FOR AGENDA

SM/86/152

CONTAINS CONFIDENTIAL
INFORMATION

June 25, 1986

To: Members of the Executive Board

From: The Acting Secretary

Subject: Venezuela - Staff Report for the 1986 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with Venezuela, which is proposed to be brought to the agenda for discussion on Friday, July 25, 1986.

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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CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

VENEZUELA

Staff Report for the 1986 Article IV Consultation

Prepared by the Staff Representatives for the 1986 Consultation with Venezuela

Approved by E. Wiesner and S. Kanesa-Thasan

June 23, 1986

I. Introduction

The 1986 Article IV consultation discussions with Venezuela were conducted in Caracas during the period April 10-25, 1986. 1/ The discussions also reviewed performance under the 1985 Quantified Economic Program and prospects under the new Program for 1986. This is the third report prepared under the procedures for enhanced surveillance approved for Venezuela by the Executive Board on May 30, 1985.

Representatives of Venezuela in the discussions included the Minister of Finance and the President of the Central Bank; the Ministers of Development, Planning, Mines and Energy, Agriculture, State Enterprises, and of the Venezuela Investment Fund; and the Director of the Budget and other senior officials. The staff representatives were Messrs. Martin Hardy (Head), Leonardo Cardemil, Jose Fajgenbaum, Jorge Guzman (all WHD), and Markus Rodlauer (ETR), and Ms. Amalia Kriegsmann (Secretary-WHD). Mr. Pedro Perez, Executive Director for Venezuela, participated in the final policy discussions. At the end of the mission, Mr. Hardy also reviewed the staff's preliminary conclusions with the President of the Republic.

The last Article IV consultation discussions with Venezuela were concluded by the Executive Board on December 13, 1985 (SM/85/308 and SM/85/136). At that time, Directors agreed to a request by the Venezuelan authorities to change the consultation cycle so as to reflect Venezuela's budgetary process. Under the new cycle, the Article IV consultation discussions would be held in the early months of the calendar year when the Quantified Economic Program was formulated; the mid-year consultation discussions to review performance under the Economic Program would be held about six months later. In view of the short lapse between the regular Article IV consultations on this occasion, a separate statistical appendix has been prepared in lieu of a report on Recent Economic Developments.

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 are described in Attachment I.

At the conclusion of the 1985 Article IV consultation, Directors commended the authorities for the substantial adjustment that had been achieved in recent years, which had strengthened Venezuela's external position and provided the basis for a multiyear restructuring of external public debt with foreign commercial banks. At the same time, they stated that the uncertain oil market situation underlined the need for continued implementation of cautious fiscal, monetary, and wage policies, supported by a realistic exchange rate policy. These policies were expected to help create an environment conducive to domestic and foreign private investment and to the diversification of the economy. Directors noted the authorities' concern about the prolonged stagnation in domestic economic activity and high unemployment, but they observed that the weakness of the economy in recent years was in part the result of excessive controls and regulations. They encouraged the authorities to reduce the scope of price and import controls and to expedite their plans to design and implement tax and tariff reforms.

Directors welcomed the preliminary agreement reached between Venezuela and its creditor banks on a multiyear rescheduling of public debt. At the same time, they expressed concern about the large stock of arrears on private external debt service and emphasized the need to eliminate arrears without delay in order to normalize Venezuela's relations with its creditors and suppliers.

II. Background

1. Developments prior to 1985

The substantial increase in oil export earnings 1/ during 1979-81, led the authorities to attempt to stimulate domestic activity by expanding aggregate demand. The measures adopted included a sharp increase in public expenditures, a large generalized wage increase, and an accommodating credit expansion. However, these policies led to an acceleration of domestic inflation, a decline in private investment, and an increase in capital outflows (Table 1). In 1982, Venezuela's fiscal and balance of payments positions weakened substantially with the downturn in the world oil market. The drop in oil revenues and a large increase in public investment combined to widen the consolidated public sector 2/ deficit to about 15 percent of GDP, and the external current account moved from a surplus of US$2 billion in 1981 to a deficit of US$3 1/4 billion. As confidence in the exchange rate waned, private capital

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1/ In Venezuela, the oil sector provides about 90 percent of export revenues and some two thirds of central government revenues, and contributes around 25 percent of GDP.

2/ The consolidated public sector in this report covers the Central Government, the Venezuela Investment Fund, the National Petroleum Company, the nonfinancial public enterprises, and the Exchange Differentials Compensation Fund (FOCOCAM).

Table 1. Venezuela: Selected Macroeconomic Indicators

	Average 1979-81	1982	1983	1984	Prel. 1985	Proj. 1986 1/
	(Annual percentage change)					
Real GDP (at 1968 prices)	-0.5	0.7	-5.6	-1.4	-0.4	—
Petroleum	-1.3	-7.2	-4.7	0.3	-4.2	0.4
Nonpetroleum	-0.4	1.4	-5.7	-1.5	--	--
Nominal GDP	19.1	2.1	-0.3	19.6	8.4	7.5
Petroleum	30.7	-16.3	-9.9	51.6	-5.1	-13.7
Nonpetroleum	15.6	9.0	2.5	11.6	13.0	13.6
Caracas consumer price index (end of period)	17.3	7.6	7.5	15.5	9.1	11.9
Wholesale price index (end of period)	14.6	6.2	10.8	23.8	12.9	15.3
Unemployment rate (in percent) 2/	5.8	7.1	10.2	13.4	12.1	...
	(In percent of GDP)					
Gross domestic expenditures (at current prices)	94.6	103.0	89.1	87.7	92.8	99.1
Consumption	68.2	77.2	77.4	72.9	76.2	...
Investment	26.4	25.9	11.7	14.8	16.6	...
Public 3/	18.2	25.2	16.3	11.3	13.4	17.8
Private 4/	8.2	0.7	-4.6	3.5	3.2	...
Gross domestic savings	31.8	22.8	22.6	27.1	23.8	...
Public	18.7	14.1	13.9	20.4	17.9	...
Private	13.1	8.7	8.6	6.7	5.9	...

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

1/ Targets and projections contained in the Quantified Annual Economic Program.
2/ Second semester data.
3/ Includes capital formation as well as capital transfers.
4/ Includes changes in inventories.

outflows rose to more than US$5 billion and the balance of payments registered an overall deficit of US$8 1/2 billion in 1982, including an accumulation of private and public sector external arrears.

In early 1983, the authorities adopted several measures aimed at arresting the loss of official reserves. The measures included a sharp cutback in public investment, a devaluation of the bolivar within a three-tier exchange system, and the introduction of comprehensive exchange, import, and price controls. The new Administration that took office in February 1984 intensified these policies, and buttressed them by a social pact with labor unions and business that contemplated wage restraint in exchange for increased employment and greater fringe benefits. The exchange system was modified into a four-tier system, 1/ incorporating a further depreciation of the bolivar and bringing the cumulative average depreciation vis-à-vis the U.S. dollar close to 40 percent compared with the position prior to February 1983 (Chart 1). In addition public sector subsidies were reduced and domestic fuel prices were increased.

These measures led to significant improvements in the public finances and in the external position (Tables 2 and 3). The overall public sector deficit declined sharply in 1983 and turned into a surplus of 5 percent of GDP in 1984. In reflection of this performance and of a low private sector demand for credit, banking system credit expanded at a slower pace in 1983 and remained virtually unchanged in 1984 (Table 4). The external current account shifted into surpluses averaging almost US$4 billion a year in 1983-84 as imports and nonfactor service payments fell by more than one half. The result of this shift was both a reduction in external public debt and an increase in net official reserves. By the end of 1984, reserves had reached US$13 3/4 billion and the public sector had eliminated its external arrears.

A major element of the change in domestic expenditure was a cut back in public sector investment from more than 25 percent of GDP in 1982 to 14 percent of GDP in 1983-84; private sector investment declined sharply in 1982 and then stagnated. Output in the nonpetroleum sector fell by more than 7 percent in 1983-84 and the unemployment rate reached 13 1/2 percent, compared with 7 percent in 1982. Consumer prices rose by 15 1/2 percent in 1984 compared with 7 1/2 percent a year in 1982-83, as price controls were administered more flexibly to allow the pass-through of the devaluation and to reflect the reduction in subsidies.

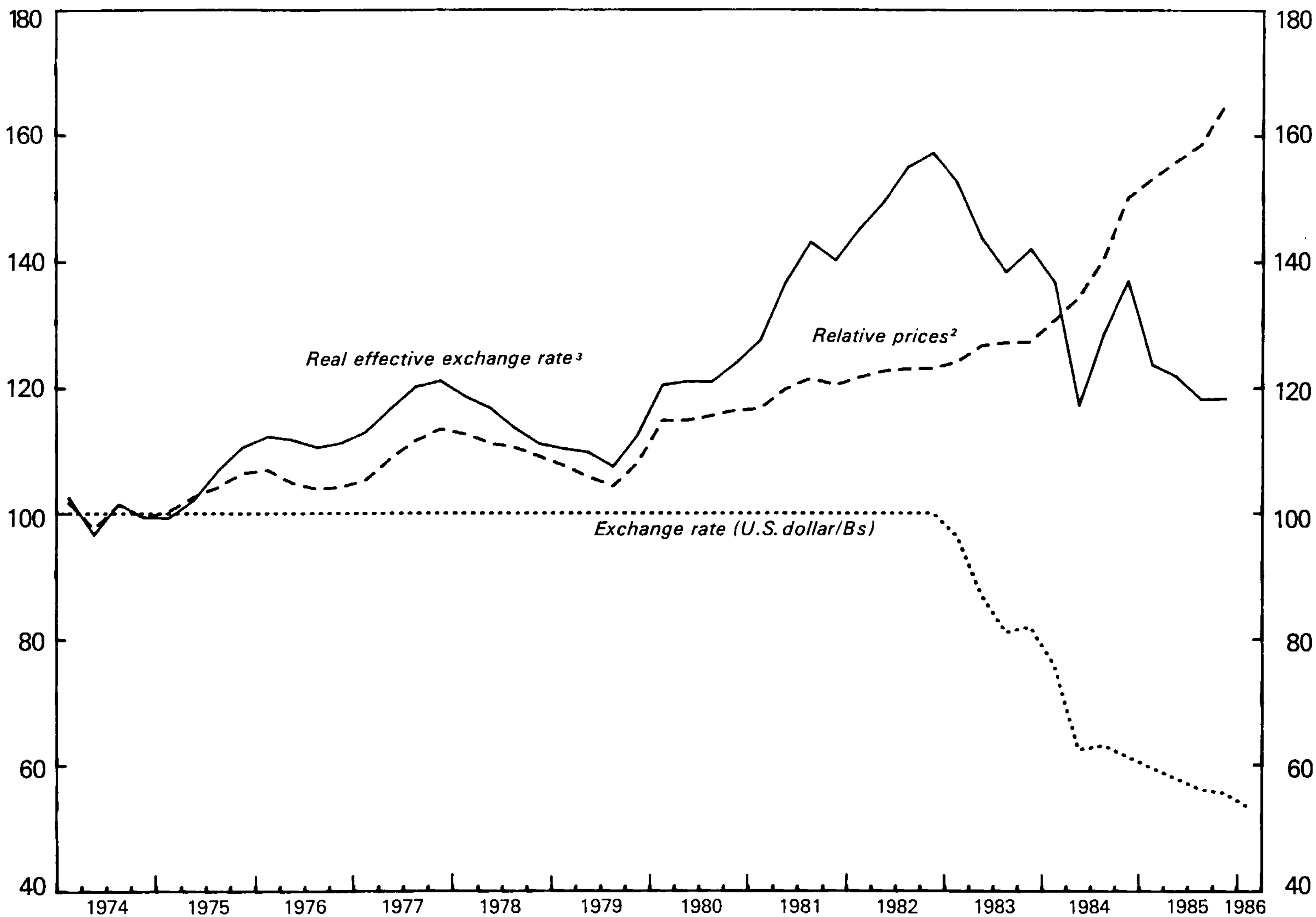
1/ The system comprised the previous exchange rate of Bs 4.30 per U.S. dollar applicable to essential imports and amortization of certain external debts; a rate of Bs 6.00 per U.S. dollar for transactions of the petroleum and iron ore sectors; a rate of Bs 7.50 per U.S. dollar for most other authorized current transactions and certain official capital transactions; and a free exchange rate for all other transactions (See SM/84/201 for a full description of the system).

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 values.

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

Table 2. Venezuela: Consolidated Public Sector Operations

	1981	1982	1983	1984	Prel. 1985	1986 Govt.	1986 Staff
	(In billions of bolivares)						
Total revenues	100.6	86.9	85.1	124.8	133.7	109.3	102.4
Tax revenues	18.6	21.0	27.3	28.5	34.3	35.3	35.3
Nontax revenues	82.0	65.7	57.6	96.0	98.2	81.7	65.9
Central Government (excluding petroleum royalties)	2.9	4.2	3.9	4.6	11.4	11.4	11.4
PDVSA operating surplus	70.5	56.3	40.3	78.1	71.7	53.8	46.9
Venezuela Investment Fund interest and dividend income	2.3	1.4	1.3	1.9	1.9	2.8	2.8
Nonfinancial public enterprises operating surplus	--	--	2.8	10.5	5.3	3.1	3.1
Other (including interest income and FOCOCAM)	6.3	3.7	1.3	1.0	7.9	1.7	1.7
Sale of fixed assets	--	0.1	0.2	0.3	1.1	1.2	1.2
Total expenditures	112.2	130.1	99.9	107.6	122.8	148.1	148.1
Current expenditures	59.9	56.8	52.7	68.5	71.5	76.0	76.0
Personal emoluments	19.6	19.2	19.3	20.3	20.2	22.7	22.7
Purchases of goods and services	4.1	5.1	3.6	4.9	4.4	6.0	6.0
Interest payments	10.3	12.6	9.5	16.3	7.1 1/	14.6	14.6
Transfers to private sector	5.2	3.0	3.2	3.9	4.3	3.5	3.5
Nonfinancial public enterprises operating deficit	2.5	0.2	--	--	--	--	--
Central Government (extrabudgetary)	--	0.1	--	--	--	--	--
Central government transfers to nonconsolidated entities	18.3	16.5	17.0	23.0	32.0 1/	18.1	18.1
Other (including FOCOCAM reimbursements)	--	--	--	--	3.5	11.1	11.1
Capital expenditures	52.3	73.4	47.2	39.1	51.3	72.0	72.0
Capital formation	37.2	46.8	33.2	29.2	38.5	54.0	54.0
Central Government (extrabudgetary)	0.9	6.6	4.0	1.6	0.4	0.3	0.3
Other (including transfers to nonconsolidated entities)	14.2	20.0	10.0	8.3	12.4	17.7	17.7
Net lending to private/external sector	0.2	0.3	0.2	0.2	0.2	0.1	0.1
Overall surplus or deficit (-)	-11.8	-43.5	-15.1	17.1	10.7	-38.8	-45.8
Financing	11.8	43.5	15.1	-17.1	-10.7	38.8	45.8
External	8.7	7.7	1.2	-13.0	-9.1	3.0	4.5
Banking system	2.1	7.8	6.3	-16.4	-8.1	32.8	38.2
Other 2/	1.0	28.0	7.6	12.3	6.5	3.0	3.0
	(As percentage of GDP)						
Total revenues	35.3	29.8	29.3	35.9	35.5	27.0	25.3
Total expenditures and net lending	39.4	44.8	34.5	31.0	32.7	36.5	36.6
Current account surplus	14.3	10.3	11.1	16.1	16.2	11.0	6.2
Overall surplus or deficit	-4.1	-14.9	-5.2	4.9	2.8	-9.4	-11.3
	(Annual rates of change)						
Total revenues	8.7	-13.6	-2.1	46.7	7.1	-9.3	-23.4
Total expenditures and net lending	21.8	16.0	-23.2	7.6	14.1	20.0	20.5
Of which: capital expenditures	16.8	40.3	-35.6	-17.2	31.2	40.4	40.4
Memorandum items							
Current account surplus (in billions of bolivares)	40.7	30.0	32.2	56.1	61.1	32.1	25.2
Nominal GDP (in billions of bolivares)	285.2	291.3	290.5	347.5	376.6	404.9	404.9

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

1/ A substantial part of the interest payments in 1985 appears as government transfers to the nonconsolidated public sector while the Central Bank is in the process of reclassifying them.
2/ Largely domestic arrears in 1982-83.

Table 3. Venezuela: Summary Balance of Payments 1/

(In billions of U.S. dollars)

	1981	1982	1983	1984	Prel. 1985	Proj. 1986 Govt.	Proj. 1986 Staff
Current account	2.1	-3.2	3.6	4.5	3.1	-0.9	-1.8
Trade balance	7.8	3.9	8.1	8.6	6.9	2.0	1.1
Exports, f.o.b.	20.2	16.5	14.9	16.1	14.3	9.2	8.3
Of which: petroleum	19.1	15.7	13.9	14.9	13.0	7.7	6.8
Imports, f.o.b.	-12.4	-12.6	-6.8	-7.3	-7.3	-7.2	-7.2
Nonfactor services, net	-4.2	-5.0	-1.9	-1.8	-1.7	-1.5	-1.5
Freight and insurance	-1.0	-1.0	-0.6	-0.4	-0.6	-0.5	-0.5
Travel	-2.1	-2.5	-0.6	-0.6	-0.6	-0.4	-0.4
Other	-1.1	-1.5	-0.7	-0.8	-0.6	-0.7	-0.7
Investment income, net	-1.1	-1.5	-2.4	-2.4	-1.9	-1.3	-1.3
Of which: interest payments accrued	4.3	3.7	3.7	4.1	3.5	2.7	2.7
Transfers, net	-0.4	-0.6	-0.2	-0.1	-0.1	-0.1	-0.1
Capital account	-0.8	-3.6	-4.8	-3.5	-2.5	-2.8	-2.7
Medium- and long-term capital	1.4	2.3	-0.6	-2.2	-2.3	-2.5	-2.5
Public sector debt, net	0.4	1.4	0.5	-0.4	-1.0	-1.1	-1[illegible]
Disbursement	1.3	3.4	1.5	0.5	--	0.3	0.[illegible]
Amortization	-0.9	-2.0	-1.0	-0.9	-1.0	-1.4	-1.4
Scheduled	-0.9	-2.0	-2.9	-3.0	-3.5	2.4	2.4
Refinanced	--	...	1.9 3/	2.1 3/	2.5	1.0	1.0
Other public sector	0.4	0.7	-0.3	-0.5	--	-0.3	-0.3
Private sector	0.6	0.2	-0.8	-1.4	-1.3	-1.1	-1.1
Direct investment	0.2	0.3	0.1	--	0.1	--	--
Other	0.4	-0.2	-0.9	-1.4	-1.4	-1.1	-1.1
Short-term capital	-2.2	-5.9	-4.2	-1.2	-0.1	-0.3	-0.2
SDR allocation	0.1	--	--	--	--	--	--
Net errors and omissions	-0.8	-1.9	-1.2	0.8	0.5	--	--
Overall balance	0.6	-8.7	-2.4	1.8	1.1	-3.7	-4.5
Financing	-0.6	8.7	2.4	-1.8	-1.1	3.7	4.5
Net international reserves (increase -)	-0.6	8.3 4/	-0.3	-1.9	-1.8	3.9	4.7
Change in arrears stock 2/	--	0.4	2.7	0.1	-1.2	-2.2	-2.2
Arrears refinancing	--	--	--	--	1.8	2.0	2.0

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

1/ Totals may not add due to rounding.
2/ Fund staff estimates.
3/ Rollover of medium- and long-term debt to financial institutions.
4/ Excludes US$2,955 million from revaluation of gold holdings.

Table 4. Venezuela: Summary Accounts of the Banking System

	1981	1982	1983	1984	1985	Proj. 1986 1/
	(Annual flows in billions of bolivares)					
Net foreign assets	5.7	-8.8	8.9	13.0	9.1	-20.9
Net domestic assets 2/	21.0	25.4	20.4	2.0	11.1	59.9
Net credit to public sector	2.1	7.8	6.3	-16.4	-8.1	32.8
Credit to private sector	16.8	20.1	5.3	15.7	15.5)	
Other 2/	2.1	-2.5	8.8	2.7	3.7)	27.2
Medium- and long-term foreign liabilities	1.7	4.1	0.5	1.7	4.4	--
Liabilities to private sector	24.9	12.5	28.8	13.3	15.8	39.0
Of which: money and quasi-money 3/	20.3	9.4	25.4	12.7	16.7	36.1
	(Annual percentage change in relation to liabilities to private sector at the beginning of the period)					
Net domestic assets	14.7	16.7	12.4	1.0	5.4	27.0
Net credit to public sector	1.6	5.1	3.8	-8.5	-3.9	14.8
Credit to private sector	13.0	13.3	3.2	8.1	7.5	...
Liabilities to private sector	17.7	8.2	17.6	6.9	7.7	17.6
	(Flows as percent of nonpetroleum GDP)					
Net domestic assets	10.1	11.2	8.8	0.8	3.8	18.0
Net credit to public sector	1.0	3.4	2.7	-6.3	-2.8	9.9
Credit to private sector	8.1	8.9	2.3	6.1	5.3	...
Liabilities to private sector	11.0	5.5	12.4	5.1	5.4	11.7
Money and quasi-money	9.8	4.1	10.9	4.9	5.7	10.9
Memorandum items						
Liabilities to private sector (in billions of bolivares)	151.7	164.2	193.0	206.3	222.1	261.1
Money and quasi-money (annual percentage change)	17.7	6.9	17.5	7.2	9.1	18.1
Excess reserves held by commercial banks (in billions of bolivares)	3.7	2.3	8.3	2.3	5.2	...

Sources: Central Bank of Venezuela; Statistical Appendix Table 33; and Fund staff estimates.

1/ Projections of the Quantified Economic Program.
2/ Includes counterpart unrequited foreign exchange and valuation adjustments.
3/ Comprises currency in circulation, demand, time, and savings deposits, and mortgage and finance bonds.

Early in 1983 the authorities started negotiations with foreign banks on a rescheduling of Venezuela's public and publicly guaranteed external debt. They also announced that the private sector would have access to foreign exchange at preferential rates for the servicing of certain external debts contracted before February 1983, provided that these debts were approved and registered by the Exchange Differential Office (RECADI). The registration process proceeded at a slow pace and during 1983 and 1984 the private sector accumulated external arrears of about US$3 1/2 billion, including about US$1/2 billion in unpaid interest. Toward the end of 1984, however, interest payments on private debt began to pick up and actual payments reached about the level of accruals.

2. Developments in 1985 and Performance under the Quantified Economic Program

The 1985 Quantified Economic Program of the authorities aimed at achieving a moderate recovery in economic activity and a reduction in the rate of inflation, while maintaining a surplus in the external current account. The program contemplated a strong rise in public capital expenditure and a shift in the overall balance of the consolidated nonfinancial public sector from a surplus of 5 percent of GDP in 1984 to a small deficit in 1985. Monetary policy was to seek an increase in domestic credit of about 20 percent during 1985. In the external area, the program envisaged the unification of all controlled exchange rates by the end of 1985, except for the Bs 4.30 per U.S. dollar exchange rate applicable to eligible external debt amortization payments. Reflecting an expected recovery in imports, the external current account surplus was projected to decline from more than US$4 billion in 1984 to US$1.7 billion in 1985. Public sector external debt was to be reduced further on a net basis and the net official reserves were projected to decline by almost US$2 billion.

Because of delays in the implementation of the public investment program, public sector capital expenditures were lower than had been projected for 1985 (even though investment accelerated toward the end of the year). In addition, public sector revenues--despite lower petroleum receipts--were slightly higher than had been expected because of improved income tax administration, higher excise taxes and stamp duties, and larger than planned operating surpluses of the public enterprises. As a result, the consolidated public sector registered a surplus of almost 3 percent of GDP in 1985 instead of moving into deficit (Table 5).

Monetary policy was less expansionary than programmed because of the strength of the fiscal position and the buildup of excess reserves by commercial banks, apparently reflecting low private sector demand for credit. Thus, overall banking system credit and broad money expanded by only about 5 1/2 percent and 8 percent, respectively, in 1985, compared with 20 percent and 15 percent planned under the program. In view of the decline in domestic inflation and in international interest rates, the Central Bank lowered domestic interest rates in March, May, and October 1985 by a cumulative 2-3 percentage points; at the end of 1985 commercial banks' average time deposit and average lending rates were about 8 percent and 13 percent, respectively, and the Central Bank rediscount rate was 8 percent. Agricultural sector loans continued to carry a preferential rate of 8 1/2 percent.

Table 5. Venezuela: Performance Under the 1985 Quantified Economic Program Targets

	1984	1985	
		Prog.	Prel.
(In billions of bolivares)			
Consolidated public sector balance	17.1	-2.6	10.7
(In billions of U.S. dollars)			
External current account balance	4.5	1.7	3.1
of which: exports, f.o.b.	16.1	15.2	14.3
imports, c.i.f.	7.3	8.5	7.3
Change in net official reserves	1.9	-1.9	1.8
(In percent of GDP)			
Consolidated public sector balances	4.9	-0.7	2.8
External current account balance	8.4	2.9	5.9
(In percent of stock of bank liabilities to the private sector at the beginning of the year)			
Banking system net domestic assets	1.0	20.4	5.4
Net bank credit to the public sector	-8.5	5.5	-3.9
Liabilities to the private sector	6.9	15.3	7.7

Source: Central Bank of Venezuela; SM/85/115 and SM/85/308.

With fiscal and credit policies more restrictive than initially planned, the external current account recorded a surplus of over US$3 billion (6 percent of GDP) compared with one of US$1.7 billion contemplated in the economic program. Petroleum export earnings continued to drop, but the decline in foreign interest rates led to lower interest payments and imports were below projection. The public sector continued to make net repayments on its external debt and the overall balance of payments registered a surplus of US$1.1 billion. Net official reserves rose to US$15.5 billion at the end of 1985, or the equivalent of more than two years of imports. External arrears on private sector debt service were reduced by about US$1.2 billion in 1985, mainly as a result of refinancing, and by the end of the year total arrears were estimated at US$2 1/2 billion, with unpaid interest on the part of the private sector of less than US$100 million (Table 6).

The review of private debt outstanding as of February 1983 for the purpose of determining who would have access to the preferential exchange rate was completed toward the end of 1985. Debt approved for servicing at the preferential exchange rate amounted to US$6.9 billion. An additional US$1.9 billion of debt was not eligible for the preferential exchange rate because it was matched by assets held abroad. The debt approved for preferential exchange rate treatment included about US$1.6 billion which had already been amortized through the free exchange rate market in the period February 1983 to February 1984; in this last-mentioned case, the former debtors are to be reimbursed in bolivares for the difference between the free market rate at the time of payment and the preferential rate of Bs 4.30 per U.S. dollar. Foreign exchange at the preferential exchange rate for amortization payments is to be released by the Central Bank on a five-year schedule. This does not apply, however, to debts guaranteed by foreign official agencies and to outstanding debts of less than US$500,000 million (about US$0.5 billion in total), which will be paid as originally scheduled. The Central Bank is now in the process of entering into contracts with individual debtors to provide foreign exchange for amortization of registered debt over the five-year period. At the end of March 1986 contracts representing debts amounting to about US$3 billion had been signed and, according to the authorities, the remaining contracts will be completed in about three to four months.

At the end of 1985 the authorities transferred to the Bs 7.50 per U.S. dollar exchange rate all current transactions that had previously been carried out at more appreciated rates. This brought the cumulative average depreciation of the bolivar in terms of U.S. dollars since February 1983 to 46 percent. The free market exchange rate averaged about Bs 14 per U.S. dollar in 1985, but it moved to about Bs 19-20 per U.S. dollar by the end of the first quarter of 1986, following the weakening in the world oil market. The staff has estimated that transactions in the free exchange market represent about 15 percent of all foreign exchange transactions. A recent central bank regulation designed to curb capital outflows restricts banks and brokerage houses

Table 6. Venezuela: External Debt

(In millions of U.S. dollars)

	1982	1983	1984	Prel. 1985	Proj. 1986
Total debt (year-end)	36,790	35,026	32,819	32,115	29,792
Public sector	28,000	27,616	25,639	24,995	23,892
Medium- and long-term	...	18,178	16,859	24,995	23,892
To official creditors	...	683	478	380	609
To private creditors	...	17,495	16,381	24,615	23,283
Financial institutions	...	15,051	14,746	23,255	22,326
Other	...	2,444	1,635	1,360	957
Short-term	...	9,438	8,780	--	--
Private sector 1/	8,790	7,410	7,180	7,120	5,900
Financial institutions	6,460	5,520	5,590	5,550	4,690
Other	2,330	1,690	1,590	1,570	1,210
Debt service 2/	6,526	6,039	6,430	5,931	5,207
Amortization	2,832	2,355	2,283	2,428	2,465
Public sector 3/	2,032	945	873	1,018	1,417
Private sector 4/	800	1,410	1,410	1,410	1,048
Interest	3,694	3,684	4,147	3,503	2,742
Public sector	2,981	2,975	3,454	2,973	2,293
Private sector	713	709	693	530	449
Stock of arrears	825	3,497	3,603	2,426	201
Public	825	945	--	--	--
Interest	400	175	--	--	--
Principal 4/	425	770	--	--	--
Private	...	1,842	3,263	2,426	201
Interest	...	432	443	64	--
Principal 1/4/	...	1,410	2,820	2,362	201
Commercial arrears	--	710	340	--	--
Memorandum item					
Debt service ratio (percent) 5/	37.1	37.7	38.0	38.9	55.1

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

1/ Gross debt (i.e., includes US$1,890 million of nonregistered debt, equivalent to assets held abroad).
2/ Excluding the rollover of short-term debt, but including interest on short-term debt.
3/ After rescheduling, before renegotiation of rescheduling agreement.
4/ Includes arrears incurred on medium- and long-term debt.
5/ In relation to exports of goods and nonfactor services.

operating in the parallel market to those with 100 percent local ownership. The new regulation also requires brokers to register with the Central Bank and submit the names of clients and amounts for foreign exchange bought and sold.

After several years of decline, real nonpetroleum GDP leveled off in 1985 as recoveries in manufacturing (3 percent) and agriculture (7 percent) offset continuing drops in construction and services. However, with the acceleration of public investment, construction and service activities strengthened somewhat in the second half of 1985. The recovery of agricultural output was aided by increases in support prices, and subsidies for fertilizers.

Consumer prices rose by 9 percent during 1985, compared with the authorities' original projection of 13 percent. Although this better-than-expected price performance seems to have mainly reflected demand conditions, it also may have been influenced by the tightening of price controls. This tightening of controls continued during the early months of 1986. In 1985, 20 items were added to the 150 items or group of items that require approval by the Price Control Commission (CONACOPRESA), and in January 1986 the authorities froze prices of 30 essential commodities within that group. The freeze took place after prices of these commodities had been adjusted to reflect the effect of the transfers of the remaining import transactions to the Bs 7.50 per U.S. dollar exchange rate. Prices of commodities not subject to prior approval by CONACOPRESA may be raised only after notification to the Ministry of Development and provided the Ministry does not object within 90 days. If requested by the Ministry, producers or importers are to provide written justification for applications for price increases and the Ministry has up to a further six months to decide.

Late last year the authorities decreed wage increases in the range of 10 percent to 20 percent (effective January 1, 1986) for all workers not covered by collective bargaining arrangements. 1/ This was the first general wage increase since 1980. The increase averaged 12 1/2 percent and affected 1.38 million workers in the private sector and 0.27 million workers in the public sector, or about one third of the Venezuelan labor force. Private employers could seek an exemption from the adjustment if they could demonstrate that the rise in costs would result in a serious deterioration in their financial position, but in such cases a six-month ban on layoffs was to be enforced. In the Central Government, wages of blue-collar workers, which are determined by collective bargaining, had increased by 12 percent in 1983 and by

1/ In the urban sector, the adjustments comprise increases of 20 percent on wages and salaries of up to Bs 2,000 per month, 15 percent on those between Bs 2,000 and Bs 4,000 per month, and 10 percent on those between Bs 4,000 and Bs 6,000 per month. In the rural sector, the increases are 10 percent on wages and salaries up to Bs 3,000 per month and 7 1/2 percent on those between Bs 3,000 and Bs 4,000 per month.

5 percent a year in 1984 and 1985. By contrast, government white-collar employees had received no wage adjustment since 1981. Minimum wages were accepted in October 1984 for the rural sector and in February 1985 for the urban sector. The available information suggests that average real wages of all workers not subject to collective bargaining had declined by 15-20 percent in the period 1982-85.

Together with the general wage adjustment, the Government introduced producer subsidies for wheat and milk to reduce the impact on consumer prices of the elimination of the Bs 4.30 per U.S. dollar exchange rate for imports. To finance these increased expenditures, the authorities at the same time raised domestic gasoline prices by 25 to 30 percent to the equivalent of US$0.66-US$0.76 per gallon at the Bs 7.50 per U.S. dollar exchange rate.

The multiyear restructuring agreement of Venezuela's public sector external debt with foreign commercial banks was signed on February 26, 1986. The agreement covers public and publicly guaranteed debt falling due during 1983-88, which amounts to US$20.9 billion (some 90 percent of the outstanding debt with banks and 85 percent of the total public debt). Under the agreement, amortization payments will be stretched over an 11-year period starting in 1987 and interest payments will be based on LIBOR plus 1 1/8 percentage points. The final agreement rephased some US$0.9 billion of amortization payments that had previously been scheduled for late 1985 and 1986 in the preliminary agreement with the banks last year. An initial downpayment of US$750 million is due on ratification of the agreement, which is expected early in the second half of 1986.

The World Bank has not been involved heavily in Venezuela in recent years as Venezuela did not qualify for World Bank lending because of its relatively high per capita income. The Bank, however, is reconsidering the question of eligibility for IBRD financing, in view of the recent decline in per capita income. The last economic mission took place in 1983. Several technical assistance missions were fielded in 1985, and the Venezuelan authorities recently requested technical assistance in the area of trade policies with a view to rationalizing the structure of protection and possibly to eliminating quantitative restrictions. The study started in late March and the report is to be completed in about six months.

III. Medium-Term Outlook

The recent sharp drop in oil prices has weakened Venezuela's economic outlook considerably. Assuming an oil price in the range of US$13-15 per barrel, total exports are estimated to decline by US$5-6 billion in 1986, a reduction of more than 40 percent from last year and the equivalent of 10-12 percent of GDP. This follows a drop of 30 percent in the U.S. dollar value of oil exports during the four years 1982-85.

The mission revised the medium-term projections presented in the last staff report to take into account the balance of payments outcome for 1985 and the most recent WEO projections on foreign interest rates and foreign trade prices. For oil exports, the mission assumed an average f.o.b. price of US$13.2 per barrel for 1986 (which was the latest realized price for Venezuela's oil exports), an unchanged nominal price for 1987, an unchanged price in real terms thereafter, and a constant volume through 1988 with a moderate increase afterwards. On the basis of these revised assumptions and without a change in policies, Venezuela's balance of payments would register sizable deficits and the country's reserves would come under severe pressure.

The mission prepared an alternative scenario as a framework for the discussion with the authorities. This scenario assumes the early adoption of policies aimed at adjusting the economy over the next two to three years to the lower oil export receipts, and at promoting structural change in order to facilitate a resumption of sustainable growth. If such policies were adopted, nontraditional exports could be expected to pick up significantly, reflecting improved competitiveness, increased private investment, and a better allocation of resources. In regard to public sector external debt, the authorities' minimum objective of maintaining roughly a constant level of debt from 1987 onward was assumed. Under these assumptions and on the basis of demand policies that would narrow the consolidated public sector deficit to around 2 percent of GDP by 1988 (see below, page 21) the external current account deficit could be virtually eliminated and official international reserves could stabilize at around US$8 billion (the stated goal of the authorities) by 1989. According to these projections, economic growth would resume in 1988 and the external debt service burden would come down from the peak reached in 1986 (Tables 7 and 8).

The above scenario is highly sensitive to the oil price assumption. A change of US$1 a barrel in the export price of oil affects export earnings and public sector revenue by US$1/2 billion, or the equivalent of about 1 percent of GDP. Other variables will depend to an important degree on economic policies being pursued over the medium term. In particular, the projected resumption of private sector gross foreign borrowing during the period 1987-90, the increase of about US$1 1/2 billion in non-oil exports, and a change in debt policies will depend critically on the perception that the authorities have dealt promptly and effectively with the difficult situation confronted by Venezuela in the wake of the oil price reduction of recent months.

IV. Summary of Policy Discussions

The discussions with the Venezuelan authorities centered on the policies needed to adjust the economy in order to ensure achievement of a sustainable balance of payments and growth over the medium term. The authorities indicated that in their view a large part of the recent

Table 7. Venezuela: Medium-Term Balance of Payments Projections

	Prel. 1985	Projected 1/ 1986	1987	1988	1989	1990
	(In billions of U.S. dollars)					
Current account balance	3.1	-1.8	-1.2	-0.4	-0.1	0.1
Exports	14.3	8.3	8.6	9.9	10.7	11.6
Of which: petroleum	13.0	6.8	6.8	7.7	8.2	8.8
Imports	-7.3	-7.2	-7.2	-7.6	-8.2	-8.9
Nonfactor services (net)	-1.7	-1.5	-1.3	-1.2	-1.1	-1.0
Investment income (net)	-1.9	-1.3	-1.2	-1.4	-1.4	-1.5
Transfers	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2
Capital account	-2.0	-2.5	-0.1	-0.2	-0.6	-0.4
Direct investment	0.1	0.1	0.3	0.4	0.5	0.5
Medium- and long-term capital	-2.5	-2.0	-0.2	-0.3	-0.8	-0.5
Public sector 2/	-1.0	-1.4	0.3	0.2	-0.2	0.1
Private sector	-1.4	-1.1	-0.5	-0.5	-0.6	-0.6
Short-term capital 3/	0.4	-0.2	-0.2	-0.3	-0.3	-0.4
Overall balance	1.1	-4.3	-1.3	-0.7	-0.7	-0.3
Change in reserves	-1.8	4.5	1.3	0.7	0.7	0.3
Memorandum items						
Current account balance as percent of GDP	5.9	-3.6	-2.1	-0.7	-0.2	0.2
Net international reserves	15.5	11.0	9.7	9.0	8.3	8.0
In months of imports	25.3	18.3	16.2	14.2	12.2	10.8
	(Percentage changes, unless otherwise indicated)					
Principal assumptions						
Real non-oil GDP growth	-0.4	--	--	2.0	3.0	3.5
Petroleum exports						
Volume (mbd)	1.37	1.41	1.41	1.41	1.44	1.47
Price (US$ per barrel)	25.9	13.2	13.2	15.0	15.7	16.4
Other exports						
Volume	26.8	9.1	13.6	13.6	8.8	8.8
Unit value	-1.4	6.4	5.3	4.5	4.5	4.5
Non-oil sector imports						
Volume	2.0	-8.0	-6.0	2.0	3.0	4.0
Unit value	-1.4	6.4	5.3	4.5	4.5	4.5
Terms of trade	-1.6	-42.5	-4.0	6.8	--	--
LIBOR interest rate	8.6	7.4	7.5	8.0	8.0	8.0

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

1/ Assumes the early adoption of adjustment measures.
2/ Assumes no net repayment of debt to commercial banks during 1987-90.
3/ Includes net errors and omissions.

Table 8. Venezuela: Medium-Term External Debt Projections

	Prel. 1985	Proj. 1986	1987	1988	1989	1990
	(In billions of U.S. dollars)					
Total debt service payments 1/	5.9	5.2	5.0	5.4	5.8	5.8
Public sector 2/	4.0	3.7	3.6	4.0	4.3	4.2
Principal	1.0	1.4	1.5	1.8	2.0	2.0
Interest	3.0	2.3	2.1	2.2	2.2	2.2
Private sector	1.9	1.5	1.4	1.4	1.5	1.6
Principal	1.4	1.0	1.0	1.0	1.1	1.2
Interest	0.5	0.4	0.4	0.4	0.4	0.4
	(As percent of export of goods and nonfactor services)					
Total debt service ratio	38.9	55.1	49.7	46.9	45.4	41.6
Public sector	26.2	39.2	35.9	34.5	33.6	30.3
Private sector	12.7	15.8	13.9	12.3	11.8	11.3
Amortization	15.9	26.1	24.7	24.0	24.7	23.0
Interest	23.0	29.0	25.0	22.8	20.7	18.6
Interest in percent of GDP	6.6	5.3	4.6	4.6	4.2	3.9
	(In billions of U.S. dollars)					
Total debt outstanding	32.1	30.5	30.4	30.4	30.0	30.0
Public sector	25.0	23.9	24.2	24.5	24.4	24.5
Private sector	7.1	6.6	6.1	5.9	5.7	5.4
	(In percent of GDP)					
Total debt outstanding	60.6	59.5	56.3	52.8	48.2	44.5
Public sector	47.2	46.6	44.9	42.5	39.2	36.4
Private sector	13.4	12.9	11.4	10.3	9.1	8.1

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.
2/ After multiyear rescheduling with foreign commercial banks.

decline in oil prices was of a permanent nature and that policies should not be based on the expectation of a significant recovery of oil prices in the near future.

In view of the relatively high level of Venezuela's international reserves, however, the authorities felt that Venezuela was in a position to avoid an abrupt adjustment to the latest drop in oil prices. Moreover, they indicated that a change in external debt policy with a view to at least maintaining the present level of external public debt (rather than reducing it as had been planned up to now) could mitigate the impact of the decline in export revenues. The authorities noted that economic growth and the reduction of unemployment remained their primary concern, and the Government's intention was to go ahead during 1986 with the first stage of a three-year special public investment plan. In the authorities' view the public sector disequilibrium this year is quite manageable.

The authorities explained, nevertheless, that the cabinet was studying adjustment measures to meet the new situation created by the drop in oil revenues. In this context, they said that the 1986 Quantified Economic Program presented to the staff should be taken as a preliminary document, possibly subject to modifications in the course of the year.

1. The 1986 Quantified Economic Program

The program aims at providing a stimulus to economic activity, while limiting the loss of official reserves to US$3.9 billion. It projects no change in real GDP for the non-oil sector 1/ and domestic inflation of 12 percent, up from 9 percent during 1985. Because of the planned increase in public sector capital outlays, total public expenditures are projected to grow by 20 percent in 1986, leading to an overall public sector deficit of almost Bs 40 billion or about 9 1/2 percent of GDP. 2/ Financing is to be provided by a drawdown of public sector deposits in the banking system and by use of about US$1 billion of the Venezuelan Investment Fund's foreign reserves. The public sector's financing needs and a planned increase in credit to the private sector are expected to result in a significant acceleration in overall domestic bank credit. On external policies, the program envisages some transfer of import transactions from the controlled to the free foreign exchange

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1/ Although the official quantitative projections indicate no increase in non-oil real GDP, the authorities said that they could expect up to 2 percent growth in 1986.

2/ The estimate of a deficit of 9 1/2 percent of GDP is that of the staff. The official presentation indicates a deficit of 7 percent of GDP because the authorities regard the revaluation of central bank external reserve holdings as public sector revenue rather than financing.

market, and a continued wide spread between exchange rates in the controlled and free markets. Controls in the form of foreign exchange budgets for imports and other foreign transactions are to be tightened, but all remaining private sector external arrears are to be eliminated through rescheduling or cash payments. The main quantitative quarterly projections of the program are presented in Table 9, and the economic policies behind these projections are discussed in the following sections.

Table 9. Venezuela: Targets of the 1986
Quantified Economic Program

	1985	1986			
	Dec.	Mar.	June	Sept.	Dec.
(In billions of U.S. dollars)					
Net international reserves (Central Bank and VIF)	15.5	15.3	13.7	12.5	11.6
Outstanding public external debt	25.0	24.8	24.2	23.8	23.9
Cumulative private sector amortization payments	...	0.1	0.6	0.9	1.2
(In billions of bolivares)					
Broad money 1/	193.0	196.9	208.8	216.6	228.2
Monetary base	46.5	43.9	43.4	41.3	48.6
Public sector net financing needs 2/	...	-7.9	5.6	20.7	33.7
(Annual rates of increase, in percent)					
Broad money	8.7	11.1	15.7	18.6	18.2
Consumer price index	9.1	7.4	8.8	10.2	10.6
Wholesale price index	13.1	12.2	12.8	14.5	15.3

Source: Central Bank of Venezuela.

1/ Comprises currency in circulation and demand, time, and savings deposits.
2/ Excludes nonfinancial public enterprises.

2. External prospects and policies

Based on a realized oil price of US$15 per barrel f.o.b. and an oil export volume of 1.41 million barrels a day, the authorities expect the value of petroleum exports to decline from US$13 billion in 1985 to US$7.7 billion this year. As indicated earlier, the mission took a more cautious approach and based its projection for 1986 on a price of US$13.2 per barrel, which corresponds to the conservative scenario of the Venezuelan National Petroleum Company. On this last-mentioned assumption, exports in 1986 would be about US$1 billion lower than the official projections.

The authorities project an external current account deficit of close to US$1 billion in 1986, compared with a US$3 billion surplus in 1985. The drop in oil export revenues is expected to be partly offset by slightly higher non-oil exports, lower nonfactor payments, and lower net interest payments on external debt because of the decline in foreign rates and the narrowing of spreads incorporated in the rescheduling agreement. Imports are projected to remain constant in U.S. dollar terms in 1986 for the third consecutive year. The capital account is expected to register a deficit of about US$2.8 billion, reflecting the US$750 million downpayment contemplated in the rescheduling agreement as well as scheduled amortization payments on the registered private external debt. As a result, official reserves are projected to decline by about US$3.9 billion in 1986. Based on the lower oil price, the staff estimated a wider current account deficit and a reserve loss of up to US$4 3/4 billion.

The authorities indicated that they plan to make every effort to save foreign exchange--including the implementation of a strict control over imports--and imports may well turn out to be lower than projected. In this respect, two ministerial commissions have been created recently to establish global limits and priorities for exchange allocations for imports of the public and private sectors, with these policies to be implemented by RECADI. The authorities pointed out that, in addition to the objective of conserving foreign exchange, import controls will continue to be aimed at promoting import substitution by domestic industry. They observed that the public investment program was not likely to be affected by the tightening of import restrictions because its import content is low. In addition to tightening restrictions, the authorities are also taking steps to encourage use of foreign financing. A recent regulation requires that only 20 percent of the foreign exchange value of private sector imports will be provided by the Central Bank upon an exchange approval of import applications by RECADI, with the remainder released only after custom clearance.

The staff stressed to the authorities that the use of import and exchange controls to limit domestic policy adjustments and to shield the exchange rate from market pressures would impede the adjustment that was needed to restore economic growth. The staff noted that oil export earnings in 1986 were expected to be lower in real terms than the 1973 levels, and yet the average real effective value of the bolivar was more appreciated at present than in the early 1970s. Moreover, the present multiple exchange system was not conducive to economic diversification, as the wide spread between the preferential and the free market rates (presently about 150 percent) led to misallocation of resources through arbitrage and illegal activities. Although part of the value of non-oil exports are channeled through the free exchange market, 1/ investment in this sector is discouraged by both the uncertainty as to whether such treatment will continue over the medium term and the export controls and regulations that are employed to operate the multiple rate system. The present exchange and trade system provides major assistance to those sectors in which imports are prohibited, thereby fostering high rents and inefficiency, and little or even negative protection to those sectors competing with imports at the controlled rate.

The authorities reiterated their intention to unify the exchange system but only at a later stage, noting that rapid progress in this area could not be expected in light of the unsettled conditions in the world oil market. Also, they expressed concern about the impact of any change in the controlled exchange rate on the cost of living and on real wages. Nonetheless, they were planning to transfer some import transactions to the free market, while at the same time increasing central bank sales of exchange in that market. However, the magnitude of such transfers in 1986 was expected to be quite small.

On external debt policy, the authorities explained their intention, in view of the major change in the international oil prices, to invoke a so-called contingency clause under the rescheduling agreement with the commercial banks in order to renegotiate the terms of the agreement. They said that their proposal would be to defer the amortization payments due over the next three to five years or to arrange for new balance of payments loans in an equivalent amount. The mission made the point that the adoption of a comprehensive adjustment program to deal with the difficulties caused by the drop in oil prices would facilitate the development of suitable external financing arrangements.

The mission welcomed the progress that had been made in registering the private external debt, but it urged the authorities to speed up the process of authorizing contracts by the Central Bank and of making payments to eliminate promptly all external arrears. The restoration of the private sector's access to external commercial credits depended in part on whether the problem of arrears was dealt with in a satisfactory manner.

1/ Exporters are allowed to sell in the free exchange market the proceeds equivalent to the domestic value added plus one half of the import content of exports. The import content of exports is determined on a case by case basis by the Institute of Foreign Trade (ICE) using import coefficients determined for a number of different categories of inputs.

In this connection, the staff noted that the subsidy implied by channeling registered private debt amortization payments through the Bs 4.30 per U.S. dollar exchange rate was placing a burden on the public finances. If the controlled exchange rates were to be adjusted in view of the change in the country's balance of payments situation, the subsidy would become even more onerous. Therefore, consideration should be given to adjusting the subsidized exchange rate with any change of the controlled rate. If special support to certain financial institutions and private enterprises were deemed necessary, it would seem advisable to do it only on a case-by-case basis.

3. Fiscal policy

The authorities' fiscal program for 1986 contemplates a sharp shift in the financial position of the consolidated public sector, from a surplus of nearly 3 percent of GDP in 1985 to a deficit of 9 1/2 percent of GDP this year. On the basis of the mission's lower oil price assumption the deficit in 1986 would reach more than 11 percent of GDP.

Public sector revenues are officially estimated to decline from the equivalent of 35 1/2 percent of GDP in 1985 to 27 percent in 1986. Apart from lower oil revenues, receipts are expected to be affected adversely by lower exchange profits and by a projected decline in the current surplus of the public enterprises because of higher operating costs (including wages and goods and services). However, these revenue losses are expected to be offset in part by certain measures taken in early 1986, including an increase in domestic gasoline prices, the application of income tax withholding on interest income, and increases in some customs and stamp fees.

Public sector expenditure is projected to increase from 32 3/4 percent of GDP in 1985 to 36 1/2 percent of GDP in 1986 according to official estimates. The program calls for continuing strong increase in capital outlays, or from 13 1/2 percent of GDP in 1985 to almost 18 percent in 1986. Almost three fifths of the increase in capital expenditures will be accounted for by the 1986 stage of the three-year special investment plan. The plan includes projects geared to the export sector, such as aluminum and steel; agricultural infrastructure; and construction of low-income housing and other labor intensive activities. Current expenditures of the public sector are projected to increase by less than inflation, as a higher wage bill and increases in subsidies will be partly offset by lower foreign interest payments and reduced transfers to the nonconsolidated public sector.

The mission expressed its concern about the size of the projected deterioration of the public finances, and it observed that the present fiscal policy stance cannot be sustained for long. The experience of the early 1980s had shown that expansionary policies, once set in motion, were difficult to reverse. The staff estimated that to achieve a viable balance of payments position within two to three years, the consolidated public sector deficit would need to be reduced to around

2 percent of GDP. Such a fiscal deficit would seem to be consistent with approximate balance in the external current account, in line with the long-term relationship between these variables. In recent years the rest of the economy has generated a large excess of savings over investment. As private sector investment recovers, this excess is expected to decline, thus returning the relationship between the fiscal balance and the external current account to their long-term trend. The mission suggested that the public sector deficit be held to about 6-8 percent of GDP in 1986 and brought down to 2-3 percent of GDP in 1987. This would require the adoption of corrective revenue and expenditure measures equivalent to at least 7 percent of GDP on an annual basis in the course of 1986.

The mission noted that a change in the controlled exchange rate would have a positive net effect on the overall fiscal position, and that additional revenue measures could include the prompt implementation of the recommendations of the 1983 Tax Reform Commission (introduction of a general sales tax, modification of the personal and corporate income taxes, and reassessment of property values), as well as adjustments of prices and tariffs of various public enterprises. On the expenditure side, the staff recognized that certain investment projects were necessary to foster the restructuring of the economy. However, the mission also observed that the capital outlays planned for 1986 could be scaled down considerably without seriously affecting short-term growth prospects.

The authorities indicated that the mission's suggestions would be studied by the cabinet and that decisions were likely to be taken in the next few months.

4. Monetary policy

The official view is that monetary policy during 1986 should accommodate the domestic financing requirements of the public sector and provide room for an expansion in real terms of credit to the private sector. Banking system overall credit is projected to grow by 27 percent (29 1/2 percent under the lower oil price assumption) of the initial stock of bank liabilities to the private sector, compared with 5 1/2 percent during 1985. The authorities have programmed an increase in broad money of 18 percent during 1986.

The mission indicated that growth of the demand for money would probably be lower than that of nominal nonpetroleum GDP, given the sharp decline in the country's income and the uncertainties surrounding future developments in the domestic economy. Therefore, an overall credit expansion of the magnitude proposed under the authorities' monetary program was likely to result in a higher-than-targeted loss of official reserves or an intensification of inflationary pressures, depending on the strength of import and exchange controls. The mission suggested targeting an increase in broad money of no more than 12 percent during 1986, and limiting overall credit expansion to about 20 percent. If the

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2 percent of GDP. Such a fiscal deficit would seem to be consistent with approximate balance in the external current account, in line with the long-term relationship between these variables. In recent years the rest of the economy has generated a large excess of savings over investment. As private sector investment recovers, this excess is expected to decline, thus returning the relationship between the fiscal balance and the external current account to their long-term trend. The mission suggested that the public sector deficit be held to about 6-8 percent of GDP in 1986 and brought down to 2-3 percent of GDP in 1987. This would require the adoption of corrective revenue and expenditure measures equivalent to at least 7 percent of GDP on an annual basis in the course of 1986.

The mission noted that a change in the controlled exchange rate would have a positive net effect on the overall fiscal position, and that additional revenue measures could include the prompt implementation of the recommendations of the 1983 Tax Reform Commission (introduction of a general sales tax, modification of the personal and corporate income taxes, and reassessment of property values), as well as adjustments of prices and tariffs of various public enterprises. On the expenditure side, the staff recognized that certain investment projects were necessary to foster the restructuring of the economy. However, the mission also observed that the capital outlays planned for 1986 could be scaled down considerably without seriously affecting short-term growth prospects.

The authorities indicated that the mission's suggestions would be studied by the cabinet and that decisions were likely to be taken in the next few months.

4. Monetary policy

The official view is that monetary policy during 1986 should accommodate the domestic financing requirements of the public sector and provide room for an expansion in real terms of credit to the private sector. Banking system overall credit is projected to grow by 27 percent (29 1/2 percent under the lower oil price assumption) of the initial stock of bank liabilities to the private sector, compared with 5 1/2 percent during 1985. The authorities have programmed an increase in broad money of 18 percent during 1986.

The mission indicated that growth of the demand for money would probably be lower than that of nominal nonpetroleum GDP, given the sharp decline in the country's income and the uncertainties surrounding future developments in the domestic economy. Therefore, an overall credit expansion of the magnitude proposed under the authorities' monetary program was likely to result in a higher-than-targeted loss of official reserves or an intensification of inflationary pressures, depending on the strength of import and exchange controls. The mission suggested targeting an increase in broad money of no more than 12 percent during 1986, and limiting overall credit expansion to about 20 percent. If the fiscal actions the mission had suggested were taken, this credit expansion would be sufficient to accommodate the credit demand of both the public and private sectors.

The authorities reiterated their commitment to maintain positive real interest rates, and the Quantified Economic Program envisages a small increase in nominal interest rates during the year. The mission emphasized the importance of a flexible interest rate policy and encouraged the authorities to discontinue the practice of fixing maximum lending and deposit interest rates and move toward market-determined interest rates. Also, in view of the improved situation in the agricultural sector, the mission suggested that the interest subsidy for agricultural loans should be phased out.

5. Wage and price policies

The authorities said that the deceleration of price increases in 1985 was evidence of the success of their price and incomes policies. They observed that the impact of the latest transfers of import transactions from the Bs 4.30 per U.S. dollar to the Bs 7.50 per U.S. dollar exchange rate had already been reflected in prices, completing the shift in relative prices from the 1983-84 exchange rate adjustment. The authorities indicated their intention to continue to use price controls to protect consumers from price increases not justified by cost considerations. They stressed that the price control system, as a key component of the social pact, had been essential in moderating labor demands for wage increases in the past few years. In this respect, the general wage increase of January 1986 had been designed to only offset the erosion in real wages that had taken place since 1980. They emphasized, however, that future wage increases should be adjusted according to productivity increases and through a process of collective bargaining.

The mission observed that in view of the changed external circumstances, it was essential to adopt a firm wage policy to help speed up the adjustment process while avoiding an undue increase in unemployment. Furthermore, there was now even less room than previously to absorb the costs and distortions that stemmed from the widespread use of price controls. A significant reduction of price controls, and of regulations in general, should be quickly implemented to help promote private investment and to provide an environment conducive to the much needed economic diversification.

6. Structural adjustment policies

The authorities said that there was a general perception on the need to move forward in the implementation of structural reforms. They observed that trade policy is being studied in a joint project with the World Bank, and that specific recommendations, covering the level and dispersion of tariff rates and export promotion measures, should be available in a few months. The authorities also said that policies were being adapted to spur foreign investment in Venezuela. In particular, the regulations on the participation of local investors and on profit remittances had been liberalized in four sectors of the economy (construction, tourism, agriculture, and agro-industry) and further progress in this area could be expected in the context of revisions to the foreign investment code of the Andean Pact, which Venezuela was trying to obtain.

The staff welcomed the new trade policy study, noting that tariffs in recent years have virtually ceased to be an instrument of economic policy because of widespread exemptions. Instead, protection of domestic producers has been mainly provided through restricting access to preferential foreign exchange or through quantitative import restrictions. Implementation of appropriate demand management and exchange rate policies, combined with reforms in trade policy to move to a limited number of tariff levels, would pave the way for the progressive elimination of import restrictions, export licensing, and exchange controls. Such a strategy would help to create the conditions for a revival of private sector investment and production.

The mission also urged the authorities to act in other areas to deregulate the economy, in line with recommendations emerging from the Presidential Commission for the Reform of the State (COPRE), 1/ such as rent controls, at least on new construction; agrarian reforms, to confirm land titles and tenant rights, and thereby encourage investment in agriculture and facilitate access to credit; and an easing of regulations in the labor market to facilitate a more rapid creation of employment.

V. Staff Appraisal

During the period 1983-85, Venezuela made substantial progress in reducing domestic expenditure in response to a major drop in its export earnings. The actions taken included a sharp reduction in public investment, a cautious wage policy, and a substantial devaluation of the bolivar within a multiple exchange rate system. At the same time, however, comprehensive import, exchange, and price controls were applied. The public sector finances and the external current account balance shifted from large deficits in 1982 to surpluses in 1984-85. During the same period, Venezuela's net outstanding public external debt declined by about US$3 billion and its net international reserves increased to US$15 1/2 billion, or more than two years of imports. On

1/ COPRE, which was set up in early 1985, is composed of academics and representatives of private sector enterprises and labor organizations. The commission is proposing reforms over a wide range of government policies, including the legal, institutional, and economic policy areas.

the negative side, nonpetroleum GDP declined by more than 7 percent from 1982 to 1985, and unemployment rose from 7 percent to about 13 percent of the labor force.

On the assumption that oil prices would remain around US$24 per barrel over the medium term, and that an agreement on rescheduling of Venezuela's public external debt was about to be signed, the authorities shifted the thrust of policies during the course of 1985 to aim at a reactivation of the economy through an expansion in public investment and a general wage increase for workers not covered by collective bargaining agreements at the beginning of 1986.

The recent sharp drop in oil prices, however, has changed drastically Venezuela's economic outlook. On the basis of a US$13-15/bbl oil price, exports in 1986 are expected to fall 35-40 percent, or by the equivalent of 10-12 percent of GDP. The authorities' Quantified Economic Program for 1986 projects a shift in the external current account from a surplus in 1985 to a deficit in 1986, and a loss of net international reserves of US$3.9 billion. The consolidated public sector deficit is projected at some 9 1/2 percent of GDP in 1986, compared with a surplus of nearly 3 percent of GDP in 1985. The authorities' program envisages a further tightening of import and price controls, and a very wide spread between the controlled and the free market exchange rates. The staff's projections are based on somewhat lower petroleum prices and thus moderately larger imbalances.

The authorities agree that it would not be prudent to base policies on the assumption of a major recovery in oil prices over the next few years. Although Venezuela can finance expansionary demand policies for a limited period by drawing down its relatively large international reserves, the policies incorporated in the Quantified Economic Program cannot be sustained for long. If adoption of corrective measures is delayed, the consequence will be a significantly harsher adjustment at a later stage. Therefore, the staff would urge the authorities to adopt promptly a comprehensive program designed to adjust domestic expenditures to the decline in oil export revenues and to set the grounds for a resumption of growth on a sustainable basis. Such a program would need to include modifications in exchange rate and demand management policies coupled with structural reform measures.

A modification of exchange rate policies is essential to establish an appropriate relative price structure. The present multiple exchange rate system has created distortions, and the staff would urge the authorities to adjust the controlled exchange rate to a level that would improve the country's international competitiveness and to proceed quickly to unify the exchange system. Following unification, the exchange rate should be managed flexibly.

Implementation of a realistic exchange rate policy would set the stage for the adoption of reforms in trade policy and the progressive elimination of import, export, and other exchange restrictions. The trade policy study initiated with the assistance of the World Bank will be a useful point of departure for the needed reform of the import tariff structure to a few uniform tariff rates. In general, the pervasive system of controls and regulations in Venezuela has hampered private investment and has given rise to the underutilization of resources. The deregulation of the economy would enhance Venezuela's growth potential.

Exchange rate action and deregulation should be supported by prudent demand management policies. In the staff's view, the public sector deficit needs to be reduced to around 2 percent of GDP within two to three years, which would be consistent with achieving approximate balance in the external current account. Accordingly, measures should be taken without delay to secure this adjustment. For this purpose, the staff would urge the authorities to implement the reforms proposed by the 1983 Tax Reform Commission and to make further adjustments in prices and tariffs of public enterprises. It also will be necessary to slow the planned expansion of the public sector capital expenditures while containing current expenditures, including curbing the exchange subsidy on registered private sector debt service.

Monetary policies should be designed to assure the achievement of a low underlying inflation rate and the avoidance of additional balance of payments pressures. Consistent with these objectives, the growth of broad money supply should be targeted at no more than 12 percent in 1986. The staff would also encourage the authorities to abandon the practice of fixing interest rates and move toward market-determined interest rates.

The reduction in oil prices has meant that Venezuela's real income has fallen by more than 10 percent, and in these circumstances the staff would particularly stress the need to maintain a firm wage policy. This would help prevent a large increase in unemployment or an inflationary spiral during the adjustment phase.

The staff welcomes the completion of the process of registration of private external debt, and urges the authorities to expedite administrative procedures to permit the elimination of the external arrears that still remain. The early normalization of Venezuela's relations with creditors would help restore confidence and thus improve the flow of external credits.

The exchange arrangements that were introduced in 1983 included a multi-tier exchange rate system that gives rise to exchange restrictions and multiple currency practices subject to the Fund's approval under Article VIII, Sections 2(a) and 3, and restrictions on imports for balance of payments reasons. The staff urges the authorities to reduce their reliance on such measures and, in the meantime, does not propose approval of Venezuela's exchange practices.

It is recommended that the midyear consultation with Venezuela under enhanced surveillance be held in about six months.

Venezuela - Fund Relations
(As of May 31, 1986)

I. *Membership Status*

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

A. Financial Relations

II. General Department (General Resources Accounts)

(a)	Quota:	SDR 1,371.5 million
(b)	Total Fund holdings of bolivares	SDR 893.1 or 65.1 percent of quota
(c)	Reserve tranche position	SDR 478.4 million or 34.9 percent of quota
(d)	Outstanding lending to the Fund (supplementary financing facility)	SDR 230.0 million
(e)	Operational budget	SDR 31.5 (transfers); SDR 13.7 (receipts)

III. SDR Department

(a)	Net cumulative allocation	SDR 316.9 million
(b)	Holdings	SDR 481.9 million or 152.1 percent of net cumulative allocation
(c)	Current designation plan	SDR 3.7 million

IV. Administered Accounts

None

V. Venezuela has not used Fund resources to date

B. Nonfinancial Relations

VI. A simplification of the Venezuelan multiple exchange system was implemented on January 1, 1986 when the remaining imports and related services, which had access to the Bs 4.30 per U.S. dollar, and all transactions of the national petroleum and iron ore companies, which had been effected at Bs 6.00 per U.S. dooar, were shifted to the Bs 7.50 per U.S. dollar exchange rate. This completed the unification of the controlled markets for current international transactions. However, the preferential exchange rate of Bs 4.30 per U.S. dollar will still apply to amortization payments of certain approved public and private external debt. Also, the free market rate, introduced in February 1983, will still be applicable to tourism, exports other than oil and iron ore, and private capital flows other than those noted above.

VII. Last Article IV consultation was concluded on December 13, 1985 (SM/85/308 and SM/85/316). Last midyear Article IV consultation (under the enhanced surveillance procedures) was concluded on May 30, 1985 (SM/85/115). The Executive Board has not approved Venezuela's multiple currency practices. The consultation is under a 12-month cycle; under the enhanced surveillance procedures a staff report is prepared twice a year.

VIII. Technical assistance missions from the Bureau of Statistics visited Caracas in December 1984 and September 1985. The purpose of the first mission, in the fiscal area, was to help the authorities reconcile fiscal data from different sources and classify consistently the public entitites. The second mission, in the monetary area, reviewed with the authorities the reporting system and suggested changes in its presentation to improve monitoring procedures.

Venezuela--Basic Data

Area and population	
Area	912,000 sq. kilometers
Population (1985)	17.32 million
Annual rate of population increase (1979-85)	2.8 percent
GDP per capita (1985)	SDR 2,851
Origin of nominal GDP (1985)	(percent)
Agriculture	8.2
Petroleum (crude and refining) and mining	22.7
Manufacturing, construction and utilities	19.3
Commerce	12.1
Transport, storage, and communications	10.4
Government	10.6
Other services	16.7
Ratios to GDP at current prices (1985)	
Exports of goods and nonfactor services	24.4
Imports of goods and nonfactor services	17.2
Net factor receipts from abroad	-3.8
Central government revenues	28.7
Central government expenditures	26.5
External public debt (end of year)	47.2
External total debt (end of year)	60.6
Savings	23.8
Investment	16.6
Money and quasi-money (end of year)	53.0

Annual changes in selected economic indicators	1983	1984	Prel. 1985	Proj. 5/ 1986
		(percent)		
Real GDP	-5.6	-1.4	-0.4	0-2
Real GDP per capita	-7.8	-4.1	-3.1	-2.8
GDP at current prices	-0.3	19.6	8.4	7.5
GDP deflator (excluding petroleum)	8.7	13.3	13.0	14.8
Wholesale prices (annual average)	6.9	17.5	18.2	13.7
Consumer prices (annual average)	6.7	12.5	11.4	9.5
Central government total revenues (budget)	-3.7	32.4	13.6	-12.3
Central government total expenditures (budget)	-9.1	18.5	12.9	5.4
Money and quasi-money (M2)	17.5	7.2	9.1	18.1
Money	25.7	3.8	12.6	...
Quasi-money	13.5	9.5	7.3	...
Net domestic bank assets 1/	11.9	-4.7	6.1	27.0
Credit to public sector (net)	3.8	-8.5	-3.9	14.8
Credit to private sector	3.2	8.1	7.5	...
Merchandise exports (f.o.b., in U.S. dollars)	-9.8	7.8	-11.3	-35.7
Merchandise imports (f.o.b., in U.S. dollars)	-46.1	7.1	1.1	-1.4

	1983	1984	Prel. 1985	Proj. 5/ 1986
Public sector finances 2/	(billions of bolivares)			
Revenue	85.0	124.8	133.7	109.3
Expenditure (including net lending)	100.1	107.7	123.0	148.1
Current account surplus or deficit (-)	32.2	56.1	61.1	32.1
Overall surplus or deficit (-)	-15.1	17.1	10.7	-38.8
External financing (net)	1.2	-13.0	-9.1	3.0
Domestic financing (net)	13.9	-4.1	-1.6	35.8
Balance of payments	(millions of U.S. dollars)			
Merchandise exports, f.o.b.	14,919	16,084	14,272	9,247
Merchandise imports, f.o.b.	-6,778	-7,262	-7,341	-7,198
Investment income (net)	-2,372	-2,422	-1,921	-1,290
Other services and transfers (net)	-2,148	-1,935	-1,877	-1,660
Balance on current and transfer accounts	3,621	4,465	3,133	-901
Official long-term capital (net)	182	-881	-1,044	-1,378
Private long-term capital (net) 3/	-779	-1,349	-1,342	-1,001
Short-term capital and errors and omissions 4/	-5,418	-458	377	-452
Change in net international reserves (increase -)	-278	-1,883	-1,757	3,882
Change in stock of external arrears	2,672	106	-1,177	-2,132
Arrears refinancing	--	--	1,810	1,982
Official International reserves				
Central Bank (gross)	11,135	12,405	13,681	10,874
Central Bank (net)	11,110	12,382	13,658	10,851
Venezuelan Investment Fund	728	1,339	1,820	745

1/ In relation to banking system liabilities to the private sector at the beginning of the period.

2/ Comprises operations of the Central Government (including extra-budgetary operations), the Venezuelan Investment Fund, the National Petroleum Company, the nonfinancial public enterprises, and the Exchange Differentials Compensation Fund (FOCOCAM).

3/ Includes direct investment.

4/ Includes valuation changes.

5/ Official projections of the Quantified Economic Program.

Venezuela - Statistical Issues

1. Outstanding statistical issues

a. Government finance

The 1985 Government Finance Statistics Yearbook (GFSY) includes data for the consolidated central government in the derivation table and the statistical tables through 1984. For local governments the 1985 GFSY includes only aggregate data through 1979, covering only the Federal District Municipality. General government data in the GFSY may be improved if data for state governments and federal territories are reported and the coverage of the local government data is expanded to include all local governments.

b. Monetary accounts

A Bureau of Statistics mission on money and banking statistics took place during September 4-17, 1985. The objectives of the mission were to review the data compiled by the Central Bank of Venezuela (CBV) on the accounts of the financial system, with particular regard to their sectorization and classification and to the procedures used in valuing foreign currency data. A report of the mission is in preparation and will be sent shortly to the CVB authorities.

Following the recommendations of a technical assistance mission in government finance statistics, the CBV has revised its accounting system to correctly classify transactions with central government, state and local governments, and public enterprises. However, for the commercial banks and other financial institutions, the corresponding changes will have to be made by the CBV in cooperation with the Superintendency of Banks, in addition to revisions in the current call report forms, to classify foreign accounts according to residency criteria rather than, as at present, according to currency.

Regarding the Venezuelan Investment Fund (VIF), the authorities agreed that VIF's operations closely resemble those of development banks. Before including the VIF's accounts as part of the nonmonetary financial institutions in IFS several other financial and specialized funds should also be reviewed in order to explore the possibility of consolidating their accounts together with those of the VIF to create a new subsection in IFS.

The authorities requested a follow-up visit to complete the review of the other financial institutions' accounts.

c. Trade

Improvements in the currentness of trade data by partner countries have not materialized; the latest data received continue to refer to 1981.

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 March 1986 issue of *IFS*. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Venezuela, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in March 1986 IFS
Real Sector	- National Accounts	1984
	- Prices: CPI	November 1985
	WPI	October 1985
	- Production: crude petroleum	November 1985
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	October 1985
	- Financing	October 1985
	- Debt	October 1985
Monetary Accounts	- Monetary Authorities	September 1985
	- Deposit Money Banks	September 1985
	- Other Financial Institutions	September 1985
External Sector	- Merchandise Trade:	
	Value	August 1985
	Export prices--crude petroleum	July 1985
	- Balance of Payments	1984
	- International Reserves	December 1985
	- Exchange Rates	January 1986