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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/84

3:00 p.m., May 30, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	K. Yao, Temporary
C. H. Dallara	
	H. G. Schneider
	G. Nguyen, Temporary
	T. Alhaimus
H. Fujino	M. Sugita
	B. Goos
	Jaafar A.
R. K. Joyce	L. Leonard
	H. A. Arias
	H. Fugmann
	A. Abdallah
	M. A. Weitz, Temporary
Y. A. Nimatallah	
P. Pérez	
J. J. Polak	
C. R. Rye	A. V. Romuáldez
G. Salehkhou	
	A. S. Jayawardena
N. Wicks	T. A. Clark
S. Zecchini	
Zhang Z.	Wang E.

J. W. Lang, Jr., Acting Secretary
R. S. Laurent, Assistant

Also Present

Exchange and Trade Relations Department: G. Belanger, S. Kanesa-Thasan, G. R. Kincaid, C. M. Watson. External Relations Department: H. P. Puentes. Fiscal Affairs Department: A. Cheasty. Legal Department: J. G. Evans, Jr., Deputy General Counsel; W. E. Holder, A. O. Liuksila. Middle Eastern Department: F. Drees. Western Hemisphere Department: S. T. Beza, Associate Director; L. E. Escobar, P. Ewenczyk, J. Fajgenbaum, K. Flug, M. E. Hardy. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: G. R. Castellanos, K. A. Hansen, J. Hospedales, H.-S. Lee, J.-C. Obame, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: W.-R. Bengs, A. K. Diaby, G. Ercel, G. D. Hodgson, Z. b. Ismail, J. M. Jones, R. Msadek, K. Murakami, M. Rasyid, D. J. Robinson, J. E. Rodríguez, M. Sarenac, A. A. Scholten, L. Tornetta, A. J. Tregilgas.

1. VENEZUELA - 1985 MIDYEAR ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 midyear Article IV consultation with Venezuela (SM/85/115, 4/24/85; and Cor. 1, 5/15/85). They also had before them an information notice on the real effective exchange rate of the bolívar (EBS/85/136, 5/24/85).

Mr. Pérez made the following statement:

This six-month Article IV consultation is the first of a series in response to the Venezuelan authorities' request to enhance the Fund surveillance of the country's economic performance and policy. Venezuela is following an adjustment program conceived and structured by the Government without recourse to external financing. In this context, the Fund's cooperation has been very useful. The more frequent exchange of views with the staff has, in the opinion of my authorities, benefited the basic aims of the program.

On behalf of my authorities, I would like to express their appreciation to the Fund staff for the highly valuable work during the last visit to Caracas. The staff report (SM/85/115) provides an accurate picture of the economic situation of the country.

In the early 1980s the economic and financial situation of Venezuela suffered a severe deterioration. The main external and internal factors contributing to this situation were

(a) a decline in oil prices leading to a substantial decrease in accrued government revenues;

(b) an increase in capital outflows stimulated by a lack of confidence on the part of the private sector and the attractiveness of higher interest rates abroad; and

(c) the impossibility of obtaining new external credits.

As a consequence, external arrears accumulated, and public finances and the balance of payments suffered a marked deterioration. During 1982, the overall deficit of the public sector reached 12.3 percent of GDP and, on the external front, the current account registered a deficit of $4.2 billion compared with a surplus of $4 billion a year earlier. The economic slowdown experienced since the early 1980s was accentuated in 1983. During that year output fell 4.8 percent, while the growth of unemployment accelerated and private investment continued to decline in real terms.

The new Administration that took office in February 1984 strengthened the measures taken a year earlier, building an adjustment program designed to correct existing internal and external disequilibria and to lay the foundation for an early economic revival. It is important to emphasize that this adjustment effort has been undertaken without recourse to external financing. Additionally, Venezuela began negotiations with its foreign creditor banks for the restructuring of the public external debt.

The Government took measures to adjust the most important relative prices and the cost-price structure of the economy; it also acted to reduce aggregate demand. These measures included a marked devaluation of the currency, a severe adjustment of fiscal policies, the liquidation and reorganization of public agencies, and a freeze on wages and salaries of most public sector employees. All these actions were framed and developed in the context of a social pact that has been a key element in the adjustment process.

With the devaluation of the bolívar and the sharp fall in real wages the competitiveness of the economy improved substantially. It should be noted that the present rate of Bs 7.5 per US$1 applied to the most essential imports represents a 70 percent devaluation with respect to the previous exchange rate and that, from 1982 to 1984, real wages fell by more than 15 percent. This improvement in competitiveness allowed Venezuela to attain a drastic turnaround in the balance of payments: a current account surplus of $4.4 billion was registered in 1984, compared with a deficit of $4.2 billion in 1982. The current account surplus resulted from a reduction in imports from $13.6 billion in 1982 to $7.3 billion in 1984, and--to a lesser extent--from a substantial increase in non-oil exports during the period. These favorable developments were reflected in an important increase in gross international reserves, which reached $13.7 billion at the end of 1984.

As mentioned above, the public sector deficit, which reached nearly 12.3 percent of GDP in 1982, was turned into a surplus equivalent to 5.9 percent of GDP in 1984. 1/ As mentioned in the staff report, the fiscal improvement reflected large cuts in public investment, the containment of current expenditures, as well as various revenue measures. These included a substantial increase in domestic fuel prices and higher domestic receipts derived from public sector exports.

1/ Latest estimates of the Central Budget Office of Venezuela.

In addition, Venezuela succeeded in keeping inflation under control. Notwithstanding the sharp devaluation, prices rose only 12.2 percent in 1984. These gains, however, were not achieved without pain--following a recession in 1983--a year in which output fell 4.5 percent--GDP again fell 1.8 percent in 1984, and unemployment reached 12.9 percent of the labor force. The above figures clearly show that Venezuela has made very rapid progress in its adjustment efforts since 1982.

After attaining both internal and external equilibrium, the authorities' present objectives are to achieve real positive growth in 1985 and to reverse employment trends. However, the authorities have firmly emphasized that the gains obtained thus far will not be endangered. To this end, the economic policy goals pursued by the Government in 1985 are

(a) the attainment of a moderate rate of growth in real non-oil GDP (between 2 and 3 percent);

(b) a reduction of the unemployment rate to below 13 percent;

(c) a decrease in the inflation rate; and

(d) the maintenance of a current account surplus.

To meet these goals, the Government is implementing cautious fiscal and monetary policies, pursuing at the same time the trend toward unification of all official exchange rates by the end of 1985.

In the fiscal area, the Government intends to achieve equilibrium in the consolidated public sector, giving the economy a moderate thrust. Equilibrium would result from a nominal revenue increase of 5 percent and from expenditure growth roughly equivalent to that of nominal GDP. Capital expenditures were targeted to increase by 43.8 percent, while the freeze on public sector salaries has continued to this date.

The Government and the monetary authorities are of the opinion that sustained economic recovery cannot be attained without lower inflation and the expectation that such a trend will continue in the future. To this end, the Central Bank of Venezuela has set a ceiling of 18.4 percent growth for the monetary aggregate, M-2 (December 1984-December 1985).

The Government remains committed to the unification of all official exchange rates by December 1985. As the Executive Board recommended at the conclusion of the 1984 Article IV consultation with Venezuela, the authorities adopted a timetable for this purpose. Since the last Fund mission's visit, the number of

agricultural products in the Bs 4.30 per U.S dollar list was reduced to six (sugar, corn, soya, sorghum, wheat, and milk). The Government has programmed four of those products (sugar, corn, soya, and sorghum) to be moved to the Bs 7.5 exchange rate category before the end of August; the rest will be transferred during the last quarter of the year. It is necessary to underscore that since 1983, the authorities have followed a gradual approach to exchange rate management. This approach has reflected, on the one hand, the predominance of oil in Venezuelan production and exports and, on the other, the need to establish conditions for a broad acceptance of the adjustment effort so as to guarantee its success. Additionally, the authorities have sought to avert a sharp deterioration in the financial situation of the private sector.

The authorities believe that the system of price controls was--and still is--a useful device for the conduit of wage policy. However, since the last Article IV consultation, prices of some key goods and services have been liberalized, and measures were introduced to increase the flexibility of the price control mechanism. It should be stressed that in a significant number of cases market prices are below authorized prices, and that the entrepreneurs are relatively satisfied about the manner in which the system has functioned during the last few months; price controls must be viewed as an essential element of the social pact, largely contributing to the achievement of wage stability, which has been a determinant of the adjustment process.

The main features of the Venezuelan economic performance during the first quarter of 1985 were

(a) a sharp deceleration of inflation;

(b) a higher external current account surplus than forecast;

(c) a public sector budget surplus higher than the one registered during the same period a year earlier; and

(d) monetary aggregates growing well below targets.

The comparison between targets and performance is illuminating:

	1985 First Quarter	
	QEP 1/ Targets	Actual
External current account (million U.S. dollars)	487	717
Central Bank reserves (million U.S. dollars)	-242	558
Fiscal expenditure (million bolívares)	19,375	17,231
M-2 (percentage change)	5.0	0.6
Monetary base (percentage change)	6.7	2.3

Sources: Central Bank of Venezuela and CORDIPLAN.

	(Percentage change December to April)	
	1984	1985
Inflation (consumer price index)	4.9	1.2

Source: Central Bank of Venezuela.

1/ Quantified economic program.

The good performance of the inflation rate to date can be largely attributed to the high degree of responsibility shown by trade unions in collective wage bargaining, as well as to the cautious manner in which the authorities have conducted the exchange rate adjustment. Regarding the external sector, the current account surplus resulted from lower than forecast imports and interest payments. Both factors more than compensated for the decline in revenues of *Petróleos de Venezuela*, S.A. (PDVSA) on account of the weakness of the oil market during the period.

The central government surplus of Bs 6,887 million was the result of higher than expected public revenues and of lower public expenditures--due to the delay in the implementation of the budget of several government agencies. The improvement in customs duties and income tax collections has contributed to the satisfactory performance in public revenues. Other contributing factors were a tax increase on liquor and cigarettes as

well as an increase in stamp taxes. In addition, the increases in prices and tariffs of several state agencies and enterprises--post office, electric power company, and airport taxes--lowered the requirements for central government transfers. With these trends, and despite the acceleration in outlays for some capital expenditure categories during the rest of the year, the authorities estimate that the public sector will register a surplus of approximately 1 percent of GDP in 1985.

The behavior of monetary aggregates has been in accordance with the public sector stance and the observed inflation. At present the authorities estimate that, if these aggregates perform in line with the quantified economic program during the remainder of the year, M-2 should increase by less than 12 percent in 1985. Taking into account the inflation rate prevailing during the last six months, interest rates have turned strongly positive in real terms, despite the 1 percentage point reduction implemented on May 21 in line with developments abroad.

Although the results obtained from the adjustment process are better than projected, the authorities remain deeply concerned with developments in economic growth and unemployment. Indeed, the process of adjustment has gone beyond what was initially foreseen, and this situation could involve certain risks for the consolidation of the gains made thus far.

At present, in addition to reducing interest rates, the Government is accelerating public investment projects, preparing a package of deregulatory measures for the construction industry, and liberalizing foreign investment legislation in order to boost the economy.

The prospects for satisfactorily concluding the restructuring of Venezuela's debt in the near future are very encouraging. The Venezuelan Government and the Bank Advisory Committee have agreed on the basic terms for refinancing the public sector debt, and significant progress has been made in solving the problems associated with the private sector debt. The terms of agreement were presented to the interested parties on May 17, and it is expected that this operation can be finalized during the last quarter of the year. Although the negotiations have been difficult and complicated, both the Venezuelan Government and the commercial banks have achieved impressive results making it one of the most important events in the financial history of Venezuela.

With respect to the restructuring arrangements of Venezuela's debt, the authorities were determined at the outset not to request additional loans from the international banking system. Even stronger is the authorities' intention to pay the external public debt in 12 1/2 years, and to condense payments of the private sector debt in a shorter period.

As regards the private debt, the exceptional nature of the Venezuelan debt negotiations must be stressed. The Government made it clear that the public and private sector debt negotiations should not be linked in any way; despite this, the Government set up a facility through which Venezuelan private sector companies were given access to preferential dollars for paying off the principal as well as the interest on their debts. It was, and continues to be, the Government's view that refinancing of the private companies' debts must take place between the banks and the individual companies. The Government and the Central Bank set up a support infrastructure, but will play no role in individual credit decisions.

Generally speaking, the private sector's outstanding loans will be refinanced over a period of seven years, with payments beginning after a grace period of two years. Dollars will be provided to borrowers who agree to this scheme at the exchange rate of Bs 4.30 per US$1 for payments of principal, and at the new official exchange rate of Bs 7.50 for interest payments. In certain particular cases, the nature of the debt, or considerations of national interest, have made it necessary to establish special rules. All this shows that the Venezuelan Government is committed to helping the private sector refinance its debts and adjust itself to the new exchange rate and the current economic circumstances.

The Venezuelan Government and the Central Bank of Venezuela established a free dollar market to which any firm, institution, or individual can have access for all types of transactions, including payments of interest and principal. Thus the Government has made available preferential dollars to those firms reaching refinancing agreements with international banks under certain principles and, at the same time, has provided an additional outlet for other operations. The adoption of these economic and financial measures, essential during a period of economic difficulties, demonstrates that the Government of Venezuela has taken on the important commitment of maintaining a sound private sector. Most of the problems that worried and disturbed the international financial community have been clarified and are on their way to satisfactory solutions.

My authorities would also like to express their deep appreciation for the support received from the management of this institution in the debt restructuring process.

To conclude, Venezuela has already overcome the hardest part of the adjustment, and it can look forward to the future with more optimism; the country is in a position to achieve economic recovery and restore its position in the economic and financial community.

Mr. Arias commended the authorities for the remarkable efforts made in economic adjustment, which had begun in 1983. The adoption of strong measures to tackle structural maladjustments had produced far-reaching results. The public sector deficit had been substantially reduced--by 7.3 percentage points of GDP--in 1983, and the sector's position had shifted from a deficit of 5.6 percent of GDP in 1983 to a surplus equal to 3.5 percent in 1984. Moreover, Venezuela's surplus on the current account of the balance of payments had been maintained in 1984 at the same figure as in 1983. Those results had been obtained by tighter fiscal and monetary policies as well as by the implementation of wage restraints that had been put in practice continually since 1983. Thus, the authorities had not only reached their short-term economic objectives but also placed the economy in a situation where some cautious stimulus might be provided to the economy within the framework of adjustment already adopted.

He could understand the authorities' concern about the adverse effects that any diminution of the Government's role in the economy would have on employment as well as on the rate of growth, Mr. Arias continued. Nonetheless, if the authorities were to follow a more liberal approach, it would be essential for them to maintain cautious controls so as to avoid crowding out the private sector and to continue promoting successful performance. Moreover, he encouraged them to persevere with improving and strengthening the financial position of many public enterprises that had experienced financial difficulties, so that they might provide the Central Government with additional financial support. It would also be important for the authorities to introduce reforms in the tax system. Did they have any schedule for implementing such reforms?

As during the 1983 and 1984 Article IV consultations with Venezuela, his chair was disappointed with the pessimistic view expressed in the staff report, Mr. Arias said. During the past two years, the Venezuelan economy had undergone significant adjustment: the authorities had framed their own economic program and had implemented it courageously. As Mr. Pérez had explained, results during the first quarter of 1985 had been more than encouraging and testified to the pace of the adjustment already achieved. Any comparison of the results actually achieved with the staff's projections and opinion would show a substantial disparity between opinion and fact. He could not understand why a country that had made such efforts and achieved such outstanding results was subject not to favorable comment but instead to an unhelpful approach that might lead to misunderstandings about the real extent of economic improvements. Indeed, the staff's attitude should be exactly the opposite if the Fund really intended to diffuse a spirit of optimism with a view toward re-establishing general confidence.

The Venezuelan authorities had attained great success in the control of wage increases, which had served as an incentive for increasing employment, Mr. Arias remarked. The authorities deserved commendation for their policy and should be encouraged to pursue it.

He agreed with the authorities that exchange rate policy should be handled cautiously and be adjusted gradually, as they had been doing so far, Mr. Arias said. Nevertheless, the Chairman's summing up at the Article IV consultation with Venezuela at EBM/84/130 (8/31/84) had stated that while Executive Directors "welcomed the authorities' intention to unify the fixed exchange rates by the end of 1985, they urged that this should be seen as a firm deadline." In contrast, the staff had maintained on page 25 of SM/85/115 that "the present exchange and trade system gives rise to significant distortions. The staff would therefore urge the authorities to complete the unification of all controlled exchange rates by mid-1985." As he believed that summings up by the Chairman reflected the views of Executive Directors, which should subsequently be used by the staff as guidelines for consultations or negotiations, he would like to learn why the staff at present was suggesting a different deadline for unification than that previously proposed by the Chairman. The authorities had maintained their commitment to unifying the controlled exchange rates by the end of 1985, and he sympathized with that position.

It was encouraging that the authorities had almost finished negotiating a multiyear debt rescheduling with the commercial banks, Mr. Arias remarked. He would appreciate it if the staff could inform Executive Directors about any recent developments in the registration of private sector debt, and also whether any timetable existed for eliminating private sector arrears.

Economic performance in Venezuela had demonstrated to the rest of the world the firmness and courage of the authorities in overcoming the difficult situation that they had faced, Mr. Arias concluded. Nonetheless, the authorities should not interrupt their continuous adjustment efforts until after sustainable growth rates had been attained.

Mr. Polak recalled that, when the concept of enhanced surveillance had been introduced, he had agreed that there were situations in which the Fund could usefully perform the function of enhanced surveillance to resolve particular problems in the world debt situation, as part of the bold and imaginative role that the Fund had played since the 1982 debt crisis. Although he was therefore satisfied that the Fund was in general receptive to the possibility of enhanced surveillance and although he was more than sympathetic to the proposition that Venezuela qualified for such special examination, a number of essential steps were missing in the documents prepared by the staff.

First, Mr. Polak noted, the staff had stated in the initial paragraph of SM/85/115 that, in September 1984, the Venezuelan authorities had requested enhanced surveillance; he did not recall that the Executive Board had been advised of such a request or that the Board had taken any decision to agree to it. Second, Venezuela had apparently proposed certain procedures, as listed in the second paragraph of the paper. He had understood from Mr. Pérez that the procedures used for Venezuela were similar to those regarding Mexico communicated in September 1984

to the Executive Board, but the Board should have seen the Venezuelan procedures as background before deciding whether to accede to Venezuela's request for enhanced surveillance. Third, the Executive Board should know the content of enhanced surveillance, such as (a) whether it contained trigger clauses, (b) the intended duration of the surveillance, and (c) the role of surveillance in the member's rescheduling agreement, including the consequences of an unfavorable report by the staff. He hoped that, in the future, the Board would be provided with basic information before it decided whether to approve enhanced surveillance.

He could accept the staff appraisal, Mr. Polak continued, although the most recent data provided by Mr. Pérez indicated that the rate of growth in broad money might well have fallen below the figure that the staff judged prudent. Finally, with regard to the paragraph beginning at the bottom of page 16 of the staff report, he was uncertain whether private sector debts with foreign official guarantees had to be rescheduled in order to be serviced at the preferential exchange rate.

Mr. Weitz asked the staff what would happen in the future if the staff report about a country were quite negative. For some years, Venezuela had been experiencing increasing economic difficulties that had culminated in a serious crisis in 1983. Since 1980, output had been stagnant, and it had even declined in 1983 following the imposition of severe adjustment measures. The exchange balance had also weakened in recent years, mainly owing to a large fall in export earnings equal to as much as 10 percent of GDP in 1982 and 1983, while the external debt situation had been aggravated and unusually high fiscal deficits had been incurred. The major causes of the country's severe difficulties could be traced to the sharp fall in oil revenues and the uncertainties in the capital markets; although the authorities had readily acknowledged inadequate policy responses in a number of areas, they had made considerable progress in the past two years by carrying out strong, realistic measures.

Since 1983, the economic situation of Venezuela had improved as a result of strong adjustment efforts implemented by the authorities, Mr. Weitz observed. They had adopted a series of measures, such as a cumulative average effective devaluation of the bolívar, a major increase in domestic prices for petroleum prices, an austerity program for the public sector, a freeze on wages for most public sector employees, and a general tightening of fiscal and monetary policies. Encouragingly, the new Government that had entered office in February 1984 had adopted a set of measures designed to adjust the cost-price structure further and to restrain domestic demand.

In the external sector, he welcomed the improvement in the current account of the balance of payments from a deficit of $3 billion in 1982 to a surplus of more than $4 billion in 1984, reflecting the strength and consistency of the measures applied, Mr. Weitz commented. By persevering with current economic policies, the authorities should be able to preserve that improvement, ensure rescheduling of the country's external obligations, and promote a steady reduction in external indebtedness.

He had been impressed by the progress already made, Mr. Weitz said, particularly the sharp turnaround in the public sector position from a deficit equal to nearly 13 percent of GDP in 1982 to a surplus equal to 3.5 percent of GDP in 1984. At the same time, the rate of inflation in Venezuela stood in healthy contrast to the high rates encountered in other Latin American countries. However, in making such adjustments, Venezuela had paid a high price: output had declined while unemployment had risen.

He broadly supported the program envisaged by the authorities for 1985, Mr. Weitz noted, although he shared some of the concerns expressed by the staff, particularly in relation to credit expansion and the restrictiveness of import controls. However, the authorities should stand ready to make changes if results turned out not to be in line with their expectations, especially in relation to inflation and the balance of payments. Moreover, he had been glad to note from Table 7 in the staff report that Venezuela's balance of payments should remain sustainable, even under the conservative scenario envisaged by the authorities. He supported the staff view that the targeted external current account surplus of $1.7 billion in 1985 was consistent with the programmed amortization of external debt and the need to limit reserve losses. He also agreed with the staff that the adjustment accomplished during the past two years provided a basis for the multiyear rescheduling of public debt with creditor banks, with positive consequences on confidence in the Venezuelan economy.

According to Mr. Pérez, the objectives of the Government in 1985 were the attainment of a moderate rate of growth, a reduction in unemployment, a decrease in inflation, and the maintenance of a current account surplus, Mr. Weitz remarked. To attain such results, the authorities should implement prudent fiscal and monetary policies.

For a number of reasons, he joined the staff in encouraging the authorities to accelerate the unification and liberalization of the exchange system, Mr. Weitz concluded. First, the present multiple rate system was causing many distortions in resource allocation. Second, with the exchange rate corrected and demand policies tightened, the exchange and trade restrictions would prove counterproductive and unnecessary for balance of payments protection. Third, the longer the authorities delayed unification, the higher would be the rate at which unification had to take place, with predictable consequences for prices and wages. The present exchange system was highly complex, and simplification would increase economic efficiency. He welcomed the authorities' intention to unify the rates by the end of 1985. Like Mr. Arias, he noted that the staff had urged the authorities to complete unification by mid-1985; in contrast, at EBM/84/130, the Chairman had said in his summing up that Executive Directors considered that unification should be completed by the end of 1985. Therefore, he would like to reiterate his support for unification by the end of the current year.

Mr. Schneider observed that since early 1983, Venezuela had taken major steps to adjust its economy. The results achieved in 1983 and 1984 had been encouraging, not only in the perspective of short-term stabilization efforts, but also in terms of a medium-term outlook favorable to the restoration of Venezuela's traditional price and exchange rate stability. A drastic reduction in the public sector deficit and a significant decline in the overall balance of payments deficit from 1982 to 1984 demonstrated the substantial progress made toward adjustment. Nevertheless, output had declined, unemployment had risen, and restrictions and controls intended to resolve those problems had produced distortions in the economy and had delayed the authorities' plans to ease fiscal and credit policies in order to stimulate economic activity in 1985.

As the staff pointed out, adjustment in Venezuela had been accompanied by a significant contraction of economic activity, Mr. Schneider noted. Inflationary pressures had remained lower than expected, a result of tight monetary and fiscal policies as well as a cautious wage policy. However, he urged the authorities to reconsider their plan to stimulate domestic economic activity by more expansionary fiscal and credit policies, because only continued adjustment would provide the basis for a sustainable economic recovery. Medium-term balance of payments projections indicated that there would be little room for relaxing demand management policies; indeed, continued progress in adjusting the economy depended greatly on the success of such policies. In addition, the generation of additional financial resources for the special investment program seemed to require that the authorities increase budget revenue by implementing tax reform soon and by raising the prices of goods and services provided by public enterprises.

Despite substantial adjustment of the economy, the authorities' gradual approach to exchange rate policy through a multiple exchange rate system had created distortions and limited the gains in competitiveness achieved by the non-oil sectors, Mr. Schneider said. A recent information notice indicated that the bolívar had appreciated by 10.1 percent since August 1984. He therefore agreed with the staff that the authorities must accelerate unification of the controlled exchange rates and substantially reduce the restrictiveness of the import control system. The recent appreciation of the bolívar specifically showed that the problem was urgent, requiring rapid and vigorous action.

In conclusion, the first steps in the efforts to combat imbalances in the Venezuelan economy had been satisfactory, Mr. Schneider noted. Greater emphasis on certain aspects of the economic policies pursued would increase further the effectiveness of adjustment policies.

Mr. Rye remarked that he could generally support the staff appraisal. The authorities' progress in the first quarter of 1985 had been both gratifying and reassuring, but he wished to concentrate on enhanced surveillance generally. The staff report on Venezuela illustrated some of the problems facing the Fund in carrying out enhanced surveillance.

First, the staff paper did not live up to its announced intention "to review the progress achieved in implementing the annual program and evaluate the performance of the Venezuelan economy," Mr. Rye continued. Nowhere did the staff paper address the implementation of the financial program or developments in the key variables that the program had been designed to affect. Clearly, the present exercise was less a true midyear consultation than a regular consultation under the procedures for enhanced surveillance. Indeed, as the Board was examining the authorities' 1985 economic program for the first time at the present meeting, it would have been premature to hold a midyear review at present. For that reason, the consultation sequence for cases of enhanced surveillance might have to be clarified, and its relation to the Article IV consultation cycle might have to be more clearly established. In particular, it would be only sensible to begin the application of enhanced surveillance with a regular consultation.

The second problem was that, although the staff gave details of the main quantitative targets of the 1985 economic program on page 13, Mr. Rye noted, it did not provide a comprehensive description of that program. He would have liked to see a more detailed description of the authorities' intentions and policies, along the lines of those that would be listed in a letter of intent. In that regard, according to SM/85/65 (2/22/85)--prepared for the annual review of the implementation of surveillance conducted by the Board at EBM/85/47 through EBM/85/49--enhanced surveillance involved "a quantified financial program, prepared by the country's authorities, which would present a comprehensive description of the major macroeconomic objectives for the year and the policies to be followed for their achievement." The present paper presented no such description.

Third, Mr. Rye said, in a normal stand-by arrangement, the relationship between the Fund and the authorities concerned was clear cut; in contrast, doubts about the relationship were likely to arise in instances of enhanced surveillance, as illustrated by the example of Venezuela. The staff was at variance with the authorities as to the program's compatibility with a viable external payments position for Venezuela. In particular, the staff assessment was that, while the target for the external current account surplus of $1.7 billion in 1985 was consistent with the programmed net amortization of external debt, fiscal and monetary policies would have to be tighter than planned if the authorities were to achieve that target. In addition, the staff's projections to the end of the 1980s were similar to the authorities' conservative scenario, indicating how little room existed for a relaxation of demand policies as well as the need for a flexible exchange rate policy. In the absence of the equivalent of a letter of intent, it was not clear whether, or to what extent, the authorities accepted the staff view; perhaps Mr. Pérez could describe the authorities' position. To the extent that the Venezuelan authorities did not accept the staff view, he wondered what steps the Fund should take.

The final problem was a possible clash between the Fund's involvement in enhanced surveillance and its usual surveillance function, Mr. Rye observed. In general, the primary interest of both the authorities and the banks was in those policy actions thought to be sufficient to ensure that the country was able to service its external debt and make net amortization payments without difficulty; that primary interest could be narrower than the Fund's interest. In fact, the adjustment being accomplished in various countries, although satisfactory to the authorities and the banks, might not necessarily be optimal or ideal from the broader perspective required of the Fund under the Articles of Agreement. Therefore, in consultations with countries, it was important that the staff should identify the long-term costs associated with the adjustment strategy being adopted by the authorities to satisfy the banks. For those reasons, his authorities were concerned that the Fund should not enmesh itself too closely in relationships between banks and debtors, and believed that the Fund's involvement in enhanced surveillance should be only temporary.

Mr. Wicks remarked that the authorities had taken substantial measures to put the Venezuelan economy back on track. Like the staff, however, he was concerned about the extent of quantitative controls in the economy--on interest rates, prices, imports, and exchange rates. He encouraged the authorities to consider the staff's advice carefully in those areas. In particular, he stressed the importance of unifying the various controlled exchange rates at the correct level and of ensuring that subsequent exchange rate policy was sufficiently flexible.

Although the objectives of the authorities' economic program for 1985 appeared broadly appropriate, Mr. Wicks said, the measures that they had taken so far might not be sufficient to achieve those objectives. He had particularly noted the staff's comments that "to achieve the current account target, fiscal and monetary policies will need to be tighter than have been planned by the authorities." Nevertheless, the fiscal surplus in 1984 might have been considerably higher than the recorded 3 1/2 percent of GDP; figures as high as 7 percent of GDP had recently been quoted in Venezuela. To the extent that the surplus was larger than expected--and he would be interested in hearing comments from the staff or Mr. Pérez--it might be easier to overachieve the fiscal targets for 1985. Specifically, he urged the authorities to bring the substantial rise in extrabudgetary expenditure projected for 1985 within the normal procedures for budgetary control.

Like the staff, Mr. Wicks continued, he was concerned about the continuing difficulties of the Venezuelan financial sector. Although banks' gross revenue had risen by 12 percent in 1984, their profits had fallen by nearly 4 percent. He would be interested in any comments that the staff or Mr. Pérez might have on the authorities' plans to create a deposit insurance fund.

While noting the measures taken by the authorities to speed up the registration of private sector debt, Mr. Wicks continued, he found it regrettable that RECADI (the exchange control agency) appeared unlikely to finish the registration by the end-June deadline. He urged the authorities to make every effort to speed the review.

The forthcoming multiyear rescheduling agreement between Venezuela and the commercial banks was welcome, Mr. Wicks considered; through provision of enhanced surveillance, the Fund had played a useful role. Nevertheless, his authorities believed that in future cases Board approval ought to be obtained in good time before the Fund agreed on a similar procedure for other countries.

He had several questions on the procedure followed for Venezuela, Mr. Wicks said. First, for how long was the Fund committed to operating the enhanced surveillance procedure and undertaking six-monthly consultations? Second, was it intended that the staff give a presentation to the bankers on the enhanced surveillance report, and would the staff answer bankers' questions on it? Third, how widely would the report be distributed among the banking community? Would it be sent merely to banks on the Advisory Committee, or would the report be received by the many hundreds of banks in the syndicate involved?

Fourth, Mr. Wicks continued, was it not unusual for a staff report to state that the authorities themselves had undertaken, without prior approval from the Board, to provide copies of the report to the bankers? His chair had given its general support to that procedure on the understanding that it would not damage the frankness of the discussions held between the staff and the authorities, that the procedure would be used rather sparingly, and that it would be used only where it promised to make a material contribution to debtor-creditor relationships. Although he recognized that the Fund already released staff papers to other bodies, such as the GATT, in those cases an explicit decision had been brought to the Board for approval on the precise arrangements for transmission of the papers. Why had a similar procedure not been followed in the present case? After all, the papers were issued under the rubric "not for public use." Was it within the responsibility of the authorities concerned to decide at their discretion to circulate the documents outside official circles?

Fifth, he assumed that the bankers would not be given any information about the Executive Board's consideration of the staff report, a novel procedure that would raise fundamental issues, Mr. Wicks remarked. In that connection, he assumed that the two paragraphs on page 2 of the staff report summarizing the previous consideration by the Executive Board of the Venezuelan economy would not be included in the version of the staff report submitted to the bankers.

As a follow-up to a point raised by Mr. Polak, Mr. Wicks said, he would like to know whether any element in the enhanced surveillance procedure was intended to serve as a trigger for action by the banks.

Finally, he would be interested in learning what liability, legal or otherwise, the Fund had to the bankers for statements made by the staff in SM/85/115. Presumably, the bankers would come to some conclusions about their future course of action on the basis of the staff views and figures set out in the report. However, what would happen if the views in the report turned out to be ill founded or, even worse, if the figures on some important economic variable proved to be wrong? In such circumstances, would the bankers have some recourse against the Fund for misleading them? Finally, he agreed with the staff appraisal, which struck the right balance between the progress already achieved and the task that remained.

Mr. Dallara recalled that several speakers had already highlighted two generally positive features of Venezuela's adjustment effort during the past two years: the sharp turnaround in the current account of the balance of payments, and the change in the consolidated public sector position from a large deficit in 1982 to a surplus in excess of 3 percent of GDP in 1984. The reversal of both accounts had been mainly the result of the sharp depreciation of the bolívar, import constraints, increases in some public sector prices, a cutback in expenditures and public investment, and wage restraint.

The most striking development in the external accounts had been the 42 percent fall in imports in two years, Mr. Dallara observed, although it might have occurred from a somewhat inflated base, as the steady real effective appreciation of the bolívar prior to 1982 must have encouraged a possibly inappropriate level of imports. Subsequently, the imposition of tight import controls might have artificially suppressed imports, an effect compounded by negative growth rates in the Venezuelan economy in both 1983 and 1984. In any event, the ratio of imports to GDP had fallen by about 10 percentage points. He had doubts about the sustainability of the relationship between imports and GDP, an issue on which he would welcome comments by the staff or Mr. Pérez.

At a time of overall improvements in the current account, nonpetroleum exports had increased but had still amounted to only 7 percent of total exports in 1984, Mr. Dallara continued. Even more striking was the fact that the private sector had accounted for only 2.7 percent of exports in the same year. In fact, the staff had suggested that the exchange rate might still not be adequate for the nonpetroleum sectors of the Venezuelan economy. In particular, he would be interested in any thoughts that Mr. Pérez or the staff might have on the medium-term outlook for the country.

In 1984, Venezuela's international reserve position had improved, with gross reserves totaling $13.7 billion by the end of the year, against accumulated arrears to foreign private creditors of $2.7 billion, Mr. Dallara recalled. He found the simultaneous buildup of gross reserves and large arrears to foreign private creditors to be anomalous and disquieting. Although progress had been made toward resolving the

difficulties with arrears, the ultimate resolution still appeared to be a number of months away. He encouraged the authorities to ensure that such difficulties were resolved as soon as possible.

As to the fiscal accounts, the shift from a large public sector deficit in 1982 to a surplus in 1984 had resulted mainly from a sharp rise in revenues to the state petroleum company and a sharp cutback in capital investment by the public sector, Mr. Dallara remarked. The first development had clearly been positive, reflecting the correction of serious exchange rate distortions. In contrast, the scaling down of public investment could eventually have adverse repercussions on economic growth, but some of it might be warranted and might not prove costly to the economy. He would be interested in learning whether the staff had any concerns regarding that area. The containment of personnel costs had clearly been another positive feature in the overall budgetary performance, such costs having remained essentially unchanged in nominal terms for the past three years. In itself, that development reflected the broader success story in wage restraint.

Despite the generally impressive shifts in the current account and fiscal balances, progress had not been clear with respect to some of the ultimate objectives of economic policy, Mr. Dallara went on. As already pointed out by Mr. Schneider and others, Venezuela had a rather discouraging record with regard to real economic activity and employment, and, underlying that record, the decline in investment had led previous speakers to express concern about the outlook for investment over the medium term; he was concerned about what it could mean for medium-term growth and balance of payments sustainability. In that connection, liberalization of the financial system could play an important long-term role in the recovery of savings and investment. He welcomed Mr. Pérez's statement concerning the liberalization of foreign investment legislation. However, he wondered whether it would cover the establishment of foreign banks because, for such an important country deeply involved in the international financial community, the authorities' policies concerning foreign banking had been somewhat puzzling. Frankly, current policies had not been particularly helpful for medium-term growth and development of the economy.

Price performance had been quite good in 1983, Mr. Dallara considered; although inflation had accelerated in 1984, it had decelerated rather impressively so far in the current year. The staff report and Mr. Pérez's statement gave some indication of the causes behind price developments, clearly indicating the role played by wage restraint. Nevertheless, the succession of sharp increases and decreases in the rate of inflation left him somewhat puzzled. He would appreciate further information from the staff about the causes of the evolution of prices in Venezuela and also about the outlook for 1985.

The authorities and the social partners in Venezuela deserved commendation for the success that they had achieved in wage restraint, which would remain crucial to economic recovery as well as to further

diversification of the economy in the years ahead, Mr. Dallara continued. In achieving such restraint, however, a variety of devices had been used, including forced hiring and limits on profit distribution, that might not contribute to growth and stability in the medium term.

As to economic prospects in Venezuela for 1985 and beyond, he shared the unease expressed by the staff concerning the proposed "more expansionary" monetary and fiscal policies envisaged for the current year, Mr. Dallara said. In the past, such efforts did not appear to have worked, and he questioned the general appropriateness of the stimulative approach as well as its consistency with the authorities' balance of payments objectives; on that point, he associated himself with the staff appraisal. Clearly, the authorities had built a firmer base for adjustment during the past few years by taking a number of important policy measures, but persistence in and a broadening of the adjustment effort would be required. Particular attention would have to be given to dismantling the broad array of restrictions if the economy were to develop the versatility and dynamism that would be needed for it to grow in the years ahead. Specifically, price controls, interest rate controls and subsidies, limits on profit distributions, and import and export controls were among the current features of the economy that must receive further attention and action if the medium-term outlook were to be positive. In sum, the authorities had taken a number of impressive steps during the past two years to promote adjustment, but he could not but be concerned about the medium-term outlook in the light of their rather heavy reliance on controls.

Over the medium term, the staff's balance of payments and debt projections were fairly reassuring, although the country's accumulation of debt and the debt service ratio would both still be high by the end of the 1980s, Mr. Dallara stated. He recognized that that aspect of adjustment was of particular interest to commercial bank creditors. In fact, the staff had stated that "the adjustment that has been accomplished in the last two years provides a basis for the multiyear rescheduling of public debts with creditor banks."

Previous speakers had already touched on many of the questions that he would have asked about enhanced surveillance, Mr. Dallara recalled. However, in reviewing the Fund's limited experience in that field, he would like to make the following points. First, the present midyear consultation with Venezuela represented one of the first examples of the Fund's efforts to develop and extend its catalytic role in response to the expressed interests of a member country, which had been working and continued to work on its adjustment efforts. As Mr. Wicks had noted, that effort by the Fund had had the beneficial effect of helping Venezuela to obtain a long-term rescheduling of its debts with commercial creditors, which could be beneficial to the country's prospects for the balance of payments and economic growth. Nevertheless, in a case-by-case fashion, certain weaknesses and certain strengths in such arrangements should be taken into account as the Fund continued to develop and implement the techniques and procedures of enhanced surveillance.

Second, Mr. Dallara asked, would the staff display the flexibility, capacity, and interest to be able to modify the understandings reached between the Fund and the authorities? Such traits would be desirable for the staff in order to take account of the interests of the member as well as the Fund while remaining mindful of the member's interest in its relationship with the commercial banking community.

Third, Mr. Dallara concluded, he had the impression that the initial understandings reached had been useful in encouraging the Venezuelan authorities to take certain corrective actions. Indeed, there might have been a degree of leverage available at that time that perhaps was no longer present; many differences, with regard to both policies and projections, appeared to exist between the Fund and the authorities. For example, the expected changes in international reserves, the timing of exchange rate unification and the nature of the subsequent system, the adequacy of the exchange rate for nonpetroleum exports, the expected growth of revenue, the appropriate size of the special investment program in the current year, and the size of the public sector deficit together with the monetary targets for 1985 all raised questions whether the present arrangements could warrant reconsideration with regard to the ability of the Fund to work closely with the authorities in encouraging and, to the extent feasible, obtaining appropriate policy changes. He would be interested in hearing any comments that the staff or Mr. Pérez might offer. If such arrangements were to serve the interests of the member country as well as the broader interests of the Fund, it would be important that all parties involved be alert to potential weaknesses and also to possibilities for strengthening those arrangements.

Mr. Fujino welcomed the first midyear consultation held by the Board as part of enhanced surveillance, which was an important expression of the Fund's function as a catalyst. The authorities had achieved commendable progress in implementing adjustment policies during the past two years. Public sector finances had improved significantly, the current account had shifted from deficit into surplus, and real wages had declined. Nevertheless, there remained two major areas of concern. The first was that the authorities had continued to rely on such measures as multiple exchange rates, tight import controls, and price controls, a reduction of which would help to improve resource allocation, thus paving the way for a sustained expansion of the economy. Moreover, external arrears in the servicing of private sector debt had accumulated under the multiple exchange rate system, while the process of registration--under which the private sector would have access to preferential exchange rates--had not been fully established. The second area of concern was that, in view of several successive years of economic stagnation and the relatively high rate of unemployment, it could be argued that the authorities should ease fiscal and monetary policies at present in order to stimulate the economy. However, the staff had observed that previous attempts to use expansionary fiscal policies as a stimulus had been unsuccessful.

Although inflation seemed to have moderated recently, according to Mr. Pérez, any premature easing of fiscal and monetary policies might accelerate the rate of inflation and prove detrimental to economic recovery, Mr. Fujino continued. At any rate, the targeted surplus on the external accounts of $1.7 billion in 1985 under the quantified economic program could be achieved only with adequate prudence in fiscal and monetary policies.

To be consistent with the authorities' targets for inflation and the balance of payments, the staff had estimated that the consolidated public sector finances needed to show a surplus of about 0.3 percent of GDP in 1985, Mr. Fujino noted. Although the authorities' fiscal program included some revenue-raising measures as well as adequate restraints on current expenditure, the revenue estimate made by the staff, taking into account the projected lower earnings from petroleum exports as well as the implementation of the first two tranches of the special investment program, would result in a deficit of 1.2 percent of GDP on consolidated public sector finances. To attain balance in that account, the corrective measures suggested by the staff might have to be implemented during 1985, including a further scaling down of the special investment program, early implementation of the tax reform package, adjustments in the prices of goods and services sold by certain public corporations, and an acceleration of the program to restructure, divest, and liquidate public enterprises.

In the quantified program, broad money was expected to grow by 18.4 percent in 1985, Mr. Fujino remarked. However, if account were taken of involuntary holdings of deposits included in the stock of broad money at the end of 1984 reflecting the accumulation of external arrears and frozen deposits within the intervened banks, then a more realistic projection of the growth of broad money in 1985 should be much lower, by perhaps nearly 10 percentage points, as projected by the staff. Therefore, the monetary stance should be more cautious than the authorities had envisaged. In particular, the Central Bank should be cautious in avoiding the creation of excess liquidity by discounting government securities being issued to settle domestic arrears of the public sector. He agreed with the staff that a flexible, freely market-determined interest rate policy was of particular importance.

The so-called social pact had contributed to adjustment in the Venezuelan economy, Mr. Fujino said. Indeed, price controls and wage stability had been mutually reinforcing. However, since the system of price control might cause inefficiencies, further simplification and a reduction in the scope of price controls were recommended. He also urged the authorities to continue to exercise wage restraint.

On external policy, in view of the distortions, especially the large subsidy element that had been created by multiple exchange rates, the authorities should accelerate their unification of the exchange system, Mr. Fujino suggested. At the same time, they needed to reduce the restrictiveness of import controls. They could protect domestic economic activity more efficiently by reformulating and simplifying the tariff

structure. Although the real appreciation of the bolívar that had taken place between 1978 and 1982 had been largely reversed during the past two years, he had noted from the staff paper that Venezuela's competitiveness had not necessarily been adequate in 1978. Therefore, it was particularly important that the authorities adopt a flexible exchange rate policy within the fully unified system. They should also eliminate as promptly as possible the accumulation of external arrears on the servicing of private sector debt. He endorsed the staff appraisal and hoped that the multiyear rescheduling with commercial banks would contribute to a further strengthening of confidence in the Venezuelan economy.

As to the form of the staff paper, the program had not been presented systematically or comprehensively, and he had some difficulty in drawing a clear picture of the program and appraising it adequately, Mr. Fujino said. In addition, he wished to have further information about the form in which the staff report for the midyear Article IV consultation would be transmitted to banks, as the present was the first occasion on which the Fund had undertaken such a midyear consultation.

Mr. Leonard observed that his chair had been cautions in its approach to enhanced surveillance, how it was to be given effect, and how it was to be used. Indeed, the modalities of enhanced surveillance could well vary from country to country, and the way should be left open for such variation. Nevertheless, the detailed quantified financial plan for Venezuela, including the medium-term projections prepared by the authorities, appeared to have provided a firm basis for the staff to come to grips with the issues facing the authorities at present in managing the economy and to give a clearer form to the related policy discussions. Could the staff provide a brief critical review of its experience during the consultation?

The presentation of the staff's findings gave rise to some questions, Mr. Leonard noted. Clearly, the staff had come to strong, firm conclusions about what needed to be done by way of corrective action. He was certain that the Board had no quarrel with such an approach in normal Article IV consultations, when any Executive Director taking issue with the staff's findings had an opportunity to question and clarify the conclusions reached. In the present instance, however, the report by the staff was to be transmitted to creditor banks and would enter into their decisions on lending to Venezuela. Although there was no reason for the staff to depart from the conclusions already reached, he wondered whether its assessment would have to be more qualified. Perhaps criticism of government intentions would have to be more amply documented and supported so that differences of views between the authorities and the staff could be better understood. Uncertainties surrounding the staff's conclusions might have to be made clear so that commercial banks could investigate them for themselves and could perhaps reach different but equally defensible conclusions. In that way, the danger that staff reports might become a definitive red or green light for bank lending would be avoided. In other words, banks ought to arrive at their decisions independently of the Fund's assessment.

The Venezuelan authorities were making continuing progress in correcting the internal and external imbalances in the economy, Mr. Leonard observed. Particularly notable were the change in the public sector position from a deficit in 1982 to a surplus in 1984 and the shift in the current account position from a deficit in 1982 to a surplus in both 1983 and 1984. The authorities' moderate wage policy and the substantial, if incomplete, correction of price distortions had made a large contribution to those achievements. Consequently, the medium-term outlook for the economy had improved considerably, a development that should help to reverse the decline in investor confidence. Of course, those improvements had been bought at a price of a substantial decline in economic activity and employment. Although it was understandable that in response to such developments, the authorities should again think of expansionary fiscal and monetary policies, they still had to safeguard the progress achieved so far in economic adjustment and proceed further in restoring sustainable budgetary and balance of payments positions.

In fiscal policy, the major effort under way to increase capital expenditure was commendable, Mr. Leonard continued, as was the careful consideration being given to the inflationary and balance of payments effects of such an increase. At the same time, the authorities would need to pay close attention to ensuring that scarce investment capital went to economically viable sectors that generated sustained growth in employment rather than to short-lived, make-work projects. Furthermore, early implementation of tax reform measures, as recommended by the staff, would help to strengthen the revenue base and allow some room for maneuver in the face of a possible overestimation of government revenues and possible crowding out of the private sector that could occur if the budget surplus of 0.3 percent of GDP, consistent with projected debt amortization targets, were not achieved.

To the extent that a drawdown occurred in 1985 of involuntary bank deposits, accumulated when external arrears had built up and when bank deposits had been frozen, the authorities would need to adjust monetary targets, Mr. Leonard suggested. Otherwise, there could be an excess of liquidity that could compromise the balance of payments and inflation targets. In addition, the authorities were risking a loss of control over base money by issuing government securities in settlement of public sector arrears and permitting them to be discounted at the Central Bank. Under the circumstances, there was a potential for entities other than the monetary authorities to create base money incidentally, by rediscounting government securities and exchanging the resulting claims for commercial bank deposits. As recommended by the staff, the authorities should therefore carefully circumscribe the eligibility for rediscounting such securities. The rediscount rate should also be high enough to eliminate artificial incentives to rediscounting; if necessary, the authorities should take offsetting measures such as raising commercial bank reserve requirements.

Interest rate policy needed more attention, Mr. Leonard recommended. After a reduction in the maximum lending rate to 14 percent on May 22, 1985, the rates were only barely positive, and real deposit rates could become negative, an inappropriate feature in the light of the need to prevent capital flight, which appeared to have been significant in recent years. Low interest rates might also reduce the flow of deposits to the banking system, diminish the resources available to banks for lending, and lead to inefficient uses of financial assets. He would therefore urge the authorities to move toward allowing interest rates to be set freely in the market or, at a minimum, toward increasing the interest rate ceilings.

Contention had arisen between the Venezuelan authorities and external creditors about the slow pace at which external arrears owed by the Venezuelan private sector were being settled, Mr. Leonard noted. By instituting eligibility conditions for preferred exchange rates, the authorities had introduced an official presence into the normal settlement of external debts of the private sector, so that responsibility for foreign exchange transfers had fallen at least partly on them. To ensure that the negotiations on a multiyear rescheduling agreement with commercial banks, currently in their final stages, could be concluded successfully, he would encourage the authorities to redouble their efforts to eliminate the remaining arrears without further delays. It was important that all arrears, including those owed to official creditors, be cleared in order to help to maintain levels of official financing, including short-term trade credits.

He welcomed the authorities' intention to accelerate the unification of the multiple exchange rates and to complete it by the end of 1985, Mr. Leonard remarked. He fully shared the concern expressed by the staff about the appropriateness of the targeted unification rate of Bs 7.50 per dollar because of the pressing need to maintain the competitiveness of Venezuela's non-oil exports at a time of weak oil markets worldwide. Finally, correct price incentives, which an appropriate exchange rate could engender, would also encourage economically sound import substitution.

Mr. Jaafar said that he shared the views expressed by Mr. Polak regarding certain omissions by the staff in its description of enhanced surveillance. In addition, he had four questions. First, what was the nature and extent of the Fund's assistance or involvement in designing the adjustment program undertaken by Venezuela? Second, to what extent were the views and recommendations of the Fund on certain policy areas binding on Venezuela? Third, would the release of the relevant staff report to creditor commercial banks be automatic or subject to confirmation from Venezuela? Fourth, would the Chairman's summing up of the Board discussion of the staff report also be released to the commercial banks?

He noted with satisfaction the continued progress achieved in 1984 in adjusting the Venezuelan economy to the new scarcity of resources brought about by lower oil prices, Mr. Jaafar continued. The sharp

reduction of public investment, the depreciation of the bolívar, wage restraint, and direct controls on exchange allocation, trade, and prices had more than restored balance to the external account and public finances. Moreover, the country's international reserve position had rebounded, and an agreement had been reached with creditor commercial banks on a multiyear rescheduling of external debt. The rescheduling agreement portended the return of confidence in the national economic management and would contribute significantly to the viability of the balance of payments in the medium term. At the same time, he shared the authorities' concern about the contraction of economic activity and the sharp rise in unemployment during the past few years. Although he appreciated the need to improve the growth prospects of the economy, it should be done with caution so as not to cause a setback to the process of adjustment.

The medium-term prospects for the balance of payments pointed to the need for maintaining a restrained stance in demand policy, Mr. Jaafar stated. Supply-side policies had to play a more important role in promoting growth and economic transformation. Increasing the role of market forces in determining prices, the exchange rate, interest rates, and resource allocation should form an essential part of the authorities' policy strategy during the next few years. He agreed with the staff that more rapid progress in those spheres was required.

On demand policy, Mr. Jaafar noted with concern the significant discrepancy between the fiscal and monetary targets set in the official program and those considered appropriate by the staff. Did both sets of targets use the same assumptions regarding economic growth and inflation rates? In any event, there were many reasons for the authorities to monitor demand as well as its spillover effects on imports and capital flows.

He joined the staff in calling on the authorities to proceed cautiously with the plan to raise capital expenditure in 1985, Mr. Jaafar said. First, to minimize the impact on the fiscal deficit, they should accompany the rise in expenditure with appropriate revenue measures, possibly including tax reforms and adjustments in public sector prices, particularly the price of fuel. Second, to the extent that the increase in capital spending could not be matched by additional revenue or cuts in current expenditure, the authorities should consider scaling down the investment plan. Third, they should apply more stringent criteria in selecting investment projects, with a focus on developing efficient and competitive industries outside the oil sector. Advisory assistance from the World Bank in directing such investment spending would be helpful.

On monetary and credit policy, he supported the authorities' pursuit of more prudent targets for 1985 than those envisaged in the official program, Mr. Jaafar remarked. Apart from the uncertainty in the underlying demand for money, the acquisition by the Central Bank of government securities, issued to settle domestic arrears of the public sector, might well contribute to excessive monetary expansion. He concurred with the

staff that, under the circumstances, the authorities must act carefully when using the rediscount window, in order to reduce the expansionary impact of government security issues on the money supply. He also underscored the importance of a definite plan to liberalize interest rates and to phase out gradually the subsidy element in agricultural credits.

He welcomed the initiatives taken by the authorities to start moving away from generalized price controls by applying them more flexibly, Mr. Jaafar continued. Nevertheless, given the crucial importance of market-determined policy to the efficiency of resource allocation and economic growth, he encouraged the authorities to draw up a definite plan to remove most price controls within a reasonable period. Experience had shown that, except for its once-and-for-all effect, price liberalization would help to hold down inflation only when accompanied by fiscal, monetary, and wage restraint. On wages, the general policy stance of promoting wage adjustments through collective bargaining was appropriate. In line with that policy, the Government should restrain wage increases within the public sector.

In the external sphere, the recent measures taken and the plan to transfer more imports and other current transactions from the lower to the upper tier of the exchange system were encouraging, as was the intention to unify controlled exchange rates by the end of 1985, Mr. Jaafar said. However, more tangible and speedy progress would be required if the complex and highly restrictive nature of the present exchange and trade system were not to undermine the authorities' efforts to promote non-oil exports and import substitution. Flexible and realistic exchange rates would not only help to stimulate non-oil exports and import substitution but would also facilitate efforts toward further liberalizing the exchange and trade system.

The authorities were to be commended for the large amount of assistance provided to other countries under the program of cooperation with Central America and the Caribbean, Mr. Jaafar concluded. Venezuela was also a major contributor to the Trust Fund, which had benefited other developing countries.

Mr. Goos observed that enhanced surveillance in certain circumstances could make a useful contribution by providing countries with economic policy advice and by mobilizing financial assistance, as shown in SM/85/115. In the case of Venezuela, he was glad that the staff had limited itself to providing analyses and recommendations. As he had pointed out during the recent discussion of ways to improve Fund surveillance, the Fund should proceed with great caution. Thus, he was glad that the arrangement with Venezuela did not provide for any explicit "on/off" signals on the appropriateness of further bank lending and that the Fund was apparently not becoming too closely involved in the dealings between the country and its creditors. However, he would be interested in further explanations of the nature of the understanding reached between the authorities and the staff.

While he agreed with Mr. Pérez on the usefulness of cooperation between Venezuela and the Fund, there was apparently considerable disagreement between the staff and the authorities regarding projections of important economic trends, such as oil prices, fiscal revenues, and monetary aggregates, Mr. Goos remarked; more important, there was a divergence of views on the necessary policy stance. It was understandable that the authorities were contemplating a relaxation in their restrictive fiscal and credit stance after the economic contraction and the rapid rise of unemployment in the past two years, all the more so because Venezuela had already achieved impressive economic adjustment, as demonstrated by large fiscal and external surpluses. Furthermore, he had noted from Mr. Pérez's statement that developments in the first quarter of 1985 had been better than expected. However, a shift in the economic strategy at present would entail considerable risks that might jeopardize the achievements made so far, thereby endangering the medium-term viability of the external position.

In fact, there were a number of compelling reasons why the authorities should not adopt a more expansionary policy stance, as they apparently intended to do in 1985, Mr. Goos noted. First, like the staff, he was worried that a stimulative policy would not be consistent with the authorities' current account objectives. It was particularly doubtful whether a major boost in public investment spending would not again overburden the financial and real resources of the country. Second, the continued existence of a number of weaknesses and uncertainties in the economy should caution the authorities against any undue relaxation in their policy stance. Indeed, the economic adjustment achieved so far was based at least in part on policies that seemed to perpetuate and even exacerbate structural distortions, thereby impeding further growth prospects, particularly the multiple exchange rate system and the comprehensive controls on imports, foreign exchange, and prices.

Third, despite price controls, Mr. Goos said, inflation had shown a surprisingly strong acceleration in 1984, and a further surge appeared likely for 1986. Although the rate of price increase was still low in comparison with other Latin American countries, recent and prospective price developments would also speak against relaxing demand management policy. Furthermore, it appeared that the unsatisfactory price performance had been due largely to insufficient efforts to address structural deficiencies.

Fourth, the policy stance envisaged for 1985 seemed to depend upon quite optimistic economic projections, Mr. Goos continued. Like the staff, he believed that less optimistic projections would be more appropriate, especially with respect to public sector revenue. Moreover, the latest survey of developments in the international oil market indicated a prolonged period of weak demand as well as the likelihood of further downward pressure on prices.

Fifth, the renewed real appreciation of the bolívar, as described in the information notice, had reversed much of the real depreciation of the currency during 1984, Mr. Goos remarked. The adverse repercussions of that appreciation were evident: inter alia, it hampered the needed diversification of Venezuela's exports and was worsening the prospects for the current account. In addition, he would like to emphasize the staff's finding that earlier attempts by the Venezuelan authorities to spur economic activity had proved unsuccessful. He could thus fully support the staff's recommendation for a continued cautious stance regarding economic policy.

He was concerned about the delay in the authorities' response to a number of recommendations offered by the staff in the course of the discussions, a delay that cast some doubt on the authorities' commitment to adjustment, Mr. Goos observed. In particular, the authorities had responded rather ambiguously to the need for specific steps to improve public revenue, especially a reform of the tax system, which had been recommended as early as 1983 by the tax reform commission. He was also disappointed that the authorities had felt unable to present a specific timetable for liberalizing imports and eventually unifying the exchange rate system; the staff's suggested timing of the end of 1986 for full unification represented the minimum of what the authorities should do. Furthermore, according to some reports, the President of Venezuela was said to have instructed the Central Bank to lower its interest rates. As real interest rates were already quite low, such a move could not but hamper adjustment. In conclusion, his authorities had serious doubts about the appropriateness of the economic policy stance in Venezuela, especially in view of the urgent need for securing sufficient adjustment in the external accounts.

Mr. Fugmann expressed general agreement with the staff's views. In the recent past, the Venezuelan economy had performed quite well; according to Mr. Pérez, developments in the first quarter of 1985 had compared satisfactorily with the official targets. However, it would be crucial for them to maintain a cautious policy stance in coming years if economic performance were to remain on a stable course. In view of Venezuela's experience with more expansionary policy stances and the necessity to consolidate domestic and international confidence in the adjustment effort, the authorities' economic policies should be more restrained, as the staff had commented on page 25 of SM/85/115.

According to the information notice, the bolívar had substantially appreciated in real terms during 1984 and 1985, Mr. Fugmann continued. Given the desirability of diversifying the economy and avoiding market distortions, and for the reasons mentioned by Mr. Leonard, the authorities would be well advised to expedite the implementation of a unified, flexible exchange rate and to dismantle existing trade and other external restrictions in accordance with the schedule proposed by the staff.

He agreed with Mr. Goos that the generally cautious approach taken by the staff in order to avoid transmitting "on/off" signals to the banks was welcome, Mr. Fugmann went on. However, he had some procedural questions along the lines of those raised by Mr. Polak, Mr. Wicks, and Mr. Jaafar. In a recent speech at the Institute of International Finance, the Managing Director had mentioned, inter alia, that the procedures for enhanced surveillance were still being developed and would doubtless evolve with experience on a case-by-case basis. Therefore, no precise answers could be expected at the present meeting. Nevertheless, the staff had stated that "during the consultations, the mission agreed with the authorities on procedures for reporting and monitoring of performance under the program." Could the staff explain precisely which procedures were involved and how close the relationship between the Fund's recommendations and the Government's implementation of the economic strategy was expected to be? In that connection, perhaps Mr. Pérez could explain what commitment the authorities had made to their own program: were the targets designed mainly to serve as guideposts for evaluating whether the economy was generally on the right track, or did the authorities intend to adhere to them strictly?

As enhanced surveillance had been initiated with a view to facilitating the banks' monitoring of the Venezuelan economy, Mr. Fugmann concluded, he wondered whether the staff could be more specific about the role of Fund assessments. For instance, which Fund documents would be transmitted to the banks by the Venezuelan authorities? In addition, had the banks established mechanisms that would trigger renegotiations or other changes in the multiyear rescheduling agreement in the event that Fund reports suggested the advisability of a tighter policy stance, as they did at present?

Mr. Zecchini agreed that reports for midyear consultations should focus on the consistency and adequacy of countries' annual programs with the Fund, particularly how those programs were being carried out. Therefore, an important aspect of the midyear review would concern its timing, which should be related to the availability of the data forming quantitative targets under the program. However, only data up to December 1984 were available from Venezuela. Mr. Pérez had informed Directors about the country's performance up to March 1985, but, owing to a lack of comprehensive data on the real economy on a recent monthly or quarterly basis, midyear reviews were likely to focus attention solely on the monetary economy, thereby impeding a balanced assessment of the total economy and the authorities' policies.

The staff report demonstrated that Venezuela was continuing to pursue its adjustment efforts successfully, Mr. Zecchini noted. The authorities had made remarkable progress in adjusting the current account position from a deficit of over $3 billion in 1982 to a surplus of over $4 billion in 1984; likewise, the fiscal position had changed from a deficit equal to 11.9 percent of GDP in 1982 to a surplus equal to 3.5 percent of GDP in 1984. The medium-term outlook for the balance of payments was viable, and projected surpluses on current account would

allow for substantial yearly reductions in the stock of external debt. According to Mr. Pérez, the economic program for 1985 was well on track. However, there was still scope for intervention in the exchange rate system, the import regime, price controls, and other restrictions. Some concerns also arose from the stance of fiscal and monetary policies in 1985: as pointed out by the staff, it might not be sufficiently restrictive to obtain the desired outcome on the current account.

As he was in broad agreement with the staff report, he would merely like to ask four clarifications on some of the figures reported by the staff, Mr. Zecchini said. From Table 3, Table 4, and the staff appraisal, he had detected some differences between the projections made by the staff and those made by the Government with respect to public sector operations and the monetary and credit aggregates for 1985. Owing to those differences, the staff had argued that Venezuela's current account objective for 1985 might not be met. However, Table 2 in SM/85/115 showed that both the staff and the Venezuelan Government projected a current account surplus in 1985 equal to $1.7 billion, which would be in line with the program's objectives. He would therefore like to know how those results had been reconciled and what assumptions had been made by the staff in its 1985 current account projections. Furthermore, Mr. Pérez had mentioned the authorities' estimate that the public sector would register a surplus of about 1 percent of GDP in 1985, but, according to Table 3 of the staff report, the Government had estimated an overall deficit equal to 0.7 percent of GDP. Had there been any new developments that might change the projected fiscal outcome and, if so, how might those developments affect monetary aggregates and the balance of payments?

The four-tier exchange system had undesirable consequences for the allocation of resources within the economy, Mr. Zecchini remarked. The free market was quite thin, accounting for only 10 percent of transactions, a feature that explained the wide fluctuations that had occurred in the exchange rate and the importance of central bank intervention in determining the exchange rate in the free market. As all nonpetroleum exports were conducted in the free market, the uncertainties about the exchange rate and its wide fluctuations negatively affected export industries. On the other hand, import volumes were being checked through direct controls. Domestic prices for imports were kept artificially low through a system of fixed exchange rates, hampering the development of import-substitution industries. He would therefore favor a relaxation of the system of import licensing, the passage of a greater amount of transactions through the free market, and a unification of controlled exchange rates at Bs 7.50 per dollar, the highest level of the present range.

Mr. Alhaimus recalled that, at EBM/84/130 (8/31/84), Executive Directors had reviewed the overall developments in the Venezuelan economy in recent years together with the policy response to the sharp recession of 1983 and the ensuing serious financial difficulties. The present staff paper indicated that the authorities had continued their adjustment

efforts in 1984, having made visible achievements in various key sectors of the economy. The consolidated public sector position had improved, following a substantial reduction in the fiscal deficit in 1983; thus, the position of the public sector had shifted from deficit into surplus, representing a turnaround of some 16 1/2 percent of GDP in two years. In addition, the current account of the balance of payments had again recorded a surplus of over $4 billion, following the improvement in 1983 from a large deficit. Those accomplishments were significant, especially as Venezuela had depended entirely on its own efforts and resources in overcoming the serious difficulties at a time of weakening oil demand and deepening uncertainties in world capital markets.

However, Venezuelan policymakers were still confronted with major problems, Mr. Alhaimus noted. Economic activity remained sluggish, as growth of non-oil real GDP had again recorded a decline in 1984, although one much less steep than in 1983. Furthermore, the unemployment rate seemed to have risen from 10 percent to 14 percent, while the rate of inflation had accelerated sharply, reversing the moderate trend experienced since 1980. Venezuela's debt service ratio had changed little in 1984, and private sector arrears had continued to accumulate during most of the year. The achievements in the fiscal and external areas had owed much to transitory exchange and trade measures as well as to a sharp cut in investment and a decline in real wage rates that could not long endure.

In designing the economic program for 1985, the authorities had attempted to address the major problems facing the economy, Mr. Alhaimus said. The basic aim of the program--to provide a modest stimulus to economic activity--was appropriate, given the deceleration in economic activity and the increase in the rate of unemployment. The other objecrives seemed realistic, and some had been actively urged by the staff and the Executive Board. The authorities planned to reduce the current account surplus to less than half the figure registered in 1984, owing to a decline in oil receipts and a large rise in imports. Appropriately, they were stressing moderation in the rate of inflation, after the exceptionally large increase of the previous year. Furthermore, the intended unification of the exchange rates and the elimination of all external arrears by the end of 1985 should further enhance Venezuela's standing in the capital markets.

Regarding the design of the quantified economic program for 1985, Mr. Alhaimus remarked, it was useful to keep in mind that the program was the first exercise of this nature that the Venezuelan authorities had attempted. Therefore, improvements and adjustments could be expected as results became apparent during the year. Indeed, some points at issue between the authorities and the staff might have already been clarified by actual developments during the past few months, including the differences in assessing oil export proceeds and fiscal revenues together with the staff's doubts on the projected expansion of credit and broad money. The encouraging figures provided by Mr. Pérez on the first quarter of 1985 might have already helped to provide assurances about the direction of the major economic indicators.

On more specific issues, it might have been helpful if the staff had explained in greater detail the authorities' views on whether economic activity could be spurred by increasing fiscal expenditure and relaxing credit policies and whether unification of the exchange rate should be accelerated, Mr. Alhaimus said. On the arrangements followed to eliminate private external debt, the staff's call for clearer procedures was appropriate, although he could understand why the authorities would seek to ensure that the most appreciated exchange rate should be used only in legitimate cases. He welcomed Mr. Pérez's statement that most of the problems with private debt that had disturbed the international financial community "have been clarified and are on their way to satisfactory solutions."

Regarding the medium-term prospects, Mr. Alhaimus added, it was significant to note that, in the staff's view, the outlook for Venezuela remained favorable. Even with a gradual recovery of oil exports, it was expected that, given appropriate policies, Venezuela should be able to service its external debt and make net amortization payments without difficulty. That conclusion was particularly relevant to the present exercise of multiyear rescheduling of public debt.

The present staff report (SM/85/115) was the first to be prepared under the procedures for enhanced surveillance, Mr. Alhaimus noted. The report could usefully have devoted more space to presenting the authorities' views, especially on issues such as the exchange rate and the use of fiscal expenditure to stimulate growth, on which the staff's positions differed from those of the authorities. As only the staff paper would be transmitted to the banks, they would not have the advantage of receiving other views on the authorities' policy stance. In such circumstances, a more comprehensive report elaborating on that stance might better help the banks to formulate an independent judgment.

Mr. Doe recalled that the Venezuelan economy had improved substantially in 1984. The position of government financial operations had improved from a deficit in 1983 to a surplus; in the external sector, the overall balance had also shifted from deficit to surplus, owing to a reduction in the capital account deficit. Official reserves had increased to the equivalent of 18 months' imports, and all external government arrears had been eliminated. Nevertheless, real GDP had fallen for the second consecutive year, while both unemployment and inflation had risen.

As to the 1985 economic program, Mr. Doe continued, he welcomed the authorities' intention to pursue the restructuring of public enterprises and to adjust the prices of several of the goods sold by them. In particular, the increase in the price of fuel, as the staff had suggested, would contribute toward strengthening the financial position of the Government. Moreover, the authorities had kept an open mind with regard to the special investment program and had already made some downward adjustments as a result of the predicted decline in petroleum revenue; those were steps in the right direction that should be strengthened.

He welcomed the authorities' decision to monitor credit expansion closely with a view to adjusting it if warranted by developments in prices and the current account, Mr. Doe commented. However, he urged the authorities to exercise the utmost care with respect to government securities issued to settle domestic arrears; the accounting procedure used had the potential of creating excess liquidity.

In view of the substantial improvement in Venezuela's reserve position during 1984, he wondered whether the authorities might accelerate the proposed unification of the multiple exchange rate system, currently planned for the end of 1985, Mr. Doe went on. The new rate should sufficiently reflect the market value of the bolívar. Unification would also stimulate activity in the non-oil sectors. Furthermore, following the debt rescheduling, the medium-term outlook for Venezuela's debt service burden appeared more favorable. Nevertheless, the authorities needed to pursue cautious demand management policies and avoid large external borrowing during the next few years.

Finally, although it was too early to draw any definite conclusions about enhanced surveillance, it would be useful for the staff to provide the Executive Board, from time to time, with sufficient information to evaluate the usefulness of the new policy, Mr. Doe remarked. In particular, he would wish to know whether, as a result of enhanced surveillance, national authorities had responded more rapidly and more effectively to policy recommendations by the Fund. Such evaluations would be all the more important for Venezuela in the light of apparent differences of opinion between the Fund staff and the national authorities on the speed at which they were to implement the needed policy changes, if not on the substance of the changes.

Mr. Nguyen commented that the midyear Article IV consultation with Venezuela, the first practical application of enhanced surveillance by the Fund, raised questions about the nature of the understanding between the two parties. He would be particularly interested in hearing the staff's answers to several issues raised by previous speakers, especially Mr. Polak and Mr. Wicks. He broadly agreed with the staff appraisal.

Following a sharp drop in earnings from petroleum in 1982, Venezuela's balance of payments had come under strong pressure, Mr. Nguyen observed; a lack of confidence in the bolívar had led to large capital outflows, while public finances had deteriorated sharply and arrears had built up rapidly. Against that background, important corrective measures had been implemented in the wake of the devaluation of the bolívar since February 1983 within a multitier exchange system. Like other Executive Directors, he commended the Venezuelan authorities for the success of their policies in 1984, especially in the current account and public sector finances, which had both moved from deficit into surplus. In addition, the figures provided by Mr. Pérez gave ample reason to be optimistic about the prospects for 1985. However, the adjustment effort had been achieved at the cost of a further decrease in real GDP in 1984, and a doubling of the rate of inflation as well as the rate of unemployment.

That last development had led the authorities to conduct a new policy aimed at attaining a moderate rate of growth without impairing the current account or raising consumer prices.

The authorities' goals were commendable, Mr. Nguyen continued. However, there had been a divergence of views between the staff and the authorities on the present policy stance. The staff appeared to consider that the adjustment process had not yet been carried out, although in view of the results achieved thus far, the authorities were in the midst of reflating the economy. Could the staff or Mr. Pérez comment on that divergence of opinion? Although he had the greatest sympathy for the Venezuelan authorities--and other governments in the same dilemma--he cautioned them against too much precipitation, particularly in the light of recent developments in the world oil market. Indeed, the figures mentioned by the staff on the effects of declining oil prices were worth considering and hardly a cause for optimism, even if the medium-term outlook for Venezuela still seemed relatively favorable. Given the high sensitivity of the country's export receipts to oil price developments, the authorities had to consolidate their current gains through a sound economic policy. In that connection, the maintenance of strict incomes and demand management policies appeared appropriate, especially since, in the words of the staff, "attempts to spur activity by increasing fiscal expenditure and relaxing credit policies have not proved successful." Thus, the authorities should pay attention to the numerous impediments, such as price and import controls, that prevented the economy from functioning smoothly.

Given the undesirable consequences of the present foreign exchange system, Mr. Nguyen said, he had noted the staff's suggestion to complete the unification of all controlled exchange rates by mid-1985. Could Mr. Pérez say whether there was any room to accelerate unification, in line with the staff recommendation? On the whole, he remained confident that the Venezuelan authorities would be in a position to react rapidly, if needed.

He would also appreciate comments from the staff or Mr. Pérez on several other matters, Mr. Nguyen stated. First, what were the economic prospects for 1985, especially with the package of measures being implemented or prepared? Second, what was the reason for the discrepancy between the inflation rate projected by the staff and the recent figure given by Mr. Pérez? Third, under the industrial policy being contemplated, would there be any room for privatization of such industries? He had been struck by the divergence between public investment, equal to 12 percent of GDP, and private investment, equal to only 2.9 percent of GDP. Fourth, what efforts were being made to mobilize savings, equivalent to 28.8 percent of GDP, for investment, which had consistently decreased as a proportion of GDP to equal only 15.6 percent at present? Fifth, what measures were under consideration to diversify exports?

The impressive results obtained in a short period in Venezuela boded well for the future, Mr. Nguyen concluded. Increased confidence in the prospects for the Venezuelan economy had allowed negotiations with the international financial community to be concluded successfully. The authorities' commitment to dealing responsibly with the debt issue, both public and private, was to be commended.

Mr. Nimatallah welcomed the first case of enhanced surveillance by the Fund and asked the staff to pay special attention to Venezuela in order to determine how the Fund could improve its procedures. Furthermore, there was a case for speeding up preparation of the policy paper on enhanced surveillance; there might be some danger in implying that not every country was treated uniformly but that enhanced surveillance took place on a case-by-case basis.

He agreed with the staff appraisal, Mr. Nimatallah continued. Indeed, no country, not even an oil exporting one, could escape the fact that there came a time when adjustment was unavoidable. Therefore, he commended the Venezuelan authorities for having realized the need to adjust and having adopted concrete, substantial measures to that end. They had done well and should continue to do so on their present course.

Mr. Zhang observed that the Venezuelan authorities had been able to carry out an adjustment program on their own; the economy had entered a stage of recovery and growth. However, the staff appraisal tended to be much less optimistic than Mr. Pérez had been in his statement. How could the divergence in tone be reconciled?

Venezuela represented the first case of enhanced surveillance by the Fund, Mr. Zhang continued. It was disappointing that the staff had not taken the present opportunity to explain more fully the implications of the new procedure and whether it should or could be applied to other countries, particularly in Latin America, currently seeking multiyear debt rescheduling. One crucial difference between enhanced surveillance and periodic reviews under a Fund stand-by arrangement was that, under enhanced surveillance, the Fund could not enforce its decisions. When a country was not obliged to accept the Board's advice, what precise role was the Board expected to play? For instance, what actions could the Venezuelan authorities be expected to take in the light of the present discussion that differed in any way from those recommended during the regular Article IV consultation discussion some six months previously? Did enhanced surveillance merely amount to increasing the frequency of consultations within a given period? Furthermore, as neither the record of the Board discussion nor the Chairman's summing up was going to be transmitted to creditor commercial banks, why did the Fund need to play a monitoring role for those banks? Perhaps it was intended that the documents, or some summary of them, would be sent to the banks. In conclusion, he was not opposed to the Fund having agreed to undertake enhanced surveillance as requested by Venezuela, but he wished to discover the nature, functions, and techniques intended for enhanced surveillance in general and for its future application.

Mr. Salehkhou recalled that in recent years, several oil producing countries had had to cope with significant diminutions in their sources of external revenue and to adjust their economies accordingly, almost always signifying the adoption of demand-suppressing measures, which in turn had often resulted in slowing growth and employment. Therefore, the success of the Venezuelan authorities in undertaking forceful adjustment measures amid a continuing decline in oil prices, while trying to minimize the short-term adverse consequences that often accompanied such programs, was highly noteworthy.

From the onset of the sharp weakening of oil markets in 1982, Mr. Salehkhou continued, Venezuela had undertaken a series of measures intended to prepare the economy and adapt its productive capacity to the changed environment. Those measures had proved effective in arresting the deterioration in public finance, international reserves, and the balance of payments. Thus, in 1983, the balance of payments had shown a surplus despite a continued fall in prices of commodities, notably petroleum. However, those improvements had been attributable mainly to drastic reductions in imports and a relative shortage of foreign exchange. Moreover, a series of effective devaluations of the bolívar in 1983 and 1984 had reversed the previous rise in the exchange rate and brought the average real rate down to below where it had been in 1978.

With the prevailing weakness in the oil markets and the uncertain future, the authorities had wisely continued their prudent policies of demand management and cost control in 1984, Mr. Salehkhou said. As Mr. Pérez had pointed out, the adjustment effort undertaken by the authorities did not incorporate any external financing. The prudent debt management policy clearly demonstrated the need to check the growth of external indebtedness and to keep it within manageable proportions.

In the fiscal sector, a cap on wages, restraint on current outlays, and greater revenue through increased fuel prices and export proceeds had transformed a public sector deficit into a surplus, Mr. Salehkhou noted. In 1984, monetary developments had remained cautious, with net domestic assets of the banking system actually declining. The external account had also performed satisfactorily, with exports and imports both rising, although imports had increased far less than earlier projections had indicated. Venezuela had also managed to reduce its net outstanding external public debt, although private sector arrears had risen.

Those monetary and financial achievements had been accompanied by some setbacks in the targets for real growth and investment, Mr. Salehkhou commented. The authorities had made large cuts in public investment, and real growth had fallen for the second year, while the rate of inflation had doubled; unemployment had risen to a post-1980 record. For 1985, the authorities were understandably focusing greater efforts and priorities on problems with growth and employment while continuing the cautious fiscal and monetary stance. Thus, the authorities were aiming at a reduction in net outstanding public external debt while targeting both broad money and the monetary base to rise only moderately.

The fiscal program for 1985 aimed at attaining balance in the consolidated public sector finances, Mr. Salehkhou continued. Although there were some differences between the staff's fiscal projections and those of the authorities, with the latter expecting better revenue performance, there were no provisions for wage increases in 1985, and current expenditure was projected to rise by only 7 percent in nominal terms, a possible reduction in real terms. With regard to capital expenditure, the special investment program--following a sharp drop in previous years--had been revised downward as a result of the fall in projected revenue from petroleum. On page 25 of SM/85/115, the staff had called for a further cutback in projected investment by the Government to achieve the current account objective without crowding out the private sector. If the authorities were to adopt such a course, would the existing target projections for 1985 growth and unemployment need to be revised accordingly? He invited the staff to explain.

With over 90 percent of Venezuela's export revenue deriving from petroleum, the effects of the massive devaluation of the bolívar would naturally be transmitted more to imports and prices than to export revenue, Mr. Salehkhou suggested. In view of the prudent monetary and fiscal policies pursued in 1984, it would be interesting to know how far inflationary pressures in that year had originated from price elements as a result of the devaluation. By the same token, were there any estimates for the effects on prices resulting from the unification of the exchange rates for imports?

The authorities should be commended for having achieved substantive results at a time of deteriorating revenue prospects, Mr. Salehkhou concluded. As the present meeting marked the first discussion under the enhanced surveillance procedure, he wished to reiterate his concern about the adoption of such procedures for developing countries while industrial countries were exempt from them. As a prominent international institution, the Fund should not become a vehicle for facilitating or enhancing monitoring or surveillance by outside private organizations, which in certain respects might be even better equipped and have access to more current data for that purpose. Assistance provided by the Fund under enhanced surveillance might be regarded as a subsidy to the commercial banking system, a practice that was not justifiable in the framework of the free-market mechanism.

The staff representative from the Western Hemisphere Department noted that there was no firm schedule for the implementation of tax reform. In 1983, the tax reform commission had produced its report; as he understood it, the Government intended to submit a proposal for modifying the personal income tax during 1985. The staff did not know the timetable for introducing further reforms under the 1983 reform proposal on corporate income taxes and other levies.

The staff believed that the pace of unification of the exchange rates should be speeded up, compared to its position at the previous Article IV consultation with Venezuela, because the present system was

clearly creating significant distortions, the staff representative continued. As the recent information notice had pointed out, the real competitiveness of the Venezuelan economy, under the existing exchange rate system, had been eroding for the past 12 months while the real exchange rate had been appreciating. In view of the medium-term outlook for oil prices worldwide and the need to accelerate structural change within Venezuela, the staff had reached the conclusion that it would be helpful for the country if unification were speeded up.

As of mid-May 1985, approximately 80 percent of the debt that had been presented for registration had been processed by the exchange control agency (RECADI), the staff representative explained, and about 70 percent of the debt had been transmitted to the special debt commission for approval procedures. The staff did not know what the final amounts would be that the commission would approve for access to the preferential exchange rate. The authorities were still working with the figure of about $6 billion for private sector debt in Venezuela.

In the first four and one-half months of 1985, approximately $300 million of interest payments had been made to the Central Bank, the staff representative recalled. That sum appeared to have been somewhat larger than the rate at which interest had accrued, but did not imply that arrears on interest had diminished to a large degree. The process of registering and servicing private sector debt did continue to pose difficulties. As to Mr. Polak's question whether private sector debts with foreign official guarantees would have to be rescheduled, the Government had decided that all debts guaranteed by foreign official agencies would be repaid on schedule.

In the general context of enhanced surveillance, the staff representative said, a number of Executive Directors had asked what would be the impact on rescheduling agreements with banks if a staff report on Venezuela were regarded as highly negative. The interpretation of such staff reports would be the responsibility of the banks themselves. It would be most inappropriate for such reports to be regarded as on/off signals.

In the absence of a letter of intent, the staff would be feeling its way as it engaged in enhanced surveillance of Venezuela, the staff representative remarked. The authorities' reaction to a number of the recommendations made by the staff could be seen in the context of the continuing review, which would occur every six months. He agreed with Mr. Rye that it might have been more convenient to have held the Article IV consultation with Venezuela at present and to take account of how policies were evolving in the next midyear report. As it was, the staff report spelled out the objectives for 1985 instead of reviewing the actual achievements.

The authorities had drafted a proposed mechanism for deposit insurance for the entire banking system, which had been given to interested parties for comments, the staff representative said. They probably intended to introduce the insurance mechanism during the current year.

Although imports might have fallen dramatically from 1982 to 1984, the $7 billion worth of imports projected for 1985 would, in terms of purchasing power, be only some 10-12 percent below the figure registered in 1979, the staff representative continued. Prices of exports from industrial countries in 1984 were at or below their 1979 levels. In the meantime, real non-oil GDP in Venezuela would have contracted by 5.6 percent, so what appeared to have been a sharp reduction in imports compared with 1982 might turn out to be roughly a sustainable amount in the medium term.

The principal explanation for the upsurge in inflation during 1984 had been the pass-through of the effects deriving from the devaluation of the bolívar, especially the roughly 35 percent of imports--largely basic foodstuffs that had a fairly high share in the consumer price index--for which the exchange rate had been substantially devalued, the staff representative explained. That accounted for at least half, and perhaps two thirds, of inflation during 1984. As to the outlook for 1985, both the authorities and the staff had been working with a projection on a calendar-year basis of 13 percent inflation. The most recent 12-month figure available was for some 16-17 percent; the impact of the final pass-through of products from the Bs 4.30 to the Bs 7.50 exchange rate should account for about 4 1/2 percentage points of inflation in 1985. Therefore, although the staff could not determine to what extent the favorable recent behavior of prices might reflect the continued application of price controls, inflation might turn out to be even lower than the 13 percent target, provided that the authorities did not significantly alter their present demand management policies.

Enhanced surveillance had been helpful not only in the discussions held between the staff and the authorities, but also to the authorities themselves, as it had induced them to improve the coordination of economic policy in general, the staff representative remarked. For the first time in Venezuela, financial planning had been extended to cover a wide range of the public sector, and the authorities had made a conscious effort to set quantified targets for both monetary and fiscal variables on a wide scale, which had no doubt helped them in their policy discussions with the Fund staff. In fact, the authorities' own projections were internally quite consistent; and the staff had used the same basic assumptions on GDP and inflation as the authorities had been using. Some of the differences of views described in the staff paper reflected the staff's apprehensions about a possible inconsistency of monetary and fiscal policies with those basic targets. In its appraisal, the staff had pointed out that the medium-term outlook for Venezuela would be relatively manageable--provided that demand management policies were kept tight--and that there was little room for maneuver.

The staff had tried to follow the normal standards and procedures for surveillance under Article IV consultations, even though there was some linkage to a rescheduling operation, the staff representative observed. The banks would decide how to interpret the divergence of views expressed on rescheduling. Perhaps the difference in the case of Venezuela was the degree of quantification in the program and discussions as well as the frequency of monitoring the country's execution of its own program.

The staff had reached agreement with the authorities on flows of information to be sent to the Fund and had agreed on a six-monthly schedule for discussions, the staff representative recalled. The authorities were to set up a planning unit dealing with the program and its execution; the first quarterly report under that procedure had recently been made available. However, since that time, the flow of information to the staff had been deficient, and the staff would have to work more closely with the authorities in organizing the flow.

As to whether recent developments might lead to a modification in the outlook for 1985, the staff representative observed, it was true that fiscal policy at the moment appeared to be tighter than had been envisaged, and it remained to be seen whether capital spending would pick up sharply during the rest of the year. Although part of the better performance in the current account of the balance of payments might indeed reflect a lower interest payment than had been projected by the Fund staff, the overall results in the first quarter suggested that the financial program for 1985 would remain on track, provided that the policy stance was not significantly modified.

To some extent, the staff had been trying to make the point in the appraisal that before moving decisively or moderately toward reflating the economy, the authorities might first find it advisable to move more decisively toward reducing the distortions and controls that were hindering economic growth, the staff representative continued. Subsequently, according to the staff view, the authorities could move on to implementing demand management policies. The staff had also noted that low private investment might seem to narrow the scope for privatization of government enterprises. The Government had a heavy involvement in the economy, and the authorities were moving to divest some of those enterprises to the private sector.

The industrialization policy of Venezuela to date had been heavily based on state involvement in basic industries such as iron and steel, aluminum, and petrochemicals, the staff representative from the Western Hemisphere Department noted. As the staff paper pointed out, more appropriate policies and a better policy environment to stimulate the private sector would be useful for broadening and deepening industrialization. For that reason, the staff had placed great stress on exchange rate policy and a reduction in controls in general.

The staff representative from the Exchange and Trade Relations Department said that Executive Directors generally had expressed support for the use of the enhanced surveillance approach in dealing with Venezuela. Mr. Polak had raised the procedural question of whether the Board should have been informed of Venezuela's request for the enhanced consultation procedure and of the specific modalities to be used, before the Fund had become involved. In that connection, at the most recent Article IV consultation with Venezuela in August 1984 (EBM/84/130, 8/31/84), Executive Directors had given some consideration to a possible role to be played by the Fund and the nature of the enhanced consultation procedure. As the Chairman had noted in his summing up, there had been broad support by Executive Directors for that procedure to be applied to Venezuela.

In arriving at the specific modalities of the enhanced consultation procedure applied to Venezuela, the staff had been guided principally by the Board discussions of Fund surveillance at EBM/85/47 (3/22/85) through EBM/85/49 (3/25/85), the staff representative explained. The Chairman's summing up of those discussions had presented the salient features of enhanced surveillance. The Chairman had begun by saying that Directors believed that the Fund should be selective in acceding to requests for enhanced surveillance and that some Directors had cautioned against any involvement by the Fund in such arrangements for too long a time. He had then gone on to say that a number of Executive Directors considered that, in practice, enhanced surveillance would be appropriate for countries where strong adjustment policies were well under way; otherwise, the Fund would continue to consider endorsing a country's adjustment program in the context of a stand-by or extended arrangement.

Discussions of enhanced surveillance had resulted in some difference of views between the staff and the Venezuelan authorities, the staff representative recalled. An underlying assumption had been that enhanced surveillance would apply in cases where a member country was already implementing strong adjustment policies. Although there were some differences between the staff and the Venezuelan authorities on specific areas of economic policy, he believed that there was no question that the authorities were following strong adjustment policies.

Questions had been asked about the duration of enhanced surveillance over the economy of Venezuela, the staff representative said. The period of enhanced surveillance would be based on the agreement between the banks and the Venezuelan Government regarding monitoring procedures, which stated that the Government would prepare for each year from 1985 for the entire period of the restructuring agreement--up to 1997--a detailed and quantified annual economic program and that the Fund would be requested to assess Venezuela's performance under the program. The agreement also specified that the Government of Venezuela would provide creditor banks with copies of the reports received from international agencies by way of evaluating its annual program. It was understood that it would be left to the banks to reach their best judgment based on the Fund's report as well as other sources. It was not

the Fund's purpose to give an on/off signal suggesting how the banks ought to conduct their relations with the country concerned. As for the trigger clauses, the staff had available to it the sections of the agreement between Venezuela and creditor banks relating to what would happen under certain circumstances if the banks were not satisfied with the performance of Venezuela.

As to whether the enhanced consultation procedure could be used to strengthen a country's policy management, the emphasis in enhanced consultation was not placed on negotiations between the Fund and the country concerned, the staff representative pointed out. Rather, the role of the Fund was to evaluate the country's program and performance. Unlike a program supported by a Fund arrangement, enhanced surveillance did not require that the two sides reach an understanding. The Fund would make an assessment of the member's policies and would state its own views on their appropriateness. However, if the procedure were to be useful, he would hope that the Fund and the national authorities would be able to reach an agreement on the major aspects of policies that could serve as a basis for restructuring by the banks or other creditors.

Neither the record of the Executive Board discussion of Venezuela nor the Chairman's summing up would be made available to the banks, the staff representative from the Exchange and Trade Relations Department concluded. At the time of the Board discussion of surveillance in March 1985, the Chairman had said that release of the staff reports to banks would be acceptable if the country requested it.

The Deputy General Counsel responded to an earlier comment concerning recourse against the Fund if the views expressed or the figures used in a report turned out to have been inaccurate. He assumed that the question had referred to the legal situation that would exist if the Fund did not rely on the immunity accorded to it and staff members by the Articles of Agreement. Generally, an individual who undertook to perform professional services, including the writing of reports and the giving of an expert opinion, would be liable for negligence to the party who contracted for the professional services. The liability was limited to the party who had contracted for the service unless it was understood at the time that the information and opinion would be passed on for the use of a third party who would rely upon it, in which case liability could arise outside the contractual relationship to the third party. The standard of liability in both cases would be based on whether the individual had performed the task negligently. Negligence would be judged by whether or not he had been performing the task in a reasonable manner as judged by the normal standard of conduct for the performance of the task in question.

The second part of the question of liability to a third party was whether it was understood at the time that the third party would rely on the information and advice provided or whether the third party that would receive the information and advice was to undertake its own independent investigation and assessment, the Deputy General Counsel continued.

Under enhanced surveillance, it was known that the information and appraisal supplied to a member would be transmitted to third parties, but those third parties had other sources of information and appraisals of that information, and those third parties were expected to exercise their own independent judgment on the issues involved.

The distribution outside the Fund of documents relevant to consultations with member countries had always been subject to decisions of the Executive Board, the Deputy General Counsel went on. Under the governing decisions, only reports on recent economic developments usually were transmitted, on the request of individual international organizations, but in accordance with those decisions staff reports were sent routinely to the World Bank, the GATT, the OECD, and the EC for confidential use by their secretariats. During the review of surveillance in March 1985, the Executive Board had come to the view that further distribution of reports on recent economic developments might be made and that in connection with enhanced surveillance the release of staff reports would be acceptable if requested by the member, and if the release was necessary for the restructuring of the member's external debt. The point of the reference in the staff paper under discussion had been to present to the Board for its approval or for its recognition as part of the sense of the meeting the expected release of the paper.

Mr. Salehkhou acknowledged that the Fund and the staff were immune from liability. Nevertheless, how would it appear if the case were proved that the staff had been negligent in making an appraisal? What if national authorities could show that a staff judgment had been based on negligence and that, accordingly, their country had suffered because banks had reached unfavorable conclusions about it from a report prepared by the Fund staff?

Mr. Zecchini asked whether the transmittal of a staff report to the country concerned for forwarding to the banks embodied the notion of surveillance that the Executive Board had in mind. He had thought that surveillance was an exercise for the entire Executive Board, involving an assessment by the Board, not by the staff. That was apparently not to be the case. The matter was, in his opinion, one of substance.

Second, he was uncertain about which countries should be entitled to benefit from the enhanced surveillance procedure, Mr. Zecchini concluded. Was he to understand that any country requesting such a procedure would be accommodated?

Mr. Wicks inquired whether references in staff documents to previous summings up would be excised from copies sent to the banks. Moreover, it seemed from the staff paper that all the banks wished to receive was some sort of technical assessment of the country's economic program, which hardly required a six-monthly Board discussion. What would be the Board's actual contribution to enhanced surveillance?

Mr. Polak noted that the staff had cited the sentence from the Chairman's summing up in March 1985 that the Fund should be selective in acceding to requests for enhanced surveillance. How would the Fund decide whether to accede to such requests?

Mr. Dallara inquired what flexibility there would be for change in the arrangements for enhanced surveillance if the authorities or the Fund considered it helpful. Although enhanced surveillance represented an assessment by the staff of the country's policies and prospects, it was interesting that monitoring arrangements themselves provided explicitly for clear assumptions in policy statements. He was concerned about the prospects that differences of view between the authorities and the staff could continue to exist for some time, in which case he would question the efficacy of enhanced surveillance. Perhaps Mr. Pérez could say whether the Venezuelan authorities would see any difficulties in continuing for some years an enhanced surveillance arrangement with the Fund where differences of views on policy matters might persist.

Mr. Joyce asked whether the Fund was contemplating maintaining enhanced surveillance of Venezuela until 1997, when the arrangement with the banks would expire.

The staff representative from the Exchange and Trade Relations Department noted that the Chairman at the March discussion had listed the criteria that would be used to guide the Fund in deciding whether to agree to enhanced surveillance of a country; the principal criteria were whether the member was following appropriate adjustment policies and whether the adjustment was well under way. Moreover, enhanced surveillance would apply to countries where banks had reasonable confidence in the future conduct of the country's policies but where surveillance could contribute to assisting the authorities in monitoring programs and assisting the banks in appraising the country's policies discussed in the staff report. One specific example had related to countries that had failed to surmount a "hump" in their debt service payments, so that once they had gotten over the hump, they would be in a position to return to the market and would have normal access to funds.

One purpose of enhanced consultation, the staff representative explained, was that an additional midyear Board discussion would induce national authorities to move toward implementing or continuing to implement appropriate adjustment policies and thereby strengthen confidence in the minds of creditors so that they would then be prepared to favor restructuring arrangements. Clearly, the principal purpose of enhanced consultation was to promote multiyear rescheduling agreements between creditors and member countries.

Enhanced consultation could serve as a means of bringing about modifications in the policies of the member country, where needed, and under normal circumstances, the staff representative went on. Should there be a series of reports in which the staff and the authorities took differing positions, creditors receiving the report would notice the differences

and at some point would arrive at certain conclusions about whether to continue the arrangement to reschedule or restructure a country's debt. Thus, there appeared to be a built-in bias in favor of bringing the two parties together and in favor of the staff's being able to influence the authorities in making the necessary policy modifications.

The first paragraph in Schedule 6, Section 1 of the restructuring principles stated that the Government of Venezuela had prepared for 1985 and would prepare for 1986 and each succeeding year during the restructuring period a detailed, quantified annual economic program, the staff representative from the Exchange and Trade Relations Department concluded. The restructuring period extended to 1997. It was stated in Section 2 of Schedule 6 that for each of those annual economic programs, the Fund would prepare an evaluation of Venezuela's performance, with specific reference to the effects of the programs and the achievement of quantified economic targets.

The staff representative from the Western Hemisphere Department noted that the covenant in the restructuring arrangement stated that the Republic of Venezuela would complete the implementation of and maintain the monitoring procedures set forth in the schedule during the term of the restructuring. It went on to say that changes limiting the monitoring procedures were to be mutually agreed by the majority banks and the Republic. In other words, although in a sense enhanced surveillance by the Fund was contemplated for the lifetime of the restructuring arrangement, any instructions to the Fund to act otherwise or any change in the procedures would be a matter for negotiation between Venezuela and the banks, but there was a provision in the arrangement for such procedures to be changed if there were to be a desirable outcome.

The Chairman noted that it was important that the staff reports should be circulated to the Board for it to examine them as a continuum. More important, the role of the Board was to confirm that the staff was correct in pressing the Venezuelan authorities to be cautious in handling fiscal and monetary policies. The present discussion in the Board would also establish the framework for future midyear consultations under enhanced surveillance.

As a matter of principle, it would be better not to include in staff reports to be transmitted to banks the conclusions reached at previous discussions, in order not to infringe upon the freedom and confidentiality with which the Executive Board expressed its views, the Chairman said. However, the two relevant paragraphs in SM/85/115 were sufficiently general to be included in the specific case of Venezuela.

The procedure for initiating enhanced surveillance--with or without use of Fund resources--would be no different than that for initiating discussions with a member country on an arrangement with the Fund, the Chairman explained. When a country with a debt restructuring problem was planning to undertake a significant adjustment effort and was receiving signals from creditors of their willingness to respond with

a rescheduling arrangement, management would consider the matter and consult Executive Directors informally. Management should not, however, refer any such initiative formally to the Executive Board for preliminary approval.

Mr. Fugmann said that the quotation from the covenant agreed to by the Venezuelan authorities and the banks indicated that the Fund must monitor Venezuela's annual program until 1997. Was there any way of telling what would happen to the agreement if the Fund decided in five years that the Venezuelan economy was on so sound a track that it might be unnecessary for the Fund to continue its monitoring?

The Deputy Managing Director stated that there would be enough flexibility in the arrangement between Venezuela and the banks for the Fund to be able to take the initiative if it became clear that reviews did not have to be held every six months. Further thought could be given to establishing a general procedure for such initiatives, although it had so far proved difficult to provide for all possible contingencies in arrangements between a country and banks.

Mr. Zecchini said that he was still not clear about the concepts and the contents of an enhanced surveillance exercise. In addition, the procedural aspects seemed to call for consideration by the Board, based on a staff paper.

The Chairman responded that a general policy paper on the subject of enhanced surveillance was being prepared. It was the Fund--the Executive Board--that exercised surveillance. Each successive staff report was a link in a chain of documents; each meeting of the Board contributed to the subsequent staff paper. Thus, even if the Fund did not provide to the interested country a summing up of the Board discussion, a similarity of outlook should be evident between Executive Directors' views and those expressed in the staff appraisal.

Mr. Zecchini remarked that that approach would involve an adaptive expectation mechanism, with a lag between the definition of Board guidelines on surveillance for a specific country and their communication and implementation. The point should be discussed further because there was a clear difference between surveillance carried out by the Fund and surveillance carried out by the staff. Moreover, the actual contents of the enhanced surveillance exercise should be more thoroughly examined.

Mr. Wicks recalled that enhanced surveillance had come about because the banks had demanded it. The banks were the third party that did not sit around the Board table. Furthermore, he hoped that nothing that the Board had done at the present meeting would commit the Fund to carrying out enhanced surveillance procedures until 1997.

The Chairman commented that great care had been taken not to let the Fund become too committed in any sense. As for the number of reviews, many member countries had more than two a year. The practice

was sound if it led to more reasonable and prudent economic policies over time. If it appeared after some time that enhanced surveillance was no longer warranted for Venezuela, there would be sufficient flexibility under the terms of its arrangement with the banks for the Executive Board to reconsider its position.

The Deputy General Counsel commented that someone engaged to give a professional judgment could later be proved to have been wrong, but that would not mean that there had been any negligence. The question was only whether the normal degree of professional competence had been observed. That would include the question whether proper steps had been followed to obtain and verify the relevant information and whether the appraisal of the situation had been based on generally accepted principles of analysis for the profession. The judgments of one economist on a particular economic situation might differ from the judgments of another economist; the two might have very different opinions, but the difference of opinion would not mean that either had been negligent in arriving at his conclusion.

Mr. Pérez observed that the economic and financial situation of Venezuela had steadily improved since the early months of 1984 as a result of a strong and courageous program implemented by the authorities, fully demonstrating their commitment to correcting internal and external imbalances. Indeed, the results for 1984 and the first quarter of 1985 had been more favorable than the staff estimates during the previous Article IV consultation and Venezuela's own program targets for the first quarter of 1985. Those results illustrated the cautious, conservative approach adopted by the Venezuelan authorities in designing and implementing their own adjustment programs.

Overall public sector performance had been more than satisfactory, Mr. Pérez continued. Seldom had such a turnaround occurred in such a short period, without recourse to substantial tax increases. Several Executive Directors had underscored the need for fiscal reform to allow an increase in revenues; a commission formed within the public sector was currently studying tax reform with the intention of modernizing the existing tax structure, making the system more flexible and sensitive to changes in economic conditions but without increasing the tax burden or avoiding any such increase as much as possible. His authorities considered that increasing the tax burden would be the easiest way of upsetting the balance in the public sector; in fact, if the reform had been carried out earlier, the Government's room for maneuver would be much narrower at present. The authorities intended to achieve real positive growth in 1985, reversing the rise in unemployment without endangering the gains obtained so far; thus, once the problem of public financial disequilibrium was solved, they would try to keep the tax burden as light as possible in order to boost the economy through the private sector.

The figures for monetary aggregates were ceilings but not targets, Mr. Pérez said. During the most recent visit of the staff mission to Caracas, the authorities had stressed their intention to manage those aggregates, bearing in mind that the ultimate goal was to boost the economy without jeopardizing the gains already achieved in the adjustment process, as shown by the performance during the first quarter of 1985. The authorities would persevere in their cautious management of the economy.

He shared some of the concern expressed about the negative aspects of the multiple exchange rate system applied by Venezuela during the present transitional period, but there were some positive aspects as well, Mr. Pérez noted. First, the transitional device had been permitted to preserve the financial health of the private sector. A faster depreciation of the exchange rate might have brought about a difficult situation for enterprises and the financial system that could have led to a sharp slowdown in economic growth, jeopardizing adjustment and the country's creditworthiness. Second, pressure on the bolívar could push up prices and interest rates; in addition, the enviable wage performance that Venezuela was recording would have been impossible, and a dangerous wage-price spiral would probably have emerged. Third, it had a positive effect on income distribution in the adjustment process. In many countries the crisis had resulted in debt being paid for through a decline in real consumption by society in general, so that citizens who had succeeded in taking capital abroad before the crisis had benefited while those unable to do so, usually the poor, had had to bear the brunt of adjustment. In Venezuela, the use of the upper rate for nonessential imports meant that holders of assets abroad were in general the same people who paid equitable rates for luxury consumer goods, while the poor were faced with only modest increases in the prices of essential goods. Thus, the implications of the Venezuelan approach for income distribution had been much more benign than in other countries.

If the Venezuelan authorities wished to maintain an open capital account, they also needed the high parallel rate, Mr. Pérez remarked. Unfortunately, experience had shown that, given the uncertainties involved in adjustment, a unified exchange rate and an open capital account did not always prevent capital flight. Notwithstanding those remarks, there was no difference between the views of the Fund and those of the Venezuelan authorities on the final goal, which was to reach a unified exchange rate. It was only a matter of time.

The system of price control used by the authorities must be seen as a preventive device, in an economy characterized by the setting of prices under monopolistic or oligopolistic conditions and, essentially, as a counterpart of wage policy, Mr. Pérez went on. As the staff had recognized in its report, the present price control mechanism had gained a major measure of flexibility, so that the authorities tried to avoid distortions in resource allocation. Furthermore, the private sector was relatively satisfied with the flexibility shown by the authorities in implementing their current price control policy. The price control

system must be seen as a counterpart for monitoring wage stability. Indeed, it was widely recognized that the wage policy pursued by the authorities had greatly contributed to the sustained adjustment achieved thus far. The maintenance of wage stability depended greatly on relatively stable price behavior. Therefore, prices and wages had to be viewed as two sides of the same coin.

On external debt, the latest figures for the amount of private debt recorded by the Government had reached 95 percent of the total, Mr. Pérez explained.

There was no similarity between enhanced surveillance over the Venezuelan economy and the monitoring arrangement with Colombia, Mr. Pérez continued. The first was a clear type of surveillance; the second must be viewed within the framework of a stand-by arrangement in the upper credit tranche policy. By no means should both policies overlap. Enhanced surveillance was defined as a classic Article IV consultation, in a shorter cycle, with more frequent, supplemental staff reports. In the present case, the Fund was providing information about the economic situation of a country and its prospects, which, together with information provided by other international agencies and national authorities would be furnished to the banks. On that basis, the majority of banks might determine that in their judgment, the results of the country's economic program and performance were incompatible with the viable external payments position consistent with continuing debt service. Clearly, the information provided by the Fund, although important, was not the only available source, and the banks must draw their own conclusions. He agreed with Mr. Goos and Mr. Fugmann that in cases of enhanced surveillance, the Fund should try to avoid transmitting signals, as often happened under Fund programs.

As to the length of time that the Fund would engage in enhanced surveillance of Venezuela, Mr. Pérez concluded, there was a paragraph in the restructuring agreement permitting changes in the monitoring procedure. For example, the case raised by Mr. Fugmann could furnish a good reason to trigger such changes in the monitoring procedure as would be mutually agreed by the majority of banks and the Republic of Venezuela.

The Chairman gave the following summing up:

> Most Executive Directors who spoke were in broad agreement with the thrust of the staff appraisal in the report for the midyear Article IV consultation with Venezuela. They welcomed the authorities' proposal for an enhancement of the Article IV consultations and noted that it would involve continuing close collaboration between the Venezuelan authorities and the Fund. The Executive Board agreed that Venezuela could provide the creditor commercial banks with copies of the staff reports for the regular and midyear Article IV consultation discussions,

and reports on recent economic developments, as they become available to facilitate the banks' monitoring of the Venezuelan economy in the context of the multiyear debt restructuring.

Directors commended the authorities for the significant progress made toward adjusting aggregate demand in the economy to the sharp drop in petroleum export earnings that had taken place after 1981. They observed that this progress, which had been accompanied by a significant contraction of economic activity and employment, provided a basis for the recent agreement on a proposed multiyear restructuring of public debts with banks, and they added that this restructuring would contribute to the improvement of confidence in Venezuela and the country's economic performance.

Directors welcomed the determination shown by the authorities in strengthening the public finances, as the consolidated public sector position had moved from a deficit of 13 percent of GDP in 1982 to an estimated surplus of 3 1/2 percent of GDP in 1984. Directors also remarked on the success of the authorities in pursuing a cautious monetary policy and in ensuring that wage policy, which had been sustained, supported the adjustment effort. These policies had helped to keep the underlying rate of inflation relatively low.

Directors noted that Venezuela's external competitiveness had been strengthened as a result of the real depreciation of the bolívar in 1983 and 1984. This change in the real exchange rate within a multiple exchange rate system, together with tight demand management policies and strict import controls, had resulted in a substantial improvement of the external accounts and had thus made possible a reduction of the external debt of the public sector in the past two years, even as official international reserves had risen.

A number of Directors noted with concern the accumulation of external arrears on private external debt servicing. Although progress has been made in reducing these arrears on interest payments in recent months, Directors underscored the need to deal with overdue payments without further delay, to improve confidence and normalize Venezuela's relations with its creditors and suppliers.

Directors also expressed concern about the continued reliance on the multiple exchange rate system and pervasive price and import controls, which were giving rise to misallocation of resources. A major reduction in the scope of these controls would improve the incentive for private investment and thus would promote economic growth.

In particular, Directors urged the authorities to move promptly to unify the controlled exchange rates at a level that would enhance the competitiveness of the economy and encourage domestic investment in the non-oil sector. Most Directors underlined the need to adopt a flexible exchange rate policy under which full unification of the exchange system could be achieved in 1986. Such an exchange rate policy, together with appropriate demand management policies, would make possible the needed relaxation of import controls.

In commenting on the 1985 quantified economic program that had been prepared by the authorities, a number of Directors noted that the achievement of a surplus in the external current account that had been targeted was of great importance and seemed to require a somewhat tighter fiscal program than that contemplated by the authorities. Attention was drawn to the possibility of further scaling down the special investment program of the Central Government, increasing public enterprise prices, including those of petroleum products, and accelerating the reorganization and sale of public entities where needed. In addition, Directors encouraged the authorities to move ahead with the planned tax reform, which aimed at improving the efficiency of the tax system and diversifying the revenue base.

In the monetary area, it was felt by most Directors that credit expansion would need to be more restrained than that contemplated in the quantified economic program to be consistent with a realistic projection of the growth of broad money in 1985. Directors also recommended a freeing of interest rates.

Directors stressed the relatively favorable medium-term outlook for Venezuela in spite of the recent weakness of the world oil market. However, the projections--which implied no further recourse to net external financing--suggested that Venezuela had no margin for error and that the medium-term outlook depended very much on the continued implementation of restrained monetary policies supported by a cautious wage policy and a realistic exchange rate policy.

The annual Article IV consultation with Venezuela is expected to be completed within about six months.

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LEO VAN HOUTVEN
Secretary