and removing distortions in the economy to set the basis for sustainable growth.

1. Balance of payments prospects for 1987 and medium-term outlook

The partial recovery in oil prices has improved the medium-term outlook for Venezuela, but not sufficiently to change the main conclusions of the last report under enhanced surveillance (SM/87/22). The previous staff projections based on an oil price of US$15/bbl in 1987 pointed to the need for new loans or additional rescheduling of US$1 1/2-2 billion a year in the period 1987-91 to offset scheduled amortization of public and private sector debt and to stabilize reserves after 1988 at around US$9 billion (the stated goal of the authorities), while sustaining economic growth of about 3 percent a year.

The revised projections are based on an average oil price of US$16.3/bbl for 1987 and US$17/bbl for 1988. However, the volume of oil exports is projected about 5 percent lower than previously, reflecting the most recent OPEC quota agreements. As a result, oil export earnings in 1987-88 would be on average around US$2 billion higher than in 1986, but only US$0.3 billion higher than in the last staff projections. 1/ Interest payments are projected to be slightly higher than previously estimated as the recent increase in LIBOR will be partially offset by the lower interest spread on public debt that was included in the modified MYRA. With official debt payments as scheduled and private sector debt arrears virtually eliminated by end-1987 or early 1988, the authorities expect a loss of US$1 1/2 billion in net official reserves in 1987 and balance of payments equilibrium in 1988, assuming that they are successful in securing additional foreign loans of around US$1 billion in the last quarter of 1987 and US$2 billion next year. The current account is projected to improve from a deficit of US$2.1 billion in 1986 to one of US$0.4 billion in 1987 and would need to be in approximate balance in 1988 to fit to the authorities' projections. According to these projections, imports would be virtually stagnant in nominal terms in 1988 (a decline of about 10 percent in real terms from 1986 to 1988).

The staff projections for the medium term assume a real import growth rate of 3-4 percent a year in 1989-92 and small current account deficits turning into a small surplus by the early 1990s. 2/ On this

1/ The medium-term forecast is based on the latest WEO oil price scenario. The average price of Venezuela's oil export mix is usually around US$0.6/bbl below the OPEC benchmark price.

2/ Balance of payments projections for Venezuela are highly sensitive to assumptions on oil prices and interest rates. An increase of US$1/bbl or 0.1 mbd in the average price or volume of oil exports, respectively, would improve earnings by US$0.5 billion on an annual basis. Each 1 percent change in LIBOR would change interest payments by US$0.3 billion.

basis, Venezuela would need to obtain new gross financing of around US$1 1/4 billion a year if net external debt is to remain about level and reserves are to be stabilized at around US$9 billion (Tables 6 and 7). The authorities explained that about US$5 billion of reserves consisted of gold and SDR holdings and the reserve tranche position in the Fund, which were not included in their definition of "operational" reserves. The Central Bank aimed at maintaining a minimum level of operational reserves equivalent to three months of imports (i.e., about US$1 3/4 billion) plus a margin of US$2 billion. Under the MYRA Venezuela has undertaken not to let operational reserves of the Central Bank fall below US$2 billion.

The authorities indicated that they were seeking new financing from foreign commercial banks and other sources of about US$3 billion to cover the requirements of 1987 and 1988. The Central Bank had recently obtained a balance of payments loan of US$0.3 billion from the Andean Reserve Fund and had arranged a line of credit with the Bank of International Settlements; in addition, the Government intended to place bonds for about US$0.3-0.5 billion later this year with foreign commercial banks which have also indicated that they could increase trade credits and loans linked to investment projects. Efforts also are being made to raise balance of payments loans in Japan and other financial centers. The authorities have initiated discussions with the World Bank on a Program Loan that would support trade policy reform, and they hope that this also might encourage commercial bank lending.

The authorities recognized that the international environment for organizing large-scale support was not propitious, but emphasized Venezuela's cooperative record in honoring its obligations. Not only had Venezuela kept current on public sector interest payments, but it had also reduced its net outstanding debt over the last few years, at considerable social cost. They further noted that Venezuela's medium-term prospects were relatively strong as the country had very large oil and gas reserves and other natural resources, and was making heavy investments in export sectors such as aluminum, coal, steel, chemicals, and pulp and paper. If Venezuela were to be successful in obtaining the new loans indicated in Table 6, net outstanding public and private debt would remain approximately level over the next few years but would decline in relation to exports and GDP.

2. Domestic policies

a. The Quantified Economic Program (QEP)

The authorities prepare an annual Quantified Economic Program which serves as the basis for the enhanced surveillance exercise. The fiscal parameters of the QEP cover the Central Government, the national petroleum company (PDVSA) and the Venezuelan Investment Fund, but do not include the important state enterprises which are part of the reduced consolidated public sector that is used by the Fund staff in its discussions with the authorities. Furthermore, the fiscal section of

Table 6. Venezuela: Medium-Term Balance of Payments Projections

	Actual	Prel.	Projected 1/					
	1985	1986	1987	1988	1989	1990	1991	1992
	(In billions of U.S. dollars)							
Current account balance	3.0	-2.1	-0.4	-0.1	-0.5	—	0.2	0.2
Exports	14.2	8.6	10.1	10.7	11.6	13.1	14.0	14.9
Of which: petroleum	12.9	7.2	9.0	9.4	10.2	11.5	12.2	12.9
Imports	-7.4	-7.8	-8.0	-8.0	-9.0	-9.7	-10.4	-11.2
Nonfactor services (net)	-1.4	-1.2	-1.0	-1.0	-1.1	-1.5	-1.5	-1.7
Investment income (net) 1/	-2.2	-1.6	-1.5	-1.8	-1.8	-1.8	-1.8	-1.8
Transfers	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital account	-2.1	-2.7	-1.2	-1.6	-1.5	-1.6	-1.4	-1.3
Direct investment	0.1	0.0	0.1	0.2	0.3	0.4	0.4	0.4
Medium- and long-term capital	-2.5	-3.3	-1.1	-1.6	-1.7	-1.8	-1.7	-1.7
Public sector	-0.9	-1.6	-0.6	-1.1	-1.5	-1.5	-1.3	-1.2
Private sector	-1.7	-1.7	-0.5	-0.5	-0.2	-0.3	-0.4	-0.4
Short-term capital 2/	0.3	0.6	-0.1	-0.2	-0.1	-0.2	-0.1	-0.1
Overall balance	0.9	-4.8	-1.6	-1.7	-1.9	-1.6	-1.2	-1.1
Change in reserves (increase -)	-1.8	3.8	1.5	--	0.5	0.6	0.2	--
Change in arrears (increase +)	0.8	0.9	-0.8	-0.3	--	--	--	--
Financing gap	--	--	0.9	2.0	1.4	1.1	1.0	1.1
Memorandum items								
Current account balance as percent of GDP	6.2	-4.6	-1.1	-0.2	-1.1	--	0.4	0.4
Net international reserves	15.5	11.7	10.2	10.2	9.7	9.2	9.0	9.0
In months of imports	25.2	17.9	15.3	15.3	13.0	11.3	10.4	9.7
	(Percentage changes, unless otherwise indicated)							
Principal assumptions								
Real non-oil GDP growth	0.6	5.2	3.0	1.0	3.0	3.0	3.0	3.0
Petroleum exports								
Volume (mbd)	1.37	1.53	1.49	1.52	1.61	1.78	1.83	1.87
Price (US$ per barrel)	26.7	12.8	16.3	17.0	17.3	17.8	18.3	18.9
Other exports								
Volume	13.8	2.1	-27.7	8.0	8.5	8.0	9.0	10.0
Unit value	-1.4	6.5	7.7	4.8	4.5	4.0	4.0	4.0
Non-oil sector imports								
Volume	3.8	-2.1	-4.2	-4.8	7.0	4.0	3.7	3.5
Unit value	-1.4	6.6	7.1	4.8	6.0	4.5	4.0	4.0
Terms of trade	-1.4	-47.2	16.0	-1.5	--	--	--	--
LIBOR interest rate	8.6	6.8	7.5	8.0	8.0	8.0	8.0	8.0

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

1/ Includes interest payments on new external borrowing to close financing gaps.
2/ Includes net errors and omissions, and outflows corresponding to imputed interest earnings on assets held abroad by the private sector.

Table 7. Venezuela: Medium-Term External Debt Projections

	Actual 1985	Prel. 1986	Proj. 1987	1988	1989	1990	1991	1992
	(In billions of U.S. dollars)							
Total debt service payments 1/	6.7	6.2	3.9	4.4	5.3	5.5	5.3	5.4
Public sector 2/	4.2	4.0	2.9	3.4	4.2	4.2	4.0	3.9
Principal	1.0	1.4	0.9	1.2	1.8	1.8	1.7	1.6
Interest	3.2	2.6	2.0	2.2	2.4	2.4	2.3	2.3
Private sector	2.4	2.2	1.0	1.0	1.1	1.3	1.3	1.5
Principal 3/	1.7	1.7	0.5	0.5	0.5	0.6	0.7	0.9
Interest	0.7	0.5	0.5	0.5	0.6	0.6	0.6	0.6
	(As percent of export of goods and nonfactor services)							
Total debt service ratio	44.5	65.5	35.7	38.4	42.1	38.5	34.9	33.1
Public sector	28.3	42.1	26.9	29.6	33.3	29.6	21.4	24.1
Private sector	16.2	23.4	8.9	8.8	8.9	9.0	8.5	9.0
Amortization	18.2	32.6	13.0	14.7	18.2	17.5	15.6	15.2
Interest	26.4	32.8	22.8	23.7	24.0	21.1	19.3	17.9
Interest in percent of GDP	8.0	6.7	6.8	7.1	7.3	6.9	6.4	5.9
	(In billions of U.S. dollars)							
Total debt outstanding	32.9	31.8	31.4	31.7	31.9	31.4	30.9	30.6
Public sector 4/	25.7	24.5	24.7	25.6	25.6	25.2	24.9	24.8
Private sector	7.2	7.3	6.6	6.1	6.3	6.2	6.0	5.8
	(In percent of GDP)							
Total debt outstanding	66.5	70.1	85.5	82.5	77.7	72.1	67.0	62.4
Public sector 4/	52.0	54.0	67.4	66.6	62.4	57.9	53.9	50.7
Private sector	14.5	16.1	18.0	15.9	15.3	14.2	13.0	11.8

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

1/ Excluding rollover of short-term debt, but including interest on short-term debt and interest on gap-fill borrowing.

2/ Reflects new terms of the multiyear restructuring agreement with foreign commercial banks agreed upon in principle in February 1987.

3/ Until 1986, reflects estimated accruals on registered debt. From 1987 onwards, includes payments under the eight-year repayment schedule established in December 1986, as well as the amortization of debt eligible for immediate payment in 1987.

4/ Includes gap-fill borrowing.

the QEP treats as public sector current revenue the local currency counterpart of the revaluation of the Central Bank's foreign assets, and the monetary projections give only an implicit measure of the planned total expansion of domestic credit; the projections do not make any allocation between credit to the private and public sectors. To make the QEP fully consistent with the targets on monetary expansion, inflation, and the balance of payments, the authorities agreed that the QEP presentation should be revised in the future. On this occasion the QEP for 1987 was presented and discussed in detail, but the QEP for 1988 could not be prepared in time for the staff visits; nonetheless, the discussions covered the policy implications of the authorities' economic targets for next year.

The main targets and projections for 1987 and 1988 are shown in Table 8. They cover targets on the external sector operations, including the amount of additional foreign financing which is yet to be secured, and on monetary expansion. The table also includes the overall balance of the consolidated public sector operations as estimated by the staff from information provided by the Central Office of the Budget and the Central Bank, and projections on real growth and domestic inflation as estimated by the Ministry of Planning and the Central Bank.

b. Fiscal policy

The mission's review of the public sector finances for 1987 indicated that on present policies the public sector deficit would be equivalent to some 6 1/2 percent of GDP in 1987, about the same as in 1986. The effects of the devaluation of the bolivar and the partial recovery in oil prices would provide a substantial increase in revenue (revenue from oil is expected to recover to almost 19 percent of GDP in 1987 compared with 12 1/2 percent in 1986), but this would be largely offset by increased expenditure.

Outlays have been estimated to rise to 39 percent of GDP in 1987 from 35 1/2 percent in 1986 because of a large increase in current expenditure. The increased exchange subsidies and those on the production of certain agricultural commodities (milk, fertilizers, animal feed, and flour) introduced at the end of 1986 to mitigate the price effects of the devaluation, the recent wage hikes granted through the compensatory bonus and those for school and university staff, and the higher interest payments abroad due to the devaluation are projected to result in an increase of nearly two thirds in public sector current expenditure during 1987 (from 17 3/4 percent of GDP in 1986 to 22 3/4 percent of GDP). The increased exchange subsidies are those given to "essential" imports, trade credits outstanding at the time of the December devaluation, and certain private debt service payments which have access to exchange rates of Bs 4.30 and Bs 7.50 per U.S. dollar. The increase in current expenditure, however, is to be offset in part by a moderate reduction in public investment from 17 1/2 percent of GDP in 1986 to 16 1/4 percent in 1987 (see Table 8).

Table 8. Venezuela: Projections of the 1987 Quantified Economic Program and Official Targets for 1988

	1984	1985	1986	Prog. 1987	Targets 1988
	(In billions of U.S. dollars)				
External current account balance	4.9	3.0	-2.1	-0.4	--
Of which: exports, f.o.b.	16.0	14.2	8.6	10.1	10.7
imports, f.o.b.	7.3	7.4	7.8	8.0 1/	8.0 1/
New money to be secured				0.9	2.0
Change in net official reserves	1.9	-1.8	-3.8	-1.5	--
	(In billions of bolivares)				
Consolidated reduced public sector balance	15.6	21.1	-27.2	-32.9 2/	-25.6 2/
	(In percent of GDP)				
Consolidated public sector balance	4.5	5.7	-6.7	-6.3 2/	-4.1 2/
External current account balance	9.3	6.2	-4.6	-1.1	--
	(Annual percentage change in relation to the stock of bank liabilities to the private sector at the beginning of the year)				
Banking system net domestic assets	1.0	4.9	30.9	23.9	17.0
Net bank credit to the public sector	-8.5	-3.9	13.6	...	...
Liabilities to the private sector	6.9	7.2	18.3	18.0	17.0
	(Annual percentage change)				
Real total GDP	-1.3	0.3	5.2	2.8	2-3
Real nonpetroleum GDP	-1.5	0.6	5.2	3.0	2-3
Consumer prices (end-year)	15.3	9.1	12.7	34.1	15.0

Sources: Central Bank of Venezuela; Ministry of Finance; and Ministry of Planning.

1/ Includes imports through the free exchange market.
2/ Staff estimates.

The mission's preliminary fiscal projections for 1988, based on the spending plans outlined in the draft budget presented recently to the Venezuelan Congress, pointed to a decline of public sector expenditure to around 35 percent of GDP, about the same as that of 1986. This decline would be achieved mainly because of a reduction in some of the agricultural subsidies and in the exchange subsidies on outstanding trade credits and private debt service. As a result, the overall public sector deficit is estimated to drop to around 4 percent of GDP in 1988.

The mission observed that while the prospective reduction in the public sector deficit next year was positive, the Government's own targets for inflation and the balance of payments would still be difficult to attain with the present fiscal plans. Given the QEP targets of 1987 for a reserve loss of US$1 1/2 billion and an expansion of broad money of about 16-18 percent, the mission estimated that the overall fiscal deficit would need to be kept to at most 5 percent of GDP. For 1988, to be consistent with overall equilibrium in the balance of payments desired by the authorities and a reduction of inflation to around 15 percent, the overall fiscal deficit would need to be reduced to no more than 2 percent of GDP. Of course, if Venezuela were to be unsuccessful in obtaining new foreign loans (nearly US$1 billion in 1987 and US$2 billion in 1988) and wished to avoid a larger reserve loss than is now envisaged, the fiscal position would need to be tightened considerably more.

To achieve the fiscal targets, the mission suggested a combination of expenditure and revenue measures. On expenditures, low-priority investment projects could be postponed and current outlays for subsidies could be reduced further. On revenues, measures could include the introduction of a general sales tax and adjustments of prices and tariffs of goods and services provided by public enterprises, including the prices of domestic petroleum products. Also, reforms to the trade system, such as removal of most duty exemptions, could provide significant revenue gains.

The authorities noted that a high rate of economic growth and a strong public investment program (largely directed toward expanding exports) remained a priority for the Government, but they assured the mission that they also viewed the prospective fiscal deficit with concern. They felt that capital spending was likely to turn out lower than estimated both in 1987 and in 1988 because of overbudgeting by the public enterprises. The Ministry of Planning was studying priorities in the public investment program and was setting up a system to monitor closely capital outlays of the Central Government and most nonfinancial public enterprises. In regard to revenues, the authorities noted that adjustments on tariffs of some of the public enterprises (e.g., electricity rates) had been made recently and that they intended to review duty exonerations in the context of the Program Loan being discussed with the World Bank.

c. Monetary policy

The authorities recognized the need for tight monetary policies to prevent a generalized upsurge of inflation, and thus ensure the permanency of the shift in relative prices sought by the devaluation of last December. They had anticipated that velocity would increase in 1987 as the rate of price increases accelerated to reflect corrective adjustments resulting from the devaluation. Therefore, the QEP targeted an expansion of broad money in the range of 16-18 percent, in line with the estimated underlying rate of inflation, even though consumer prices were expected to rise by close to 40 percent in reflection of corrective price adjustments.

In order to curb monetary expansion, the Central Bank was restricting rediscounts and attempting to absorb funds from the interbank market by offering attractive short-term interest rates. However, the authorities acknowledged that the instruments available to the Central Bank were rather limited in scope and that the rate of monetary expansion would be largely determined by the domestic financing needs of the public sector. Consistent with the authorities' targets on monetary expansion and loss of official international reserves, the growth in overall bank credit in 1987 would need to be limited to about 22-24 percent of the stock of broad money at the beginning of the year; the mission also noted that bank financing of the public sector would need to be limited to about 2 percent of GDP to avoid crowding out the private sector. For 1988, to avoid a further loss of net international reserves and to achieve a decline in inflation to about 15 percent, the growth of overall bank credit would need to slow to a range of 15-17 percent, with virtually no recourse by the public sector to domestic bank financing. These prospects highlighted the need for limiting the public sector deficit and at the same time revising the authorities' stance on interest rate policy.

The authorities noted that interest rates had become highly negative in real terms, thus stimulating the private sector demand for credit (including for speculative purposes) and discouraging the growth of financial savings. However, they were concerned about the possible impact of a removal of ceilings or a significant adjustment of interest rates, in particular on the mortgage market. Therefore, they envisaged a gradual process whereby they hoped first to increase controlled interest rates by around 4 to 5 percentage points and to free interest rates for certain types of savings bonds and loans; with the expected reduction of inflation to an annual rate of about 15 percent, the new interest rate structure was expected to be more appropriate. Subsequently, once inflationary expectations had been reduced, the remaining controls on interest rates could perhaps be dismantled. It was envisaged that the adjustment in interest rates would apply to all new real estate transactions. However, interest rates on existing and new real estate loans for low-income housing would not be adjusted, and a preferential margin for loans to the agricultural sector would be maintained.

d. Price and wage policies

The authorities indicated that price controls would be maintained, but explained that prices had been fully adjusted to reflect the exchange rate measures of December 1986 as well as the continuing transfer of transactions from the exchange rate of Bs 7.50 per U.S. dollar to the Bs 14.50 per U.S. dollar during 1987. They indicated that the recently imposed price freeze on the basket of essential commodities would be in effect through the end of 1987, but they intended to apply flexibly the discretionary controls on most other prices.

The authorities noted that real wages had fallen in the 1980s and that the wage increases during 1986 and the first half of 1987 had been intended only to offset inflation. They pointed out that this year's wage increase had been in the form of a nontaxable bonus that would not be included in the wage base. On average, it was expected that wages would increase by 23-25 percent on an annual basis, while the rise of prices would be considerably higher.

3. External policies

a. Exchange rate policy

The authorities said that they were in a process of shifting most of the current transactions remaining at the Bs 7.50 rate to the Bs 14.50 rate. During the first half of 1987 some 260 tariff items had been transferred, thereby reducing the share of imports still at the preferential rate to below 20 percent. Also at midyear transactions of the petroleum and iron ore sectors were moved to the Bs 14.50 rate. They planned to continue transferring import items to the Bs 14.50 rate before year-end with the aim of narrowing the range of commodities that would remain at the Bs 7.50 per U.S. dollar exchange rate during 1988 to essential foodstuffs and inputs with an annual import value of some US$500 million (7-8 percent of total imports). They did not envisage adjusting the Bs 14.50 rate which they still regarded as adequately competitive. Nonetheless, certain steps were being introduced to stimulate exports, including a simplification of the tax drawback scheme, and accelerated access to import licenses and foreign exchange for imports of raw materials and intermediate goods used in the production of exports.

The authorities were concerned about the continuing wide spread between the controlled and free exchange rates; in their view the free market was being affected strongly by speculative activities. For this reason last June they prohibited exchange brokers from operating in the free exchange market, but the measure had no lasting effect on the exchange rate. Net sales by the Central Bank in this market had been smaller in the first half of 1987 than in the corresponding period of 1986 because the authorities had expected a lower demand after the December 1986 exchange measures. However, demand for imports through the free exchange market in the first half of 1987 had been much larger than anticipated owing to the continuing strong growth in domestic expenditure and tight import controls in the official foreign exchange market. The authorities pointed out that their intervention policy was reviewed periodically, but that its principal aim was only to smooth out erratic fluctuations of the free exchange rate.

The authorities noted that procedures for approvals of official foreign exchange for imports had been simplified in 1987. However, almost all imports are still subject to a licensing system and, unless brought in through the free market, to exchange authorization and minimum financing terms.

b. Trade policy

The authorities explained that work was under way to develop a comprehensive tariff reform directed at rationalizing the tariff structure and providing a more uniform rate of effective protection along lines recommended by the World Bank staff; they hoped that these reforms could form the basis for a Program Loan from the Bank. In 1986 a World Bank technical assistance mission had prepared a study on Venezuela's trade policies and made recommendations with a view to gradually dismantling the system of import restrictions and moving toward reliance on tariffs for protection. As a first step, they recommended allowing exporters to have free access to imports used in export production, a measure that had been implemented recently. Subsequently, over a period of three to four years, the process of liberalization could be extended successively to machinery and inputs for domestic production, imports of consumer goods and, ultimately, to imports of luxury goods.

Tariffs vary between zero and 100 percent, with the average tariff being 31 percent. However, actual tariff collections amount to only about one fifth of the level implied by the tariff code because of widespread exemptions. As a result, tariff policy has virtually ceased to be an active instrument of economic policy, while the protection of domestic production has increasingly been achieved through exchange and trade restrictions.

Export licenses are required in the case of commodities that are subject to price controls or are deemed to be in short supply domestically. However, with the establishment of the Bs 14.50 per U.S. dollar exchange rate for non-oil exports and most import transactions last December, the previous system that was designed to allow the exporter to receive the free market rate only for domestic value added no longer applies.

c. Foreign investment and privatization

The authorities stressed that they wished to stimulate foreign direct investment in Venezuela. Although foreign direct investment is formally governed by Andean Pact rules, which are being reviewed, Venezuela has substantially liberalized its own regulations over the past two years; seven sectors (agriculture, agro-industry, construction, tourism, electronics, data processing, and biotechnology) have now been exempted from most reinvestment requirements and limits on dividend remittances. A new foreign investment code approved late last year raised the annual ceilings on dividend remittances to 20 percent plus the three-month LIBO rate, reduced the limitations on repatriation of capital, and eased the transformation requirements into local or mixed ownership. Also, new investment (both domestic and foreign) no longer requires prior approval, and ex-post registration and approval is granted if the new investment meets any one of seven rather general criteria. The authorities noted, however, that at the present time the existence of a wide spread between the controlled and free market exchange rates was a major deterrent to new foreign investment. To help solve this problem, recently the Government authorized a number of foreign investment projects or joint ventures with at least 80 percent production for exports to effect all foreign exchange transactions through the free exchange market.

The Government also recently introduced legislation permitting the conversion of external debt into foreign direct investment in import substitution and export activities, as well as in any one of 11 priority sectors, including capital goods, chemicals, petrochemicals, and aluminum. Dividends and profit remittances are limited to 10 percent of the converted debt for the first three years and 20 percent plus LIBOR thereafter. No capital repatriation is allowed for the first five years, and thereafter capital can be repatriated in eight equal yearly installments.

The authorities are considering the possibility of allowing private sector participation in certain government enterprises such as sugar processing centers, silos, and hotels. A law was passed in December 1986 to enable the Government to privatize enterprises, and some shares have been floated in the local stock market.

IV. Staff Appraisal

During the period 1983-85 the Venezuelan economy made a major adjustment to the decline in export earnings stemming from lower oil prices. However, after several years of recession and rising unemployment, in 1986 the authorities switched to policies aimed at stimulating demand just as the country experienced a major drop in its oil export earnings. Public investment, which had been curtailed significantly in previous years, expanded by more than 40 percent in real terms, monetary policy was eased, and wages were increased. As a result, domestic demand rose strongly and real GDP expanded by 5 percent. At the same time, the public sector moved from a surplus of 5 3/4 percent of GDP in 1985 to a deficit of 6 3/4 percent in 1986, while the external current account shifted from a surplus of US$3 billion to a deficit of US$2 billion. Official foreign reserves fell by nearly US$4 billion in 1986 and the value of the U.S. dollar in the free exchange market rose to a level more than three times that of the controlled market.

At the end of 1986, the Venezuelan authorities undertook a number of measures, including a major devaluation, to deal with the weakening economic situation. However, these measures have not been supported thus far by a strengthening of fiscal, monetary, and incomes policies. During the first months of 1987, bank credit expansion continued to accelerate, reflecting increased domestic borrowing by the public sector and strong private sector demand for credit which reflected in part the highly negative real interest rates that have prevailed. As a result, the 12-month rate of inflation rose from 13 percent at the end of 1986 to 33 percent in August 1987; also, the spread between the controlled and the free exchange rates, which had narrowed in early 1987, has widened sharply in recent months.

Venezuela has now virtually completed the process of rescheduling its public and private external debt with commercial banks, thereby easing its immediate debt service burden, and the authorities are now hoping to have improved access to new foreign loans. It has to be recognized, however, that Venezuela's ability to raise new funds abroad will depend on the economic program that is implemented. In the staff's view, such a program should be based on restrained fiscal and wage policies, a flexible interest rate policy, and the establishment of a unified exchange rate system. At the same time, efforts are needed to reduce price controls and reform the trade system in order to strengthen the investment and growth prospects.

On present plans, the overall public sector deficit is estimated at around 6-7 percent of GDP in 1987, which would be similar to the outturn for 1986, and it is programmed to decline to around 4 percent of GDP in 1988. The authorities believe that the outcome for both years is likely to be somewhat better than is presently estimated as the public sector investment program is likely to be underexecuted. In the view of the staff, a lowering of the public sector deficit to no more than 5 percent of GDP in 1987 and 2 percent of GDP in 1988 is necessary if the authorities' objectives as regards inflation and the overall balance of payments are to be achieved without crowding out the private sector. Any shortfall in external financing from the amount planned would require a tighter fiscal program if the loss of international reserves over 1987-88 is to be kept to the level now envisaged by the authorities.

To achieve the fiscal targets, consideration might be given to postponing low-priority investment projects and reducing current outlays for subsidies. Revenue measures also need to be considered, including the implementation of longer term tax reforms (such as the introduction of a planned sales tax) and increases in prices and tariffs of public enterprises, particularly in domestic gasoline prices. Reforms to the trade system (such as removal of most duty exemptions) also could provide revenue gains.

A tightening of monetary policy is necessary to control inflation and achieve the authorities' balance of payments objectives. In this connection, implementation of the proposed adjustment in controlled interest rates of 4-5 percentage points is urgently needed. Also, the preferential lending rate for agricultural credits should be eliminated. The aim should be to move to a fully market-determined interest rate structure as soon as possible.

A cautious wage policy is needed to provide support to the monetary and fiscal policies. At the same time, a reduction in the scope of price controls could be expected to have a beneficial effect on private investment and resource allocation. As a first step, it would be desirable to cut significantly the list of items requiring prior approval of the Ministry of Development.

The current exchange system involves widespread distortions and is hampering the achievement of a sustainable external position. The preferred solution would be a unified, floating exchange rate system, along with an immediate and a significant liberalization of the import and exchange regimes. If adoption of a unified floating exchange rate is not considered feasible at this time, other means of exchange rate flexibility could be pursued. One possibility would be to accelerate the transfer of all remaining imports from the Bs 7.50 rate to the controlled rate of Bs 14.50 together with periodic adjustments in the controlled rate. Such actions would ensure that the real effective value of the bolivar does not increase further, and could facilitate the process of exchange rate unification. At the same time, the staff would recommend that a gradual program of import liberalization and tariff reform, along the lines suggested by the World Bank, be implemented.

The multiple exchange rate system introduced in 1983, and modified on several occasions since then, gives rise to multiple currency practices, and external payments arrears on private debt service give rise to an exchange restriction on payments and transfers for current international transactions, subject to the Fund's approval under Article VIII, Sections 2(a) and 3. The staff urges the authorities to streamline this complex and highly subsidized exchange system and to improve administrative arrangements to ensure the elimination of external payments arrears. In the meantime, since the timing of the removal of such restrictions is indefinite, the staff does not propose approval of Venezuela's exchange practices. Therefore, no decision is proposed for adoption by the Executive Board upon completion of the 1987 Article IV Consultation with Venezuela.

It is expected that the next consultation with Venezuela under enhanced surveillance would be held within six months.

Venezuela - Relations with Fund and the World Bank
(As of August 31, 1987)

A. Fund Relations

I. Membership Status

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

Financial Relations

II. General Department (General Resources Accounts)

(a)	Quota:	SDR 1,371.5 million
(b)	Total Fund holdings of bolivares	SDR 953.6 or 69.5 percent of quota
(c)	Reserve tranche position	SDR 417.9 million or 30.5 percent of quota
(d)	Outstanding lending to the Fund (supplementary financing facility)	SDR 109.6 million
(e)	Operational budget	SDR 10.3 million (transfers); SDR 34.9 million (receipts)

III. SDR Department

(a)	Net cumulative allocation	SDR 316.9 million
(b)	Holdings	SDR 525.7 million or 165.9 percent of net cumulative allocation
(c)	Current designation plan	SDR 1.0 million

IV. Administered Accounts

None

V. Venezuela has not used Fund resources to date

Nonfinancial Relations

VI. Since early 1983 Venezuela has maintained a multiple exchange system. In December 1986 it was modified involving an average depreciation of the bolivar of 28 percent. The exchange system includes: (i) a rate of Bs 14.50 per U.S. dollar applicable to about 80 percent of imports and nonfactor services, all exports, and public sector capital transactions; (ii) a rate of Bs 7.50 per U.S. dollar, which now applies to "essential" imports (food, medicines, and certain inputs) and related services, and all import credits outstanding as of December 1986. This exchange rate plus a premium in bolivares also applies to service payments over an 8-year period of about 75 percent of the registered private sector external debt; (iii) the exchange rate of Bs 4.30 per U.S. dollar, which applies to amortization payments of about 20 percent of registered private debt; and (iv) the free market exchange rate, which applies to tourism and nonregistered private capital flows; largely because of import restrictions in the controlled exchange market, about 10 percent of imports are transacted through the free exchange market.

VII. The last Article IV consultation was concluded on July 25, 1986 (EBM/86/121; SM/86/152 and SM/86/153). The last midyear Article IV consultation (under enhanced surveillance) was concluded on March 2, 1987 (EBM/87/35; and SM/87/22). The Executive Board has not approved Venezuela's multiple currency practices or exchange restrictions. The consultation is on a 12-month cycle; under the enhanced surveillance procedures a staff report is prepared and discussed twice a year.

VIII. The last technical assistance mission took place in September 1985. The mission, from the Bureau of Statistics in the monetary area, reviewed with the authorities the reporting system and suggested changes in its presentation to improve monitoring procedures. A report was presented to the authorities in August 1986.

B. Relations with the World Bank

As a result of the decline in per capita income in recent years, Venezuela has become eligible again for credits from the World Bank (the last IBRD loan had been approved in 1975). In May 1987, IFC approved a US$10 million loan and a US$27.6 million domestic bond issue guarantee for a privately owned cement company. During 1986, a Bank technical assistance mission prepared a study on Venezuela's trade policies with a view to rationalizing the structure of protection and eliminating quantitative restrictions. This study could form the basis for a planned sectoral loan from the World Bank in support of trade policy reforms. A Bank economic mission visited Venezuela in January 1987, the first since 1983, and its economic report will be issued shortly.

Venezuela--Basic Data

GDP per capita (1986)	US$2,548
GDP (1986)	US$45.3 billion

	1983	1984	1985	1986
		(percent)		
Origin of nominal GDP				
Agriculture	6.7	6.9	7.9	8.9
Petroleum (crude and refining) and mining	20.5	25.8	22.7	15.8
Manufacturing, construction and utilities	19.5	18.3	19.2	21.7
Commerce	11.5	11.0	11.2	12.0
Transport, storage, and communications	11.5	10.9	11.7	13.3
Government	11.9	10.3	10.8	10.8
Other services	18.4	16.8	16.5	17.4
Ratios to GDP at current prices (1986)				
Exports of goods and nonfactor services	27.5	32.0	30.3	20.9
Imports of goods and nonfactor services	16.9	18.8	19.4	21.9
External current account	5.9	9.3	6.2	-4.6
Central government revenues	24.4	27.4	28.9	22.8
Central government expenditures	26.9	25.8	26.7	26.3
Public sector savings	11.3	15.6	17.8	10.8
Public sector overall balance	-5.0	3.6	5.7	-6.7
External public debt (end of year)	48.7	50.4	52.0	54.1
External total debt (end of year)	60.6	63.5	66.5	70.2
Gross national savings	17.6	24.0	20.8	15.8
Gross domestic investment	11.7	14.8	14.7	20.3
Money ad quasi-money (end of year)	62.4	56.5	57.5	62.4

Annual changes in selected economic indicators	1983	1984	1985	Prel. 1986
		(percent)		
Real GDP	-5.6	-1.3	0.3	5.2
Real GDP per capita	-8.1	-4.1	-1.8	2.2
GDP at current prices	-0.3	19.6	7.1	8.5
GDP deflator (excluding petroleum)	8.7	13.3	10.8	12.5
Wholesale prices (annual average)	6.9	17.5	18.2	15.7
Consumer prices (annual average)	6.7	12.5	11.4	11.6
Central government total revenues	-5.0	34.1	13.0	-14.5
Central government total expenditures	-11.2	14.6	10.9	7.0
Money and quasi-money (M2)	18.8	8.3	9.0	17.9
Money	25.7	3.8	12.6	27.5
Quasi-money	15.6	10.7	7.3	13.1
Net domestic bank assets 1/	12.4	1.0	4.9	30.9
Credit to public sector (net)	3.8	-8.5	-3.9	13.6
Credit to private sector	3.2	8.1	8.3	16.4
Merchandise exports (f.o.b., in U.S. dollars)	-9.8	7.0	-11.2	-39.3
Merchandise imports (f.o.b. in U.S. dollars)	-46.1	7.1	1.7	6.1

	1983	1984	1985	Prel. 1986
Public sector finances 2/	(billions of bolivares)			
Revenue	87.4	124.5	141.2	115.6
Expenditure (including net lending)	102.0	112.0	120.1	142.8
Current account surplus or deficit (-)	32.8	54.0	66.4	43.8
Overall surplus or deficit (-)	-14.6	12.6	21.1	-27.2
External financing (net)	-4.0	-6.4	-7.0	-4.6
Domestic financing (net)	18.6	-6.2	-14.1	31.8
Balance of payments	(millions of U.S. dollars)			
Merchandise exports, f.o.b.	14,919	15,967	14,178	8,609
Merchandise imports, f.o.b.	-6,778	-7,262	-7,388	-7,835
Investment income (net)	-2,570	-1,893	-2,226	-1,553
Other services and tranfers (net)	-2,148	-1,935	-1,515	-1,281
Balance on current and transfer accounts	3,423	4,877	3,049	-2,060
Official long-term capital (net)	182	-779	-870	-1,642
Private long-term captial (net) 3/	-1,937	-1,744	-1,557	-1,652
Short-term capital and errors and omissions 4/	-4,667	-798	310	659
Change in net international reserves (increase -)	-278	-1,883	-1,757	3,813
Change in arrears 5/	3,277	327	825	882
Official international reserves				
Central Bank (gross)	11,135	12,405	13,681	9,840
Central Bank (net)	11,110	12,382	13,658	9,782
Venezuelan Investment Fund	728	1,341	1,840	1,903

Social and Demographic Indicators

Area	Population	Density
912,050 sq. km. (total)	17.8 million (end-1986)	19.5 per sq. km.
307,692 sq. km. (arable)	Rate of growth 2.9 percent (1980-86)	59.7 per sq. km.

Population characteristics (1985) (per '000)		Health	
Crude birth rate	29	Population per physician (1982)	833
Crude death rate	5	Population per hospital bed (1985)	370
Infant mortality	26		

Income distribution (1985)		Distribution of land ownership	
% of household labor income		% owned by top 3% of owners	76.5
highest quintile	44.9	% owned by smallest 42.9% of owners	1.0
lowest quintile	5.9		

Access to safe water (1985)		Access to electricity (1984)	
Caloric intake as % of requirements	106	% of households	79.1
Per capita protein intake (grams per day)	71		

Nutrition (1984)		Education (1985)	
Caloric intake as % of requirements	106	Adult literacy rate 25 and over	84.3
Per capita protein intake (grams per day)	71	Primary school enrollment rate	85.2

1/ In relation to banking system liabilities to the private sector at the beginning of the period. Includes counterpart unrequited foreign exchange and valuation adjustments.

2. Comprises operations of the Central Government (including extrabudgetary operations), the Venezuelan Investment Fund, the National Petroluem Company, the nonfinancial public enterprises, and the Exchange Differentials Compensation Fund (FOCOCAM).

3/ Includes direct investment.

4/ Includes valuation change.

5/ Excluding arrears rescheduling.

Venezuela - Statistical Issues

1. Outstanding statistical issues

a. Government finance

The 1986 GFS Yearbook includes data for the period 1975-84 for the consolidated central government (which includes the budgetary central government, social security funds, and extrabudgetary units of the central government). Beginning in 1983, data on social security funds cover operations of all social security institutions, while those in previous years refer only to the Venezuelan Social Security Institute. The presentation for Venezuela in the GFS Yearbook does not include data for state governments and federal territories. For local governments, the 1986 GFS Yearbook includes aggregate data through 1979 covering only the Federal District Municipality. The recent Article IV consultation mission to Venezuela could obtain data for state and local governments only through 1985. A technical assistance mission to Venezuela may be useful in reference to local government statistics; a seminar on this issue for all Latin American countries will be held in Caracas, in March 1988.

Annual data in the September 1987 issue of the IFS, are available through 1984, and are the same as those published in the GFS Yearbook. However, monthly and quarterly data do not add up to the annual figures because the latter include extrabudgetary and social security transactions.

The 1986 GFS Yearbook published for the first time provisional data for many countries but not for Venezuela. However, the Venezuelan authorities have indicated that beginning in 1987 they would be in a position to produce and submit provisional government finance data. The availability of these provisional data, even if they include some estimates or projections, would be very useful for purposes of analysis and policy determination and, therefore, production of such data for Venezuela for fiscal years 1986 and 1987, particularly for major components, on the same basis and with the same coverage as for previous years, needs to be encouraged.

b. Monetary accounts

A 1985 technical assistance mission in the area of money and banking statistics made a number of recommendations with which the authorities have expressed broad agreement; implementation of these recommendations has not yet been completed.

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

The table below shows the currentness and coverage of data published in the country page for Venezuela in the September 1987 issue of *IFS*. The data are based on reports sent to the Fund's Bureau of Statistics by the Banco Central de Venezuela, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in September 1987 IFS
Real Sector	- National Accounts	1986
	- Prices: WPI	June 1987
	CPI	April 1987
	- Production: Crude petroleum	March 1987
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	May 1987
	- Financing	May 1987
	- Debt	Q4 1986
Monetary Accounts	- Monetary Authorities	May 1987
	- Deposit Money Banks	April 1987
	- Other Financial Institutions	April 1987 (partial data)
Interest Rates	- Discount Rate	June 1987
	- Bank Lending/Deposit Rates	June 1987
	- Government Bond Yields	n.a.
External Sector	- Merchandise Trade: Values	December 1986 1/
	Prices	n.a. 2/
	- Balance of Payments	1986
	- International Reserves	July 1987
	- Exchange Rates	July 1987

1/ Petroleum exports through March 1987.
2/ Crude Petroleum wholesale prices through Q4 1985.