FOR AGENDA

SM/85/308

CONTAINS CONFIDENTIAL INFORMATION

November 15, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Venezuela - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Venezuela, which is proposed to be brought to the agenda for discussion on Friday, December 13, 1985.

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

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

VENEZUELA

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the 1985 Consultation with Venezuela

Approved by E. Wiesner and S. Kanesa-Thasan

November 15, 1985

I. Introduction

This is the second report prepared under the procedures for enhanced surveillance that were proposed in September 1984 by the Venezuelan authorities. 1/ During the last Executive Board discussion, Directors approved these procedures and agreed that Venezuela could provide creditor banks with copies of the staff reports on the annual and midyear Article IV consultation discussions as well as the reports on recent economic developments, as they become available.

The Article IV consultation discussions with Venezuela and the review of performance under the authorities' 1985 Quantified Economic Program were conducted in Caracas during the period September 4-19, 1985. Venezuelan representatives included the Ministers of Finance, Development, Planning, Mines and Energy, and Agriculture; the President of the Central Bank; the Director of the Budget; and other senior officials. The staff representatives were Messrs. Martin Hardy (Head-WHD), Jose Fajgenbaum (WHD), and Julian Berengaut (ETR), Mrs. Patricia Brenner (WHD), Mrs. Susana Sosa (WHD), and Mrs. Gloria Bustillo (Secretary-WHD). Mr. Jesus Rodriguez, assistant to the Executive Director for Venezuela, participated in most of the meetings.

The authorities have requested that the consultation cycle be changed so as to hold the regular 1986 Article IV consultation discussions in February 1986, when the 1986 Quantified Economic Program will be ready for assessment, and that the midyear consultation discussions be held about six months later. The staff supports this request as it would fit better Venezuela's budgetary cycle.

The 1985 midyear Article IV consultation discussions with Venezuela were held during the period January 30-February 8, 1985, and the staff report (SM/85/115 and Corr. 1) was considered by the Executive Board on May 30, 1985. At that meeting, Executive Directors commended the

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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.

authorities for the adjustment of demand in relation to output which had contributed to the strengthening of the external current account and had provided the basis for the multiyear restructuring of external public debts with banks. The substantial improvement in the consolidated public sector finances, the depreciation of the bolivar within a multiple exchange rate system, and the policy of wage restraint were key elements supporting the adjustment effort.

However, Directors expressed concern about the distortions created by the heavy reliance on administrative restraints in the balance of payments area. They encouraged the authorities to unify promptly the controlled exchange rates at a level that would enhance the competitiveness of the economy, to pursue a flexible exchange rate policy, and to start relaxing quantitative import restrictions and prohibitions. Directors also stressed the need to liberalize the price control mechanism to improve private investment incentives and promote an efficient diversification of the economy. Directors noted that some progress had been made in reducing private sector interest arrears, but they underlined the urgency of eliminating all arrears in order to improve confidence and normalize Venezuela's relations with its creditors and suppliers. In reviewing the 1985 Quantified Economic Program, Directors suggested somewhat tighter fiscal and credit policies than those contemplated by the authorities to facilitate achievement of the targeted external current account surplus.

II. Background

1. Developments prior to 1985

The substantial increase in world oil prices that took place in 1979-80 led the Venezuelan authorities to grant large general wage increases and to expand public spending in an attempt to stimulate economic activity. 1/ At the same time, import protection was reduced and domestic interest rates were held below external rates. The results attained differed markedly from those sought, domestic inflation accelerated, the bolivar appreciated significantly in real terms, activity in the non-oil sectors stagnated, private investment declined, and private capital outflows increased (Table 1).

1/ In Venezuela, the oil sector provides about 95 percent of merchandise exports and some two thirds of central government revenue, and contributes around 25 percent of GDP.

Table 1. Venezuela: Selected Macroeconomic Indicators

(Percentage change from preceding year)

	1981	1982	1983	Prel. 1984	Proj. 1985 1/
Real GDP (at 1968 prices)	-0.3	0.7	-5.6	-1.4	-1.2
Petroleum	-3.4	-7.2	-4.7	0.3	-4.8
Nonpetroleum	--	1.4	-5.7	-1.5	-0.8
Nominal GDP	12.2	2.1	-0.3	21.3	11.7
Petroleum	4.9	-16.3	-9.9	51.6	-5.2
Nonpetroleum	15.2	9.0	2.5	13.3	17.5
Domestic expenditure (at current prices)	15.0	11.8	-13.7	17.7	15.6
Investment 2/	4.1	15.1	-54.7	50.4	17.2
Consumption	19.1	10.6	--	12.7	15.3
GDP implicit price deflator	11.8	1.4	5.5	21.3	13.3
Petroleum	9.6	-9.4	-6.8	51.6	-0.2
Nonpetroleum	15.2	7.5	8.7	13.3	18.4
Caracas consumer price index (end of period)	11.0	7.7	6.6	18.3	6.4
Unemployment rate 3/	6.1	7.1	10.2	13.4	14.0

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

1/ Targets and projections contained in the revised quantified Annual Economic Program.
2/ Includes changes in inventories.
3/ Second semester data through 1984 and first semester for 1985.

In 1982 the international oil market weakened sharply. The drop in oil export earnings coupled with a rise in public sector investment triggered a major deterioration in the public finances and the balance of payments. The external current account moved from a surplus of US$2 billion in 1981 to a deficit of US$3 1/4 billion in 1982, and the consolidated public sector deficit widened from 2 percent of GDP in 1981 to nearly 13 percent of GDP in 1982 (Tables 2 and 3). 1/ Capital flight was spurred by expectations of a devaluation and was facilitated by the pursuit of an expansionary credit policy. Short-term capital outflows reached more than US$5 billion and the overall balance of payments registered a deficit of US$8 1/2 billion in 1982. By the end of that year, the real effective exchange rate of the bolivar had appreciated by about 34 percent from the level of 1978 (Chart 1).

The further weakening of the world oil market in early 1983 led the authorities to adopt in February a set of measures aimed at arresting the loss of reserves. These measures included a sharp cutback in public investment, the introduction of comprehensive import controls and of a three-tier exchange rate system involving an average depreciation of 11 percent. 2/ To curb price increases, the authorities enforced a 90-day price freeze, and subsequently established a system of generalized price controls. At the same time, they started negotiations with foreign banks for the rescheduling of Venezuela's public debt falling due in 1983-84, which amounted to nearly US$13 billion, or more than half of the total public debt to banks.

The Administration that took office in February 1984 intensified these policies and modified the multiple exchange rate system into a four-tier system, which resulted in a cumulative effective average depreciation of 42 percent relative to February 1983. 3/ The new authorities stated that all controlled exchange rates would be unified by end-1985, except for the maintenance of a preferential exchange rate for the amortization of certain external debts. In the area of monetary policy, in February 1984 the Central Bank re-established maximum lending rates for financial institutions, introduced a preferential rate of 8 1/2 percent a year for loans to the agricultural sector, and raised the lending share to the agricultural sector from 20 percent to 22 1/2 percent of the banks' loan portfolio.

1/ The consolidated public sector in this report covers the Central Government (including its extrabudgetary operations), the Venezuelan Investment Fund (VIF), the National Petroleum Company (PDVSA), the nonfinancial public enterprises, and the newly created Exchange Differentials Compensation Fund (FOCOCAM).

2/ For a detailed description of this exchange system and subsequent modifications of Venezuela's exchange system see the accompanying Recent Economic Developments report.

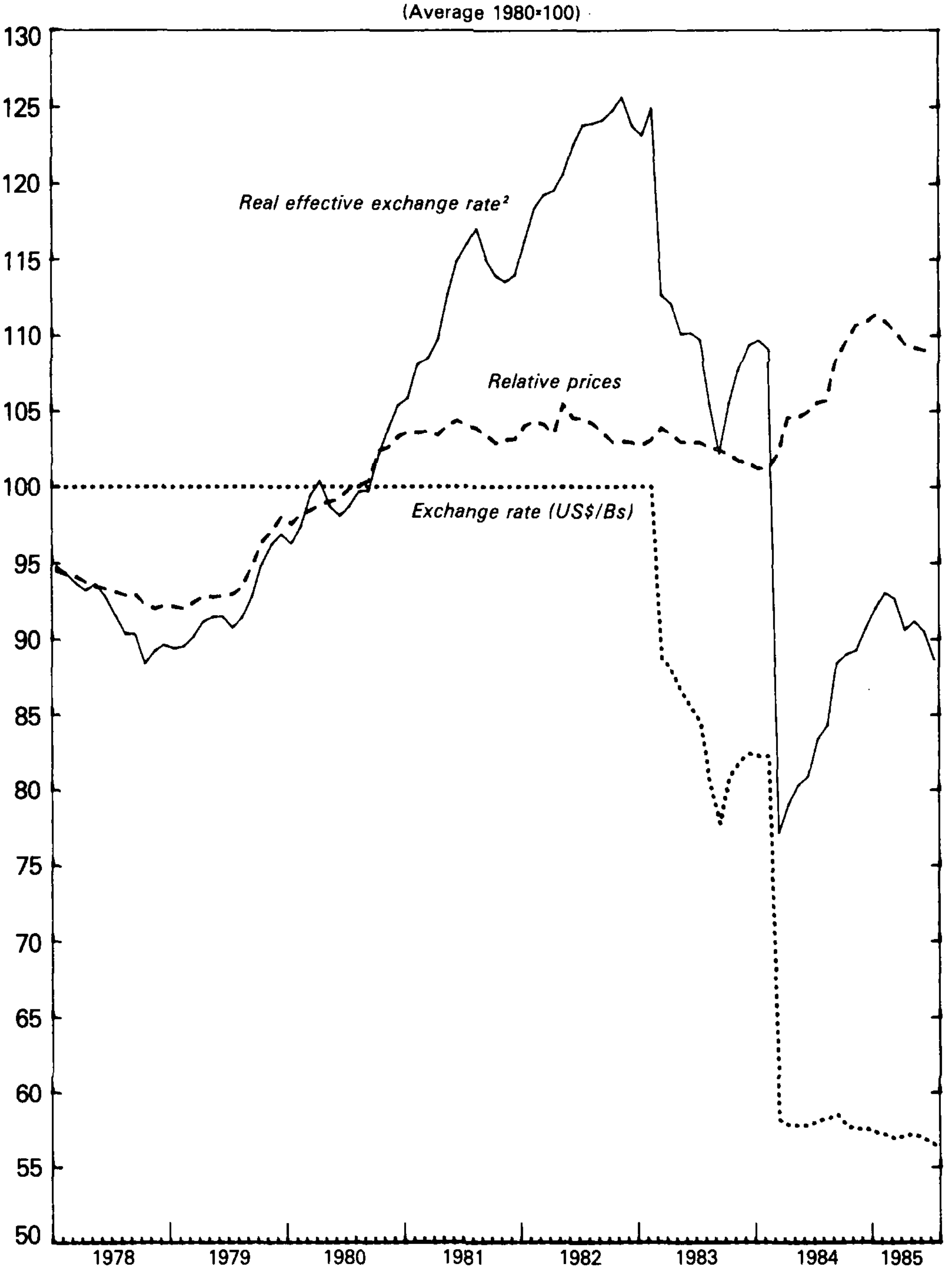
3/ The system comprises the previous exchange rate of Bs 4.30 per U.S. dollar applicable to some essential imports and amortization of certain external debts; a rate of Bs 6.00 per U.S. dollar applicable to transactions of the petroleum and iron ore sectors; a rate of Bs 7.50 per U.S. dollar applicable to authorized current transactions under the exchange control system; and a free exchange rate applicable to all other transactions.

CHART 1

VENEZUELA

EXCHANGE RATE DEVELOPMENTS[1]

(Average 1980=100)



Source: IMF, Information Notice System.

[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]Deflated by the CPI.

Table 2. Venezuela: Summary Balance of Payments 1/

(In billions of U.S. dollars)

	1981	1982	1983	Prel. 1984	1985 Original Program	1985 Revised Program
Current account	2.1	-3.2	3.6	4.3	1.7	3.6
Trade balance	7.8	3.9	8.1	8.6	6.7	7.4
Exports, f.o.b.	(20.2)	(16.5)	(14.8)	(15.8)	(15.2)	(14.0)
Of which: petroleum	/19.1/	/15.7/	/13.8/	/14.8/	/13.7/	/12.8/
Imports, f.o.b.	(-12.4)	(-12.6)	(-6.8)	(-7.3)	(-8.5)	(-6.6)
Nonfactor services, net	-4.2	-5.0	-1.9	-1.8	-2.1	-2.1
Freight and insurance	(-1.0)	(-1.0)	(-0.6)	(-0.4)	(-0.7)	(-0.7)
Travel	(-2.1)	(-2.5)	(-0.6)	(-0.6)	(-0.7)	(-0.7)
Other	(-1.1)	(-1.5)	(-0.7)	(-0.8)	(-0.7)	(-0.7)
Investment income, net	-1.1	-1.5	-2.4	-2.4	-2.8	-1.6
Of which: interest payments accrued	(4.3)	(3.7)	(3.7)	(4.1)	(4.0)	(3.3)
Paid	/4.3/	/3.7/	/3.4/	/4.2/	/4.7/	/3.7/
In arrears 2/	/--/	/--/	/0.3/	/-0.1/	/-0.7/	/-0.4/
Transfers, net	-0.4	-0.6	-0.2	-0.1	-0.1	-0.1
Capital account	-0.8	-3.6	-4.2	-3.6	-1.1	-1.4
Medium- and long-term capital	1.4	2.3	0.1	-0.9	-0.5	-0.8
Public sector debt, net	(0.4)	(1.4)	(0.5)	(-0.5)	(-1.6)	(-1.7)
Disbursement	/1.3/	/3.4/	/1.5/	/0.5/	/0.2/	/0.3/
Amortization	/-0.9/	/-2.0/	/-1.0/	/-1.0/	/-1.8/	/-2.0/
Scheduled	/-0.9/	/-2.0/	/-2.9/	/-2.8/	/.../	/-4.5/
Refinanced	/--/	/.../	/1.9/ 3/	/1.8/ 3/	/.../	/2.5/ 4/
Of which: arrears 2/	/--/	/0.4/	/-0.1/	/-0.3/	/--/	/--/
Other public sector	(0.4)	(0.7)	(-0.3)	(0.2)	(0.2)	(--)
Private sector	(0.6)	(0.2)	(-0.1)	(-0.7)	(0.9)	(0.9)
Direct investment	/0.2/	/0.3/	/0.1/	/--/	/--/	/--/
Other	/0.4/	/-0.2/	/-0.2/	/-0.7/	/0.9/ 5/	/0.9/ 5/
Of which: arrears 2/	/.../	/.../	/0.4/	/0.7/	/.../	/-0.4/
Short-term capital	-2.2	-5.9	-4.2	-2.6	-0.6	-0.6
Of which: arrears 2/	(...)	(...)	(1.1)	(-0.2)	(...)	(-0.4)
SDR allocation	0.1	--	--	--	--	--
Net errors and omissions	-0.9	-1.8	-0.6	1.0	--	--
Overall balance	0.5	-8.6	-1.2	1.8	0.6	2.2
Valuation change	--	3.0 6/	-0.2	--	--	--
Financing	-0.5	5.6	1.4	-1.8	-0.6	-2.2
Net international reserves (increase -)	-0.5	5.2	-0.3	-1.9	1.9	0.3
Change in arrears stock 2/	--	0.4	1.7	0.1	-2.5	-2.5
Of which: refinanced	--	--	--	--	1.3	1.3

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/ Under the rescheduling agreement with commercial banks.
5/ Assuming rescheduling of private debt arrears with financial institutions.
6/ Reflects a revaluation of gold holdings from US$42.20 to US$300 per ounce.

Table 3. Venezuela: Consolidated Public Sector Operations

	1981	1982	1983	Prel. 1984	1985 Original Program	1985 Revised Program
	(In billions of bolivares)					
Total revenues	101.3	88.2	88.1	124.6	132.9	134.3
Tax revenues	16.8	18.9	25.9	26.7	33.3	31.2
Nontax revenues	84.5	69.3	62.2	96.3	99.6	102.9
Central Government (excluding petroleum royalties)	(4.8)	(6.4)	(5.3)	(6.4)	(8.3)	(10.1)
PDVSA operating surplus	(71.2)	(57.7)	(51.5)	(76.5)	(76.6)	(71.9)
Venezuela Investment Fund interest and dividend income	(2.3)	(1.4)	(1.3)	(1.9)	(3.8)	(1.7)
Nonfinancial public enterprises operating surplus	(--)	(--)	(2.8)	(10.5)	(9.4)	(11.6)
Other (including interest income and FOCOCAM)	(6.3)	(3.7)	(1.3)	(1.0)	(1.5)	(7.6)
Sale of fixed assets	--	--	--	1.7	--	0.1
Total expenditures	106.2	125.6	97.5	105.1	134.3	126.3
Current expenditures	59.9	56.8	53.2	68.7	73.1	84.4
Personal emoluments	(19.6)	(19.2)	(19.3)	(20.3)	(20.0)	(20.0)
Purchases of goods and services	(4.1)	(5.1)	(3.6)	(4.9)	(3.8)	(5.4)
Interest payments	(10.3)	(12.6)	(10.0)	(16.5)	(16.5)	(19.0)
Transfers to private sector	(5.2)	(3.0)	(3.2)	(3.9)	(3.1)	(4.4)
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)	(24.7)	(28.2) 1/
Other (including FOCOCAM reimbursements)	(--)	(--)	(--)	(--)	(5.0)	(7.4)
Capital expenditures	46.2	68.8	44.3	36.4	61.2	41.9
Capital formation	(33.6)	(42.8)	(33.1)	(29.8)	(42.0)	(30.4)
Central Government (extrabudgetary)	(0.9)	(6.6)	(4.0)	(1.6)	(6.0)	(3.4)
Other (including transfers to non-consolidated entities)	(11.7)	(19.4)	(7.2)	(5.1)	(13.2)	(8.1)
Net lending to private/external sector	0.2	0.3	0.2	0.2	1.2	1.5
Overall surplus or deficit (-)	-5.1	-37.7	-9.6	19.3	-2.6	6.5
Financing	5.1	37.7	9.6	-19.3	2.6	-6.5
External	-4.8	16.3	-4.0	-6.4	-8.2	-11.5
Banking system	2.1	7.8	6.3	-16.2	11.2	6.8
Other 2/	2.4	13.6	7.3	3.3	-0.4	-1.8
	(As percentage of GDP)					
Total revenues	35.5	30.3	30.3	35.9	33.7	34.4
Total expenditures and net lending	37.3	43.2	33.6	30.3	34.4	32.7
Current account surplus	14.5	10.8	12.0	15.6	15.2	12.8
Overall surplus or deficit	-1.8	-12.9	-3.3	5.6	-0.7	1.7
	(Annual rates of change)					
Total revenues	9.5	-13.0	-0.1	41.4	5.1	7.7
Total expenditures and net lending	21.1	18.3	-22.4	7.8	18.1	21.4
Of which: capital expenditures	(14.7)	(48.7)	(-35.6)	(-17.8)	(32.2)	(14.8)
Memorandum items						
Current account surplus (in billions of bolivares)	41.4	31.4	34.9	54.2	59.8	49.8
Nominal GDP (in billions of bolivares)	285.2	291.3	290.5	347.5	394.0	390.3

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

1/ Includes transfers originally classified as capital transfers to nonconsolidated entities.
2/ Largely domestic arrears in 1982-83.

The 1984 policy package relied significantly on a social pact with labor union and business representatives. The pact contemplated wage restraint in exchange for requirements on private enterprises to limit profit distribution, raise employment by 10 percent during 1984, and pay certain fringe benefits (such as a two-year transportation bonus of Bs 100 a month to employees earning less than Bs 3,000 a month). In practice, sectors facing increased demand complied with the employment requirement while other sectors were exempted.

These various measures led to significant improvements in the public sector finances and the balance of payments. The consolidated public sector finances improved by 18 1/2 percentage points of GDP in 1983-84, as the balance shifted to an overall surplus of 5 1/2 percent of GDP. This reflected a reduction in public investment from 24 percent of GDP in 1982 to 11 percent in 1984, a freeze of salaries, restraint on other current outlays, increased revenues from higher domestic fuel prices (which were more than doubled in March 1984), and higher domestic receipts from exports by public enterprises. As a result of the change in the public sector's position, the net domestic assets of the banking system declined by 6 percent in 1984 (in relation to private sector liabilities at the beginning of the period), compared with average annual increases of some 15 percent in the previous three years (Table 4).

The external current account moved from a deficit of US$ 3 1/4 billion in 1982, to a surplus of US$3 1/2 billion in 1983 and the surplus widened to US$4 1/4 billion in 1984. This change in the current account position stemmed largely from a near halving of imports and a drastic drop in travel-related expenditure. The capital account showed deficits of about US$4 billion a year in 1983-84 as short-term capital outflows persisted, albeit at a declining pace, and net external debt amortization continued (Table 5). The overall balance of payments shifted from a deficit of US$8 1/2 billion in 1982 to a surplus of over US$1 3/4 billion in 1984, and by the end of that year gross official reserves reached US$13 3/4 billion.

Nonpetroleum output declined by nearly 6 percent in 1983 and by a further 1 1/2 percent in 1984; however, industries in the export and import competing sectors experienced moderate growth. Unemployment rose from 7 percent in 1982 to 13 1/2 percent in 1984. As a result of allowing the pass-through of the devaluation and the reduction of subsidies (such as on oil derivatives and milk), consumer prices increased by 18.3 percent in 1984, compared with 6.6 percent in 1983. In November 1984, the system of price controls was modified to allow prices, except for those of 150 selected products or groups of products, to be increased 60 days after the Ministry of Development had been notified, and provided that the Ministry did not object to the increase. Price adjustments for the 150 selected products--including food, clothing, a number of home appliances, and certain vehicles--require approval by a commission with government, labor, and business representatives (CONACOPRESA).

Table 4. Venezuela: Summary Accounts of the Banking System

	1981	Adjusted 1/ 1982	Adjusted 1/ 1983	Adjusted 1/ 1984	July 1984– June 1985	1985 Govt. Program Orig.	1985 Govt. Program Rev.	1985 Rev. Staff Projection
(Annual flows in billions of bolivares)								
Net foreign assets	5.7	3.2	9.6	49.0	14.5	-9.8	-3.2	-2.8
Net domestic assets	18.5	29.8	20.6	-11.1	4.6	41.7	30.4	23.7
Net credit to public sector	2.1	7.8	6.3	-16.2	-16.8	) 40.5	) 28.9	6.8
Credit to private sector	16.8	20.1	5.3	15.7	13.5	)	)	8.0
Other	-0.4	1.9	9.0	-10.5	7.9	1.2	1.5	8.9
Valuation and other adjustments	—	20.3	0.2	24.8	0.1	0.4	0.4	—
Medium- and long-term foreign liabilities	1.3	0.2	1.2	0.2	1.5	—	—	1.8
Liabilities to private sector	22.9	12.5	28.8	12.9	17.5	31.5	26.8	19.1
Of which: money and quasi-money 2/	22.7	8.2	31.1	13.4	13.2	32.6	23.1	16.3
(Annual percentage change in relation to liabilities to private sector at the beginning of the period)								
Net domestic assets	14.4	19.6	12.5	-5.7	2.1	20.4	14.8	11.6
Net credit to public sector	1.6	5.1	3.8	-10.6	-8.6	...	...	3.3
Credit to private sector	13.0	13.3	3.2	8.1	7.0	...	...	3.9
Liabilities to private sector	17.7	8.2	17.6	6.7	9.0	15.3	13.0	9.3
(As percent of nonpetroleum GDP)								
Net domestic assets	61.1	69.2	67.4	56.0		59.1	58.2	56.0
Net credit to public sector	-10.1	-5.8	-8.0	-16.1		...	...	-13.0
Credit to private sector	68.3	71.5	72.1	70.7		...	...	63.3
Liabilities to private sector	73.0	72.5	83.1	79.5		75.2	77.1	74.6
Money and quasi-money	59.2	58.0	70.0	67.9		69.1	65.9	63.6
Memorandum items								
Liabilities to private sector (in billions of bolivares)	151.7	164.2	193.0	205.9	211.7	237.4	237.7	232.7
Money and quasi-money (annual percentage change)	22.6	6.7	23.8	8.2	8.8	18.4	13.0	9.2
Excess reserves held by commercial banks (in billions of bolivares)	3.7	2.3	8.3	2.3	6.7	...	...	...

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

1/ Adjusted for the revaluation of Central Bank holdings of gold and foreign exchange; the transfer of the Securities Stabilization Fund from the Central Bank to the Central Government; the transfers of part of the gold and foreign exchange revaluation profits to the Central Government; and the deposit at the Central Bank of PDVSA's foreign exchange previously held abroad.

2/ Comprises currency in circulation and demand, time, and savings deposits.

Table 5. Venezuela: External Debt

(In millions of U.S. dollars)

	1982	1983	Prel. 1984	Proj. 1985
Total debt (year-end)	...	34,326	32,781	30,677
Public sector	28,003	27,616	26,441	24,728
Medium- and long-term	...	18,178	17,661	24,728
To official creditors	(...)	(683)	(478)	(391)
To private creditors	(...)	(17,495)	(17,183)	(24,337)
Financial institutions	/.../	/15,051/	/15,990/	/23,057/
Other	/.../	/2,444/	/1,193/	/1,280/
Short-term	...	9,438	8,780	—
Private sector 1/	...	6,710	6,340	5,949
Financial institutions	...	5,200	5,200	5,579
Suppliers	...	800	800	370
Other	...	710	340	—
Debt service 2/	6,526	7,293	7,667	5,744 3/
Amortization	2,832	3,598	3,513	2,416
Public sector	(2,032)	(2,896)	(2,813)	(1,996)
Private sector	(800)	(702)	(700)	(420)
Interest	3,694	3,695	4,154	3,328
Public sector	(2,981)	(2,975)	(3,454)	(2,735)
Private sector	(713)	(720)	(700)	(593)
Temporary rollover financing	—	10,716	12,710	—
Medium- and long-term	—	1,936	3,930	—
Short-term	—	8,780	8,780	—
Stock of arrears	825	2,510	2,633	150
Public	825	945	—	—
Interest	(400)	(175)	(—)	(—)
Principal 4/	(425)	(770)	(—)	(—)
Private	...	855	2,293	150
Interest	(...)	(455)	(563)	(150) 5/
Principal 1/ 4/	(...)	(400)	(1,730)	(—)
Commercial arrears	—	710	340	—
Memorandum item				
Debt service ratio (percent) 6/	37.1	45.7	45.9	38.4

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

1/ Assumes that only US$6 billion of net private debt will be registered by RECADI, and excludes nonregistered debt.
2/ As originally scheduled; i.e., includes arrears on principal and the temporary rollover of medium- and long-term debt.
3/ Under rescheduling agreement with commercial banks.
4/ Includes arrears on short-term as well as medium- and long-term debt.
5/ Assumes a delay of about one quarter in RECADI's and Central Bank's processing of interest payments on private debt.
6/ In relation to exports of goods and nonfactor services.

Concerned about the possible financial impact on enterprises of the devaluation of the bolivar, and particularly of the adoption of a free exchange rate for financial transactions, in February 1984 the new authorities reaffirmed the policy of granting the private sector access to the preferential exchange rates for the servicing of private sector external debts contracted before February 18, 1983. 1/ Access was limited to the net liability position of the debtor (i.e., net of foreign assets) and required that the debt be registered with the Office of Differential Exchange Rates (RECADI) and restructured into seven-year loans with two years of grace. However, debts smaller than US$500,000 (originally the amount was US$100,000) and debts guaranteed by official credit guarantee agencies would be amortized according to their original schedule.

During 1984, although the public sector eliminated its external debt service arrears on both interest and principal, the private sector continued to accumulate arrears as a result of the slow pace of private debt registration. The authorities have not compiled statistics on private sector external arrears, but the staff has estimated that by the end of 1984 arrears amounted to more than US$2 1/2 billion (of which more than US$1/2 billion represented interest arrears); these estimates were based on the assumptions that the stock of net private debt was some US$6 billion and that some interest payments have been made through the free foreign exchange market.

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

The Venezuelan authorities designed the 1985 Quantified Economic Program to provide a modest stimulus to economic activity through higher public investment while still achieving a surplus of US$1.7 billion in the external current account. The program projected an increase of prices of about 13 percent and growth of nearly 3 percent in nonpetroleum real GDP. It also envisaged the transfer of import items still remaining at the Bs 4.30 per U.S. dollar exchange rate to the Bs 7.50 per U.S. dollar exchange rate, and the unification of all controlled exchange rates by the end of 1985 except for a preferential rate applicable to eligible external debt amortization. The registration of private external debt was expected to be completed by midyear to facilitate the virtual elimination of external arrears before end-1985.

Mainly reflecting delays in the implementation of public investment programs, the public sector finances showed a larger than projected surplus for the first half of 1985 (by about 3 percentage points of GDP on an annual basis). As a result, Venezuela met the balance of payments and inflation targets of the authorities' program for the first half of

1/ Decree 61 established that the applicable rates would be Bs 4.30 per U.S. dollar for all principal payments and for interest due before December 31, 1983; and Bs 7.50 per U.S. dollar for interest payments due after that date.

1985 with ample margins (Table 6). In the monetary area, the attempts of the Central Bank and FOCOCAM (with funds transferred by the Central Bank) to expand liquidity only led to an increase in excess reserves held by commercial banks because of the weakness of private sector demand for credit and the cautious lending attitude shown by the commercial banks. Broad money (M2) grew by only 1.6 percent during the first half of the year, compared with the 5.8 percent increase expected under the authorities' program.

Nonpetroleum output declined further in the first half of 1985, although the drop was less pronounced than in 1984, and unemployment rose slightly to 14 percent. Consumer prices increased by 2.4 percent in the period January-July 1985, well below original projections, reflecting the sluggishness of demand and possibly the effects of a tightening of price controls.

The authorities continued to transfer import items to the Bs 7.50 per U.S. dollar exchange rate, and only five agricultural commodity groups (milk, wheat, sorghum, soya beans, and peanuts) remained in the Bs 4.30 per U.S. dollar exchange rate by the end of September 1985; the annual import bill of these products amounts to around US$300 million, or less than 5 percent of total imports. Fluctuations in the free market exchange rate have reflected in large part changes in views about the state of the international oil market. In that market, the bolivar fell to about Bs 13.50 per U.S. dollar early in the year, appreciated to less than Bs 12 per U.S. dollar in April-May, and depreciated to over Bs 15 per U.S. dollar by mid-August recovering slightly to about Bs 14.50 per U.S. dollar. Central Bank intervention in the free market was quite limited during the first half of year, but it has risen somewhat since August.

Even though petroleum export earnings were somewhat lower than projected for the first half of 1985, official reserves rose by over US$1 billion instead of declining as had been expected, and at midyear reserves stood at US$14 3/4 billion. This result was largely due to substantially lower than expected imports reflecting low aggregate demand and some tightening of import controls, a slower than projected reduction in arrears on private debt service, a larger than expected decline in international interest rates, and the re-establishment of some trade credit lines. The availability of trade credits increased when the Central Bank began to issue certificates of foreign exchange availability to importers who made use of letters of credit.

With regard to the registration of private external debt, the review of applications has been completed by RECADI, but as of end-September the ministerial commission that authorizes access to the preferential rates had decisions pending on debts for about US$2 billion, or some 15 percent of the total under consideration.

Table 6. Venezuela: Quantitative Targets of the
1985 Economic Program

	1984 1/ Dec. 31	1985 June 30 Program	June 30 Actual	Sept. 30 Original Program	Sept. 30 Revised Program	Dec. 31 Original Program	Dec. 31 Revised Program
	(In millions of U.S. dollars)						
Net international reserves (Central Bank and VIF)	13,718	12,817	14,848	12,394	14,383	11,867	13,527
Net outstanding public external debt 2/	26,441	25,640	25,820	25,161	25,675	24,890	24,538
	(In millions of bolivares)						
Broad money 3/	177,567	187,852	180,466	196,890	183,121	208,862	200,631
Monetary base	38,128	39,007	43,279	42,355	44,289	45,920	49,901
Public sector net financing needs 4/	...	-5,033	-9,598	-6,364	-9,333	-4,276	-7,383

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

1/ Actual rather than estimated data as presented in SM/85/115.
2/ Revised figures according to preliminary debt reconciliation with banks.
3/ Venezuelan definition.
4/ Excludes nonfinancial public enterprises and contains revisions in the operations of FOCOCAM.

In May 1985, the authorities reached an agreement with creditor banks on the principles for a multiyear rescheduling of public and publicly guaranteed debts falling due during 1983-88 (amounting to US$21.2 billion). 1/ The agreement provides for, inter alia, a down-payment of US$750 million, a spread of 1 1/8 percentage points over LIBOR, and a repayment period of 12 1/2 years. According to the agreed schedule, by the end of 1990 Venezuela will have amortized an additional US$5 1/2 billion of its outstanding public debt with banks. The agreement also includes a currency switching option for banks that elect to redenominate their loans in their home currency.

Because of the uncertain outlook for oil prices, the agreement has been criticized in Venezuela because of its inclusion of a large net repayment to banks. The authorities have maintained that the agreement could be honored as long as there is no sharp decline in oil prices, but they have asked creditor banks to include a "contingency clause" in the rescheduling contracts. Under such a clause, payment provisions would be modified in case of major changes in the economic circumstances of the country, such as a sharp drop of world oil prices, or if better rescheduling terms are developed in other comparable cases.

III. Economic Prospects and Policies

The Venezuelan authorities have revised the Quantified Annual Economic Program for the second half of 1985 in the light of the outturn in the first half of the year and prospects in the world oil market. For the year as a whole, the authorities are now projecting a consolidated public sector surplus of close to 2 percent of GDP, compared with the original estimate of a deficit of nearly 1 percent of GDP. Also, they are now projecting an external current account surplus of US$3 1/2 billion (7 percent of GDP), or about double the previously targeted surplus. The authorities expect nonpetroleum real GDP to remain stagnant in 1985, or even decline somewhat, compared with an initially projected growth of 3 percent. Prices are expected to rise in the 6-7 percent range, compared with an earlier forecast of 13 percent. Accordingly, their target for the expansion in M2 has been lowered from 18 percent to 13 percent.

1. Demand management policies

The authorities noted that the policies that have been pursued since 1982 have resulted in stronger contractionary effects on the economy than had been expected. Their primary concern now was to reverse the declining trend in nonpetroleum real GDP, and thus to lower the unemployment rate. Therefore, during the second half of the year

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1/ This amount includes US$0.6 billion owed to branches of Venezuelan banks abroad.

the authorities intend to accelerate the speed of project implementation and adopt a more expansionary credit policy to provide a stimulus to economic activity.

a. Fiscal policy

The authorities expect total revenues to be slightly lower than originally projected but still about 8 percent higher than in 1984. They noted that increased nonpetroleum revenues would nearly offset the decline in petroleum earnings, reflecting a tightening in income tax collections and increases in excise taxes on liquor and cigarettes and in stamp duties. In addition, the nonfinancial public enterprises are to improve further their operating surplus because of increases in certain domestic prices.

The authorities expect public expenditure to grow by 20 percent in 1985 compared with nearly 8 percent in 1984. Current expenditure is projected to rise by 23 percent owing to larger transfers to the nonconsolidated public sector, higher interest payments (as a result of the bonds issued to pay off the floating debt), and FOCOCAM reimbursements to the private sector for exchange rate differentials (equivalent to some 2 percent of GDP). The wage bill is expected to show little change for the fourth year in a row, reflecting the authorities' restrained wage policy. On the assumption of some pickup in capital outlays in the second half of the year, capital spending for the year is projected to grow by 15 percent, but this would be less than half the rate of increase originally projected. As a result, the consolidated public finances are expected to show an overall surplus of less than 2 percent of GDP in 1985. The mission generally agreed with these projections.

The Venezuelan authorities went on to explain that, in the light of the major adjustment in aggregate demand that had taken place and the comfortable level of reserves, they were planning a major increase in extrabudgetary capital expenditure in order to stimulate economic activity and employment. Specifically they were giving consideration to the implementation of a three-year special investment program of up to Bs 15 billion (nearly 4 percent of GDP) a year starting in 1986.

The mission agreed that the sluggishness in economic activity and high unemployment was a matter of concern. The mission also agreed that raising public sector investment expenditure could be an appropriate policy response in present circumstances. However, since revenues were unlikely to show much strength because of the expected decline in petroleum revenues in 1986, full implementation of the program contemplated by the authorities would result in a consolidated public sector deficit of more than 3 percent of GDP in 1986. Such a large swing in the public sector's position could give rise to inflationary pressures and a significant loss of reserves, especially if it were associated with an expansionary credit policy to avoid crowding out private investment.

Moreover, if oil revenues were to decline further, the increase in public investment would soon need to be reversed, leading to a wasteful stop-go cycle.

Because of these considerations, the mission suggested a somewhat more cautious approach to fiscal expansion in 1986. The mission also emphasized that expansionary demand policies via higher public spending might not produce lasting gains in output and employment. For this to happen, further efforts to promote structural changes in the economy were needed, such as a reduction of controls and adoption of more market-oriented policies. It was noted that attempts to increase public expenditure had had little permanent effect on growth and employment in the past; for example, the non-oil sector remained stagnant during the period 1980-82 despite substantial increases in public expenditure.

The authorities agreed that the public finances need to be maintained in approximate balance over the medium term to assure a satisfactory level of international reserves, to facilitate the servicing of the external debt, and to avoid the crowding out of the private sector. They noted in this connection that they were giving consideration to some revenue measures for next year, although they were not yet in a position to provide specifics on the actions that might be taken. They also noted that the three-year special investment program was still in the initial discussion stage, and it was still open as to how rapidly it would be put into effect.

The authorities noted that there had been delays in the implementation of a tax reform to include a modification of the personal and corporate income taxes and the introduction of a general sales tax, as recommended by the 1983 Tax Reform Commission. Although such a reform would improve resource allocation, they have decided to direct their efforts first toward improving collections, both at the Central Government and public enterprise levels, and to introduce the reform at a later stage.

b. Monetary policy

In the light of developments, the authorities have revised the projected growth for broad money (M2) during 1985 from 18 percent to 13 percent. On the assumption of a small loss in international reserves (US$0.2-US$0.3 billion), the net domestic assets of the banking system would grow by 15 percent in relation to bank liabilities to the private sector at the beginning of the period. The authorities said that they would continue to exercise flexibility in the management of interest rates on the basis of the Central Bank's monthly assessments of domestic rates, which take into account expected domestic inflation and international interest rates. It was noted that while the Bank had lowered both the maximum lending rate charged by commercial banks and the rediscount rate by 2 percentage points to 14 percent and 9 percent, respectively, since December 1984, domestic interest rates were positive in real terms and competitive with foreign rates (Chart 2). In March 1985, the Central Bank imposed a set of minimum and maximum deposit rates, according to the type of deposit and financial institution, aimed at shifting deposits toward mortgage banks and finance companies (financieras). As a consequence of this action, deposit rates at commercial banks were lowered by 1 percent on average. (Since the mission, the staff has learned that the Central Bank cut its rediscount rate by 1 percentage point to 8 percent and lowered the lending and deposit interest rates of financial institutions by an average of 1 percent. This would reduce the commercial banks' time deposit rate to less than 9 percent.)

The mission noted that in its view the growth of broad money was likely to be about 9 percent during 1985, which was below the latest projections for nominal nonpetroleum GDP growth in the year. The mission observed that the stock of broad money at the end of 1984 included "involuntary" holdings of deposits in the form of frozen deposits in the intervened Workers' Bank and in the Discount National Bank, 1/ and that with the gradual release of these deposits the ratio of broad money to nonpetroleum GDP could be expected to return to the 1980-82 average. Thus, the mission suggested that the expansion of net domestic assets of the banking system be held to about 11 1/2 percent (in relation to banking system liabilities to the private sector at the beginning of the period) if the loss of international reserves was to be limited to the small amount contemplated by the authorities in their program.

The mission agreed with the broad thrust of the authorities' interest rate policies, but it stressed the importance of maintaining flexibility. Thus, it recommended the elimination of maximum lending and deposit rates to improve resource allocation, and the phasing out of the subsidy element furnished by the preferential interest rate on agricultural loans because profitability in the agricultural sector had been re-established. The authorities said that they would not extend the coverage of the preferential interest rate to other sectors, but stressed that present circumstances were not appropriate for its elimination for agriculture. They felt that this measure was still making an important contribution to the recovery in agriculture that was taking place.

2. External sector prospects and policies

The authorities expect petroleum exports to decline by about 14 percent to US$12.8 billion in 1985, which would be US$0.9 billion below the figure initially projected. This projection assumes an average export volume of 1.356 million barrels a day (mbd) and an average price of US$25.81 a barrel. They noted that this would require an average export volume of 1.45 mbd and an average price of US$25.29 a

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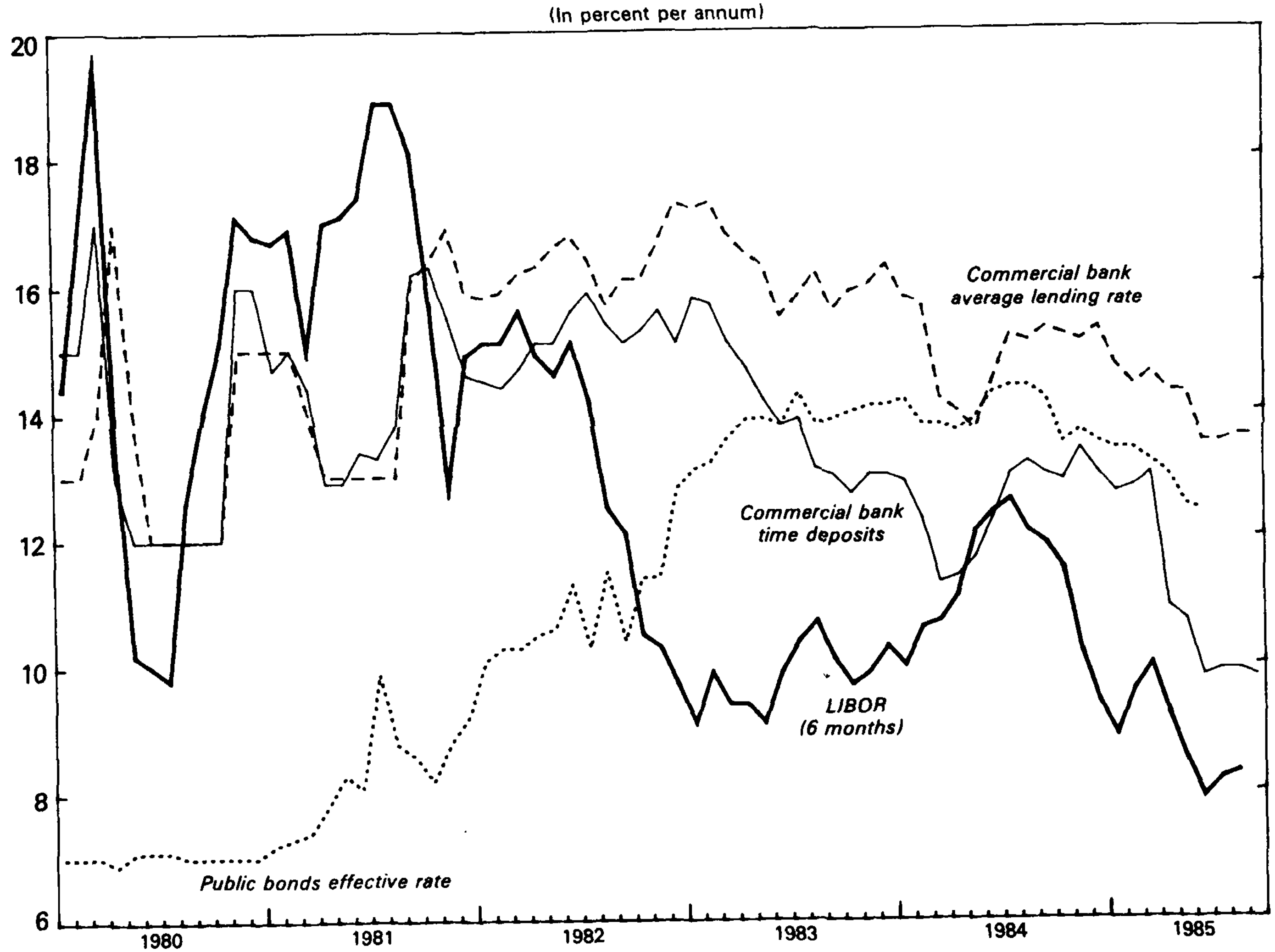
1/ In 1982 the authorities intervened in the operations of the Workers' Bank; in June 1984 they closed the National Discount Bank which had been intervened in 1978.

CHART 2

VENEZUELA

INTEREST RATES

(In percent per annum)



Source: Central Bank of Venezuela.

barrel during the second half of the year, which they regarded as conservative assumptions. They did not expect a decline in prices for the remainder of the year, particularly in view of seasonal factors. Non-oil exports are projected to increase by about 20 percent in 1985. Their growth had been expected to be even higher, but exports had been affected by marketing difficulties and protectionist measures adopted by major trading partners, especially with regard to steel products.

Notwithstanding a weaker export picture than originally envisaged, the external current account is expected to show a surplus of US$3.6 billion in 1985, compared with an earlier projection of US$1.7 billion. This revision reflects in large measure the failure of imports to recover. Indeed, imports are now expected to decline by 9 percent, to US$6.6 billion, from the already low level of 1984. This behavior of imports would seem to reflect both the relative sluggishness of demand and an effective tightening of import controls, as import permits are granted only to the extent that domestic production is not sufficient to satisfy local demand. The revised current account projection also includes lower net interest payments than previously estimated, to reflect both lower international interest rates and increased earnings due to higher international reserve holdings.

The capital account is expected to show a deficit of US$1.4 billion in 1985, or, virtually the same as the original projection. This deficit includes net repayments of external public debt of US$1.7 billion, a continued outflow of short-term capital, although at a much slower rate than in recent years, and a partial re-establishment of trade credit lines. As a result, the overall balance of payments is expected to show a surplus of US$2.2 billion; however, net international reserves could decline by US$0.2-US$0.3 billion if private sector external arrears were to be eliminated. In this event, international reserves would amount to US$13.4 billion by the end of 1985, the equivalent of about two years of projected imports in 1985. The mission agreed with the authorities' projections in this area.

The authorities expected that the debt registration process would be completed by end-1985, thereby facilitating the virtual elimination of private sector arrears, either by payment or rescheduling. They stressed that interest arrears arising from the registration process had been reduced significantly but they remarked that a number of debtors whose debt had been registered were not making payments because of financial difficulties. The authorities estimated that the final figure for net debt approved for access to the preferential rates would be around US$6 billion, and they added that the servicing of the nonregistered debt can be made freely through the uncontrolled foreign exchange market. The mission said that information received from official credit guarantee agencies indicated a rather large backlog in debt service payments and urged the authorities to address this problem without delay.

With regard to exchange rate policies, the Venezuelan authorities stressed their commitment to transfer the remaining import goods from the Bs 4.30 per U.S. dollar exchange rate to the Bs 7.50 per U.S. dollar exchange rate, the rate at which the controlled exchange rates will be unified by the end of the year. They stated that the exchange rate policy to be pursued after December 31, 1985 will be judged in the light of developments in the economy and abroad, and that in any case they would not allow the unified controlled rate to appreciate in real terms. They did not foresee rapid progress toward full unification because of the uncertainty prevailing in the international oil market and the large spread between the Bs 7.50 per U.S. dollar exchange rate and the free market exchange rate (which has been fluctuating around Bs 14.50 per U.S. dollar). The authorities noted that a number of minor import items had been transferred to the free market and that they intended to continue with such transfers. However, they thought that the adoption of the free market exchange rate for a wide range of transactions would have adverse effects on the economy. Because of this and the likely impact on consumer prices, the authorities said that they did not consider it advisable to shift major groups of imports to the free market. They added that the Central Bank would continue its intervention in the free market to avoid disruptive fluctuations and to work toward an eventual unification of the exchange rates.

The mission emphasized the importance of pursuing a flexible exchange rate policy in conjunction with the unification of the controlled rates. In this connection, the mission noted that there had been a 15-20 percent average effective appreciation of the bolivar since the last exchange rate change in February 1984, 1/ that the international oil market had weakened further, and that import and exchange controls needed to be relaxed in order to accelerate the diversification of the economy. Furthermore, policy with respect to the unified controlled exchange rate needed to take account of the desirability of moving as soon as possible to a fully unified exchange system. For this purpose, the mission urged the authorities to accelerate the transfer to the free exchange market of imports and other current transactions at present in the controlled market, and to accompany this with a substantial reduction in the scope of import controls.

The authorities responded that they saw merit in maintaining the present import control system in order to change the composition of imports toward inputs for the manufacturing sector as well as to protect domestic industry which has large unused capacity. They felt that the system of controls was functioning satisfactorily and observed that no shortages had emerged during 1984-85. The authorities also noted that the system for processing import permits has been streamlined.

1/ This appreciation might be larger depending on the degree of price repression.

The mission emphasized that the objective of protecting domestic industry could be achieved more efficiently on the basis of a flexible exchange rate policy combined with a suitable structure of import tariffs; the authorities had under consideration plans for a new tariff structure, but action in this field had been subjected to some delay. Finally, the mission recommended the removal of the complex export licensing system since it seemed to be hampering the diversification and growth of exports.

3. Price and wage policies

The authorities were satisfied with price developments so far this year, which they viewed as evidence of the success of the social pact and their incomes policies. They stressed that most of the impact of the devaluation of the bolivar already had been reflected in prices, and thus a significant shift in relative prices had been brought about. They felt that the price control system that was established late last year was working satisfactorily. Proposed price increases were generally small, suggesting that prices were not repressed to any great extent. However, they noted that about 20 products had been added to the 150 goods or groups of goods that require approval by CONACOPRESA because the planned price adjustments were considered to be relatively large.

The authorities remarked that price controls were an integral part of the social pact and had been helpful in maintaining wage stability and in containing inflationary pressures while a change in relative prices was taking place. The authorities felt that the compensation policies included in the social pact such as the transportation bonus and other nonwage benefits, as well as the employment programs had moderated wage demands in 1984 and thus far this year. They noted that the increase in minimum wages 1/ had not had a major effect on the enterprises' cost structure, especially in the urban sector, because very few workers actually earned the minimum wage and because certain enterprises were exempted from paying this wage to avoid adverse effects on their economic situation. The authorities emphasized that, in their view, wages should be adjusted according to productivity increases and through free collective bargaining rather than through generalized wage increases as has been requested by some labor leaders.

While agreeing that the social pact had been helpful in the adjustment process, the mission underscored the inefficiencies introduced by the price control system. It seemed therefore necessary to reduce the scope of price controls to help improve confidence and incentives for private investment. The mission commended the authorities for the wage

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1/ The minimum wage in the agricultural sector was raised by 33 percent to Bs 900 a month in October 1984 and that in the urban sector was increased by 67 percent to Bs 1,500 a month in February 1985.

policy that had been pursued and encouraged them to continue exercising restraint to help stimulate employment in a context of a satisfactory price performance.

As regards possible moves to deregulate the economy, the authorities said that a tripartite commission was reviewing areas where regulations could be reduced and that a more flexible law regarding housing rent control was being prepared. They noted that Venezuela had a long history of controls, and that it would not be easy or advisable to change quickly. With regard to foreign investment, the authorities noted that regulations have been liberalized in the areas of construction, tourism, agriculture, and agro-industry. They stressed that Venezuela was bound by the foreign investment legislation of the Andean Pact and that further changes would only take place if the Pact's regulations were modified.

4. Medium-term outlook

In the light of the recent developments in the oil market, the authorities have revised Venezuela's outlook for the period 1986-89. Their projections assume stable international interest rates and import growth of 6 percent a year in real terms. The most optimistic scenario assumes an OPEC reference price of US$28 a barrel and a slight increase in oil exports. In this case, large current account surpluses are expected with international reserves increasing to US$18.3 billion, or 21 months of 1989 imports. The most conservative scenario assumes that OPEC will strive to maintain its market share and thus, the OPEC reference price would decline to US$24 a barrel by 1987 and then stabilize. Under this scenario, the current account surpluses would be sharply curtailed and overall balance of payments deficits would emerge in 1987 and would reach nearly US$2 billion by 1989; international reserves would decline to US$9.4 billion, or ten months of 1989 imports.

The staff's latest medium-term projections are similar to the authorities' conservative scenario and are based on the assumptions of the recent WEO exercise (Table 7). It assumes oil exports of 1.4 million barrels a day throughout the rest of the decade and a decline in the average export price of oil to US$24.50 a barrel in 1986; the price is projected to remain constant until 1988 and to increase by 7 1/2 percent annually thereafter. As a result of a relaxation of import controls, the volume of imports is expected to grow by 12 percent in 1986 (compared with a decrease of 14 percent in 1985) and by 4 percent a year subsequently. The LIBO rate is expected to fall to 8 percent in 1986 and remain constant for the rest of the period. Under these assumptions, the surplus in the current account is expected to decline from US$3.6 billion in 1985 (7 percent of GDP) to US$1.4 billion by 1988 (2.5 percent of GDP) and to recover to US$2.2 billion by 1990 (3.7 percent of GDP).

Table 7. Venezuela: External Sector Medium-Term Projections, 1986-90 1/

(In millions of U.S. dollars)

	1984	1985	1986	1987	1988	1989	1990
			I. Balance of Payments				
Current account	4,225	3,591	2,471	1,917	1,391	1,752	2,192
Trade balance, f.o.b.	8,585	7,445	5,996	5,579	5,218	5,751	6,342
Exports	(15,847)	(14,038)	(13,664)	(13,882)	(14,133)	(15,337)	(16,653)
Petroleum	/14,794/	/12,774/	/12,211/	/12,211/	/12,211/	13,127/	/14,111/
Other	/1,053/	/1,264/	/1,454/	/1,672/	/1,922/	/2,211/	/2,542/
Imports	(7,262)	(6,593)	(7,668)	(8,304)	(8,915)	(9,586)	(10,312)
Nonfactor services	-1,798	-2,106	-2,070	-2,242	-2,407	-2,588	-2,784
Investment income	-2,425	-1,606	-1,298	-1,248	-1,231	-1,203	-1,136
Of which: interest payments	(4,305)	(3,328)	(3,050)	(2,936)	(2,835)	(2,707)	(2,574)
Transfers	-137	-142	-156	-172	-189	-208	-229
Capital account	-2,460	-1,393	-2,586	-2,132	-2,044	-2,342	-2,027
Direct investment	42	48	53	58	64	70	90
Medium- and long-term capital	-908	-834	-1,358	-908	-1,126	-1,431	-1,236
Public sector	(-227)	(-1,713)	(-683)	(-583)	(-776)	(1,181)	(-1,111)
Disbursements	/765/	/280/	/700/	/800/	/800/	/800/	/800/
Amortization	/2,992/	/4,477/	/2,427/	/2,277/	/1,527/	/919/	/638/
Amortization after rescheduling	/992/	/1,993/	/1,383/	/1,383/	/1,576/	/1,981/	/1,911/
Private sector	(-681)	(879)	(-675)	(-325)	(-350)	(-250)	(-125)
Disbursements	/29/	/1,300/	/500/	/800/	/1,100/	/1,400/	/1,800/
Amortization	/710/	/421/	/1,175/	/1,125/	/1,450/	/1,650/	/1,925/
Short-term capital	-1,594	-607	-1,281	-1,281	-981	-981	-881
Overall balance	1,765	2,198	-115	-215	-652	-590	165
			II. External Debt Indicators				
Total debt	32,011	31,177	29,819	28,911	27,785	26,354	25,118
Public debt	25,641	23,928	23,245	22,662	21,886	20,705	19,594
Medium- and long-term capital 2/	(16,861)	(23,928)	(23,245)	(22,662)	(21,886)	(20,705)	(19,594)
Short-term capital	(8,780)	(--)	(--)	(--)	(--)	(--)	(--)
Private debt	6,370	7,249	6,574	6,249	5,899	5,649	5,524
Total debt/GDP	64.94	60.23	56.34	53.03	49.49	45.57	42.16
Public debt/GDP	52.02	46.23	43.92	41.57	38.98	35.80	32.89
Private/GDP	12.92	14.00	12.42	11.46	10.51	9.77	9.27
Total debt service ratio	35.99	38.36	38.17	36.28	38.12	37.95	35.31
Public debt service ratio	26.63	31.58	25.47	24.51	24.74	24.61	21.63
Private debt service ratio	9.36	6.78	12.70	11.77	13.38	13.34	13.68
Interest payments ratio	25.79	22.23	20.76	19.56	18.44	16.21	14.18
Amortization payments ratio	10.20	16.13	17.41	16.72	19.68	21.74	21.13
Exports of goods and nonfactor services	16,694	14,970	14,689	15,010	15,373	16,702	18,153
			III. General Indicators				
Petroleum exports	14,794	12,774	12,211	12,211	12,211	13,127	14,111
Volume (mbd)	1.52	1.36	1.40	1.40	1.40	1.40	1.40
Unit value ($/barrel)	27.39	25.81	24.50	24.50	24.50	26.34	28.31
Imports of oil sector	607	645	740	810	810	820	830
Other imports	6,655	5,948	6,928	7,494	8,105	8,766	9,482
Volume (annual percentage change)	...	-14.06	12.00	4.00	4.00	4.00	4.00
Unit value (annual percentage change)	...	4.00	4.00	4.00	4.00	4.00	4.00
Current account/GDP	8.57	6.94	4.67	3.52	2.48	3.03	3.68
LIBOR (percent per annum)	...	8.50	8.00	8.00	8.00	8.00	8.00
International reserves	13,721	13,436	13,321	13,107	12,454	11,864	12,029
(In months of imports)	23	24	21	19	17	15	14
Rate of growth of real non-oil GDP (in percent)	...	...	2.0	3.0	3.0	3.0	3.0

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

1/ Assumes completion of the multiyear rescheduling agreement with creditor banks.
2/ Excludes Central Government dollar-denominated bonds held by the Central Bank of Venezuela and the Venezuelan Industrial Bank.

As regards public sector medium- and long-term capital, the mission used the authorities' projections of gross disbursements of about US$0.7-US$0.8 billion a year from multilateral institutions and official credit agencies for the period 1987-90. Assuming that the multiyear rescheduling agreement with banks is completed, net annual repayments of external public debt will range between US$0.6 billion and US$1.2 billion. A small reduction in net private sector medium- and long-term debt is also assumed. Thus, the total debt outstanding is projected to decline from US$31 billion in 1985 (60 percent of GDP) to US$25 billion in 1990 (42 percent of GDP), with the debt service ratio expected to stabilize at around 35-38 percent of exports of goods and services. On this basis, the overall balance of payments would register small deficits in the period 1986-89 and international reserves would decline to US$12 billion in 1990, or 14 months of imports. In view of the large dependence of the economy on oil export earnings and the uncertainties of the oil market, the staff agreed with the authorities that Venezuela needed to maintain relatively high reserves.

This medium-term outlook appears reassuring in that it contemplates moderate real growth while no net borrowing from commercial banks is required to achieve a sustainable balance of payments. The staff representatives stressed that these projections assumed the implementation of an exchange rate policy that helped to promote exports and to moderate the growth of imports; policies of deregulation that would stimulate private investment; and the pursuit of relatively conservative demand management policies, including a balanced position (or even a small surplus) in the consolidated public sector finances, to be consistent with the projected amortization of external debt and thus avoidance of domestic inflationary pressures.

The mission noted that the possibility of a major decline in world oil prices could not be excluded. The sensitivity of the Venezuelan economy to this variable is such that a decline in the average export price of US$1 a barrel would reduce export earnings by US$1/2 billion (about 1 percent of GDP). Thus, a sharp drop in the reference price of oil (for example to around US$20 a barrel) would pose a serious adjustment problem.

5. International cooperation

The Venezuelan representatives described the Program of Cooperation with Central American and Caribbean countries which covers the period from August 1985 through July 1986, the sixth year under the joint oil facility with Mexico. Through this facility the two countries had committed themselves, in equal shares, to provide and partially finance 160,000 barrels a day of crude oil to ten countries in the region. Average annual disbursements under this program have exceeded US$200 million in recent years. The mission commended the authorities for the assistance provided to other countries at a time when Venezuela itself was adjusting its economy.

IV. Staff Appraisal

Over the past few years Venezuela has made substantial progress in adjusting domestic expenditure to the large drop in its oil export earnings. Restrictive fiscal and monetary policies and a cautious wage policy constituted key elements of the adjustment effort as they helped to contain inflationary pressures while relative prices were shifted through a depreciation of the bolivar under a multiple exchange rate system. The public finances improved from a deficit of nearly 13 percent of GDP in 1982 to a surplus of 5 1/2 percent of GDP in 1984.

These policies, together with the application of strict import controls, produced a major improvement in the external accounts, with imports falling by nearly one half in U.S. dollar terms from 1982 to 1983 and remaining roughly at that level since that time. The external current account shifted from a deficit of US$3 1/4 billion in 1982 to surpluses of about US$4 billion a year in 1983-84, and the overall balance of payments moved from a deficit of US$8 1/2 billion in 1982 to a surplus of US$1 3/4 billion in 1984. At the same time, nonpetroleum GDP declined by more than 7 percent in 1983-84 and unemployment rose from 7 percent in 1982 to 13 1/2 percent in 1984. As a result of the pass-through effects of the devaluation of the bolivar and other corrective adjustments, the rate of price increase as measured by the CPI rose from 6.6 percent in 1983 to 18.3 percent in 1984.

Domestic growth continued to be relatively subdued in the first half of 1985. Mainly because of delays in implementing a planned increase in public investment, the public sector surplus was larger than planned. Price increases were lower than expected, and unemployment increased slightly. Imports have been running substantially lower than had been projected, and official reserves rose by more than US$1 billion in the first half of 1985 even though oil export earnings experienced a decline.

In the light of these developments, the authorities revised the 1985 Quantified Economic Program. Notwithstanding the expectation of a significant acceleration in public investment in the second half of 1985, the public sector is projected to show a surplus of nearly 2 percent of GDP for the whole of 1985 whereas the earlier official projection was for a deficit of nearly 1 percent of GDP. Also, the external current account surplus is now projected at US$3 1/2 billion, compared with an earlier estimate of US$1.7 billion. Consumer prices are expected to increase by around 7 percent in the year ended December 1985, whereas the original official projection envisaged a rise in prices of 13 percent. Nonpetroleum real GDP is likely to remain stagnant or even decline slightly this year, compared with the earlier projection of moderate growth.

The authorities are concerned about the weak performance of output and the high level of unemployment. At the same time, they feel that, given the recent price and balance of payments developments, there is room to seek to stimulate economic activity. In particular, the authorities are preparing a special public investment program that would produce a very sharp increase on such outlays in 1986, followed by the maintenance of a high level of public investment in 1987-88.

In the light of the major adjustment in domestic expenditure that has taken place and the relatively comfortable level of reserves, the staff agrees that there is scope for some expansion in government spending at least in the short run. However, full implementation of the plans that the authorities are considering would result in a consolidated public sector deficit of over 3 percent of GDP in 1986, and thus could lead to the emergence of inflationary pressures and a significant loss of reserves. The staff therefore would advocate a somewhat more cautious approach to fiscal stimulation, especially in view of the not negligible risk that oil income may decline further.

The view of the staff is that actions other than demand stimulation are also urgently needed in order to deal with the problem of stagnation in economic activity. The pervasive application of controls and regulations seemed to give rise to underutilization of resources and created major disincentives to private investment and employment, thus preventing the much needed diversification of the economy and probably contributing to the export of capital. Therefore, prompt and decisive steps are needed to deregulate the economy, including a progressive reduction in the scope of price and import controls, the elimination or drastic simplification of controls on exports and on private investment (both domestic and foreign), the adoption of a flexible exchange rate policy, and implementation of tax and tariff reforms.

Exchange rate policy is critical in promoting the restructuring of the economy and in fostering economic growth. The staff urges the authorities to unify the controlled rates at a level that would further improve the country's international competitiveness and that would take account of the weakening in the international oil market and of the need to reduce the reliance on import controls. Unification of the controlled rates would need to be followed by a flexible exchange rate policy to encourage export diversification and efficient import substitution. In the staff's view, the aim should be to achieve full unification of the exchange system as soon as possible, an objective that could be facilitated by accelerating the transfers of imports and other current transactions to the free market. Pursuit of a flexible exchange rate policy would in turn facilitate the progressive elimination of import controls that is needed to improve resource allocation. Furthermore, protection of domestic industry could be achieved more efficiently through import tariffs, and in this regard the staff would encourage the authorities to expedite their plans to design and implement a new tariff structure.

In the light of the balance of payments and price objectives, and given the excess liquidity that exists in the banking system, the staff would recommend a somewhat less expansionary credit stance of the

Central Bank than is envisaged in the authorities' program. Also, while the staff notes that domestic interest rates have been kept positive in real terms and above foreign rates, it would urge the authorities to abandon the practice of fixing maximum lending and deposit rates and to gradually eliminate the subsidy element implicit in the interest rate on agricultural loans.

A cautious wage policy has constituted an essential factor in the adjustment process and has been instrumental in containing inflation. The staff would encourage the authorities to maintain a firm wages policy and to continue their reliance on wage determination through free bargaining.

The medium-term outlook for Venezuela's balance of payments remains relatively favorable in the absence of a further substantial decline in oil prices. Even with the staff's assumption that oil export earnings will be relatively weak in the next several years, a significant recovery in imports in 1986 and moderate growth in subsequent years would still be consistent with surpluses in the external current account averaging some US$2 billion a year. On this basis, Venezuela should be in a position to service its external debt (including private debt) and to make the net repayments implied by the rescheduling agreement without a significant loss of reserves. It should be noted that this forecast is based on fiscal policies that produce a balanced position (or perhaps a small surplus) in the public finances, supported by fairly restrained monetary and wage policies and an adequate exchange rate policy. It is presumed in this projection that the generation of growth and employment over the medium term will have to come in large measure from changes in economic conditions designed to foster greater private sector investment and improved resource allocation.

The registration of private debt turned out to be a lengthy and cumbersome process, and has resulted in substantial payments arrears. Although there has been some improvement in the servicing of the private debt during the first half of 1985, it needs to be emphasized that full elimination of external arrears should be completed without delay to normalize the commercial relations of the private sector with its foreign creditors and thus to bolster confidence in the country's economic management.

The exchange arrangements that have been introduced since February 27, 1983 include 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. The processing of foreign exchange applications for current international transactions to be settled at the fixed rates continues to be subject to approval and delays. This, together with the restrictions and prohibitions on imports that are being maintained for balance of payments reasons, have made the exchange and trade system highly restrictive. The staff urges the authorities to reduce reliance on such measures, and to liberalize the exchange and trade system. As the authorities have not committed themselves to eliminate these measures by a date acceptable to the Fund, the staff would not propose approval under Article VIII, Sections 2(a) and 3 of Venezuela's exchange practices and, therefore, no decision is proposed for adoption by the Executive Board upon completion of the 1985 Article IV consultation with Venezuela.

It is recommended that the 1986 Article IV Consultation with Venezuela be held in about six months and the midyear consultation six months later.

Venezuela - Fund Relations
(As of September 30, 1985)

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 890.0 or 64.9 percent of quota
(c)	Reserve tranche position	SDR 481.5 million
(d)	Outstanding lending to the Fund (supplementary financing facility)	SDR 274.9 million

III. SDR Department

(a)	Net cumulative allocation	SDR 316.9 million
(b)	Holdings	SDR 438.2 million or 138.3 percent of net cumulative allocation
(c)	Current designation plan	None

IV. Administered Accounts

(a)	Trust Fund	
	(i) Donation	US$52.4 million

V. Venezuela has not used Fund resources to date

B. Nonfinancial Relations

VI. Effective February 24, 1984, a four-tier exchange system was established, comprising an exchange rate of Bs 4.30 per U.S. dollar for priority transactions; 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 all other transactions approved under the exchange control system; and a free rate for the remaining transactions.

VII. Venezuela has proposed an enhancement of the Article IV consultations. The last Article IV consultation was concluded on August 31, 1984 (SM/84/192 and SM/84/201). Last midyear Article IV consultation (under the enhanced surveillance procedures) was concluded on May 31, 1984 (SM/85/115) and the Executive Board did not approve Venezuela's exchange measures. The consultation is under the 12-month cycle.

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 entities. 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 (1984)	16.85 million
Annual rate of population increase (1979-84)	2.9 percent
GDP per capita (1984)	SDR 2,854

Origin of nominal GDP (1984)	(percent)
Agriculture	6.8
Petroleum (crude and refining) and mining	25.8
Manufacturing, construction and utilities	18.3
Commerce	11.0
Transport, storage, and communications	10.8
Government	10.3
Other services	16.9
Ratios to GDP (1984)	
Exports of goods and nonfactor services	30.3
Imports of goods and nonfactor services	18.0
Net factor receipts from abroad	-2.4
Central government revenues	27.4
Central government expenditures	25.4
External public debt (end of year)	52.2
External total debt (end of year)	64.9
Savings	27.1
Investment	14.8
Money and quasi-money (end of year)	50.6

Annual changes in selected economic indicators	1982	1983	Prel 1984	Proj. 1985
		(percent)		
Real GDP	0.7	-5.6	-1.4	-1.2
Real GDP per capita	-2.2	-7.8	-4.1	-4.0
GDP at current prices	2.1	-0.2	19.6	11.7
GDP deflator (excluding petroleum)	7.5	8.7	13.3	18.4
Wholesale prices (annual average)	8.1	7.0	17.5	18.4
Consumer prices (annual average)	10.0	6.4	12.5	12.0
Central government revenues (budget)	-19.5	-3.7	32.3	10.8
Central government expenditures (budget)	-6.3	-9.1	18.5	8.0 1/
Money and quasi-money (M2)	6.7	23.8	8.2	9.2
Money	(-8.2)	(25.8)	(3.8)	(...)
Quasi-money	(17.5)	(22.6)	(10.9)	(...)
Net domestic bank assets 2/	19.6	12.3	-5.7 3/	11.6 3/
Credit to public sector (net)	(5.1)	(3.8)	(-10.6)	(3.3)
Credit to private sector	(13.3)	(3.2)	(8.1)	(3.9)
Merchandise exports (f.o.b., in U.S. dollars)	-18.2	-10.1	6.8	-11.4
Merchandise imports (f.o.b., in U.S. dollars)	1.7	-46.1	7.1	-9.2

Public sector finances 4/	1982	1983	Prel. 1984	Proj. 1985
	(billions of bolivares)			
Revenue	88.2	88.1	124.6	134.3
Expenditure (including net lending)	125.9	97.7	105.3	127.8
Current account surplus or deficit (-)	31.4	34.9	54.2	49.8
Overall surplus or deficit (-)	-37.7	-9.6	19.3	6.5
External financing (net)	16.3	-4.0	-6.4	-11.5
Domestic financing (net)	21.4	13.6	-12.9	5.0
Balance of payments	(millions of U.S. dollars)			
Merchandise exports, f.o.b.	16,516	14,842	15,847	14,038
Merchandise imports, f.o.b.	-12,584	-6,778	-7,262	-6,593
Investment income (net)	-1,530	-2,397	-2,425	-1,606
Other services and transfers (net)	-5,648	-2,148	-1,935	-2,248
Balance on current and transfer accounts	-3,246	3,519	4,225	3,591
Official long-term capital (net)	2,100	182	-227	-1,713
Private long-term capital (net)	215	-71	-639	-927
Short-term capital and errors and omissions	-7,681	-4,847	-1,594	-607
Change in net international reserves (increase -)	8,187 5/	-278	-1,883	285
Change in stock of external arrears and refinancing	425	1,685	123	-2,483 6/
Official International reserves	(millions of SDRs)			
Central Bank (gross)	10,044	11,152	12,382	11,856
Central Bank (net) 7/	9,214	8,636	9,743	11,706
Venezuelan Investment Fund	1,650	728	1,339	1,581

1/ Excludes special investment program.

2/ In relation to banking system liabilities to the private sector claims on the banking system outstanding at the beginning of the period.

3/ Excludes change in valuation of Central Bank net foreign assets.

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

5/ Excludes revaluation of gold holdings from US$42.20 to US$300 per ounce.

6/ Of which, US$1,300 million of private debt is to be refinanced.

7/ Net of external arrears and other estimated liabilities.

Venezuela--Statistical Issues

1. Outstanding statistical issues

a. Government finance

The 1984 Government Finance Statistics Yearbook includes data for the consolidated Central Government in the derivation table through 1982 and in the statistical tables through 1983. For local governments the 1984 Yearbook includes only aggregate data through 1979, covering only the Federal District Municipality. General government data in the Yearbook 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. For the 1985 Yearbook the GFS correspondent has reported revised 1983 data and 1984 data for the Central Government (including data for the derivation table).

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, particularly with regard to their sectorization and classification and the procedures used in valuing balance sheet data expressed in foreign currency.

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 done 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 within the nonmonetary financial institutions in IFS, several other financial and specialized funds should 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 called "Financial Funds" within the current category of nonmonetary financial institutions (Section 40).

A follow-up technical assistance mission has been requested by the authorities to complete the reviewing of the other financial institutions' accounts.

c. Merchandise trade

The latest data on trade by partner countries received by the Bureau of Statistics 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 October 1985 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 October 1985 IFS
Real Sector	- National Accounts	1984
	- Prices (CPI)	June 1985
	- Production (crude petroleum)	June 1985
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	June 1985
	- Financing	June 1985
	- Debt	June 1985
Monetary Accounts	- Monetary Authorities	May 1985
	- Deposit Money Banks	May 1985
	- Other Financial Institutions	March 1985 (partial)
External Sector	- Merchandise Trade: Value: Exports	Dec. 1984
	Imports	March 1985
	Prices: (crude petroleum)	July 1985
	- Balance of Payments	1984
	- International Reserves	Aug. 1985
	- Exchange Rates	Aug. 1985