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Economic Adjustment Programs - Venezuela

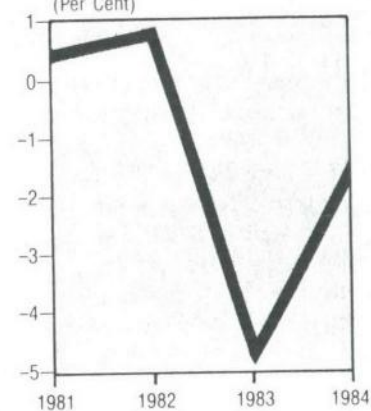
  
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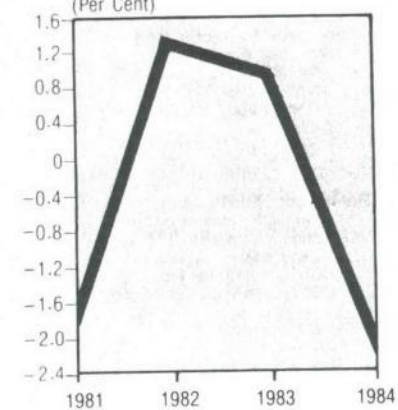
# Venezuela

## Economic Indicators

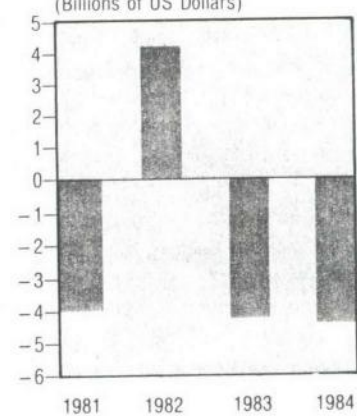
Growth of Gross Domestic Product  
(Per Cent)



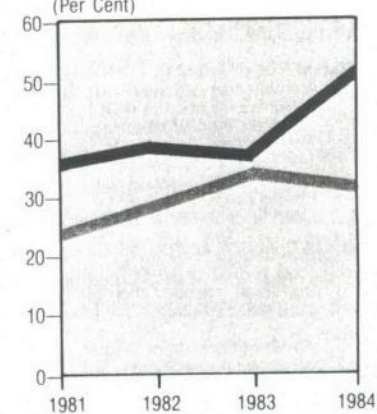
Overall Deficit of the Central Government Relative to GDP  
(Per Cent)



Balance of Payments: Current Account Deficit  
(Billions of US Dollars)



External Public Debt  
(Per Cent)



— Debt/GDP Ratio

— Debt Service/Exports Ratio



## Statistical Profile\*

Area (Km <sup>2</sup> )	898,805		
Population: Total 1984 (85.2% urban)	16,857,000		
Annual growth rate 1970-84	3.0		
Birth rate (1980)	35.4		
General mortality (1981)	5.6		
Infant mortality (1981)	35.2		
Life expectancy (1980)	68.6		
Literacy (1982)	89.0		
<b>Labor force by sector (1983)</b>	(Percentages)		
Agriculture	15.1		
Mining	1.5		
Manufacturing	14.6		
Construction	7.9		
Others	60.9		
<b>Real production</b>	(Growth rates)	1982	1983 1984**
Total GDP (market prices)	0.7	-4.8	-1.7
Agricultural sector	3.6	0.4	2.0
Mining sector	-10.2	-6.3	1.0
Manufacturing sector	4.1	-1.7	2.8
Construction sector	-8.4	-13.3	-22.9
<b>Central government</b>	(Percentages of GDP)		
Current revenues	26.9	24.7	29.3
Current expenditures	18.7	18.5	20.9
Current savings	8.2	6.2	8.3
Capital expenditures	9.4	7.1	6.3
Deficit or surplus	-1.3	-0.9	2.1
Domestic financing	0.1	0.7	-2.1
<b>Money and prices</b>	(Growth rates)		
Consumer prices	9.7	6.3	12.2
Money supply	12.4	26.2	-8.1
Domestic credit	22.4	6.4	6.3
Public	n.a.	n.a.	n.a.
Private	12.7	4.6	12.0
<b>Exchange rate, average</b>	(units of national currency per dollar)	4.30	4.30 7.5
<b>Balance of payments</b>	(Millions of dollars)		
Merchandise exports (FOB)	16,516	14,759	15,890
Merchandise imports (FOB)	13,584	6,409	7,195
Merchandise balance	2,932	8,350	8,695
Net services	-6,539	-3,860	-4,106
Current account balance	-4,246	4,295	4,434
Official capital	7,817	-658	-1,358
Private capital	-3,906	-3,482	-1,811
Change in net reserves (- increase)	2,935	-155	-1,269
<b>External debt</b>	(Millions of dollars)		
Total	n.a.	n.a.	n.a.
Disbursed (includes short-term)	26,690	25,086	23,635
Debt service (interest and amortization)	4,786	4,985	5,190
	(Percentages)		
Debt service coefficient	27.9	32.6	30.4
Interest coefficient	22.7	20.6	23.4

\* Where necessary, the items of information presented in this table are defined in the list of sources appearing on page 375. Any clarification or interpretation of the data should be referred directly to the pertinent source.

\*\* Preliminary estimate.

n.a. Not available

## Venezuela

## Recent Economic Trends

During a second year of efforts to adjust to the difficult conditions created by the external payments crisis—a period in which the downward trend in oil export earnings continued—the Venezuelan economy showed mixed results in 1984. On the one hand, the positive balance of payments position of the previous year was strengthened and improved, which thus made it possible to envisage an orderly servicing of the external debt, even in the absence of additional external resources. At the same time, the public sector, which only two years earlier had shown a high deficit, recorded a surplus equivalent to nearly 5 per cent of the gross domestic product (GDP) in 1984. The growth rate of prices was held to below 20 per cent. On the other hand, real GDP and investment continued to deteriorate, although at a slower rate than in 1983, and open unemployment again rose.

In 1984, measures for containing public expenditure, coupled with a further decline in private investment and an increase in the prices and a decrease in the quantum of imports, combined to again reduce production. Real GDP, which in 1983 had fallen by 4.8 per cent, again shrank in 1984, this time by 1.7 per cent, to below the 1977 level.

The substantial relative changes in the price of foreign exchange—and consequently in the profitability of minor exports and of domestic production substituting imports—pushed up manufacturing output by 2.8 per cent. Despite negative results in some items, agricultural output was 2 per cent higher than in the previous year while the oil and natural gas sector grew by 1 per cent. In contrast, the sectors producing non-exportable goods and services (other than electricity) were more affected by the economic recession of 1984: construction fell by more than 20 per cent (the 1984 level was only 45 per cent of that of 1978), and commercial, restaurant, and hotel activities were down by about 15 per cent. Other services, including communications, financial services, and government, also showed a lower level of activity than in the previous year.

The fall in production and investment after the economic stagnation of 1979-82 and the severe recession of 1983 was reflected in a gradual deterioration in employment and real wages. Employment peaked in the second half of 1982 while unemployment rose from 7.1 per cent in 1982 to 10 per cent in 1983 and 13 per cent in 1984. Real wages fell by 2.8 per cent in 1982 and a further 0.5 per cent in 1983, but probably rose by an estimated 0.5 per cent in 1984.



Although domestic economic activity and employment continued to deteriorate, the external sector consolidated the favorable results achieved in 1983. Oil exports, which were limited by the production quotas set by the Organization of Oil-Exporting Countries (OPEC), increased in value terms by almost 6 per cent, because of: (a) a change in the composition of those exports in favor of heavy crudes and derivatives whose prices were more favorable; (b) an increase in the production of condensates; and (c) a further fall in the consumption of derivatives. The remaining exports, stimulated by the exchange rate and the more favorable conditions of the United States market, rose by almost 21 per cent in value terms, increasing total exports by 7.7 per cent. Merchandise imports, depressed by quantitative controls, the rise in the exchange rate and the fall in domestic demand, reached a level (\$7.195 billion) only 12 per cent higher than the 1983 low. Consequently, the trade surplus was \$8.695 billion, up by \$345 million from 1983.

Non-factor services, such as transportation and insurance, travel, and other services (drastically reduced in 1983), continued to show modest net outflows in 1984, while factor payments to capital, boosted by increasing accrued obligations in the form of interest on the external debt, increased their deficit by 15 per cent. As a result, the surplus in the current account of the balance of payments in 1984 was \$4.434 billion, slightly higher than the previous year's.

Since the lengthy renegotiation of the external debt service has paralyzed the use of new external credits while postponing the payment of large amounts of principal, the balance of the capital account of the balance of payments has basically reflected outflows for amortization of the external debt not covered by the renegotiation, as well as the accumulation of arrears on certain interest payments. In 1984, the deficit of the capital account was estimated at approximately \$2.243 billion while there was an unidentified outflow of foreign exchange (errors and omissions) in the amount of \$922 million. The overall result was a build-up in international reserves of \$1.269 billion.

The moderate increase in oil export earnings, combined with the rise in the exchange rate and the increase in the domestic prices of gasoline, increased fiscal revenue from the petroleum sector by almost 50 per cent. Added to this was: (a) a substantial increase in the share of the Government in exchange profits, a result of the application of the system of multiple exchange rates; (b) increases in non-oil income-tax collections and (c) larger Government receipts from its share of Central Bank profits. As a result of all these factors, the revenue of the Central Government rose from 24.7 per cent of GDP in 1983 to 29.3 per cent in 1984.

Central Government expenditure rose from 25.6 of GDP in 1983 to 27.2 per cent in 1984. However, this increase was not produced by the growth of operating expenses or investment expenditure—they both fell as a percentage of GDP—but rather by a sharp increase in interest payments (from 2.4 to 5.5 per cent of GDP) and in transfer payments to public sector agencies and enterprises to enable them to fulfill their debt commitments. Thus the finances of the Central Government moved from a deficit equivalent to 1 per cent of GDP in 1983 to a surplus equivalent to 2.1 per cent of GDP in 1984.

The financial surpluses of the Central Government and of the most important public sector institutions produced increases in the deposits of the sector in the banking system, which had a contractionary effect on liquidity trends. Indeed, in 1984 the expanded money supply (M2) increased by 8 per cent whereas GDP at current prices rose by 16.8 per cent. Credit to the private sector expanded by only 12 per cent. This tight domestic liquidity, which limited the reactivation of some productive sectors and was accompanied by administered increases in interest rates, was more marked in the second half of the year.

In 1984, as expected, domestic prices were more heavily influenced than in the previous year by the effects of the adjustments in the exchange rate, the correction of the price of gasoline and of rates for public services, the partial elimination of subsidies on consumer goods and agricultural inputs, and the quantitative restrictions on imports. In spite of the fact that in 1984: (a) a wide range of prices continued to be controlled; (b) preferential exchange continued to be granted for the import of certain essential consumer goods; (c) some subsidies were maintained in part; (d) domestic demand was reduced; and (e) the real liquidity of the system was restricted, the consumer price index increased from 6.3 per cent in 1983 to 12.2 per cent in 1984. Meanwhile, the wholesale price index rose from 8.8 per cent in 1983 to 23.7 per cent in 1984.

### Economic Policies

At the beginning of 1984 and of the new Government, the most serious problems to be dealt with by public action were: (a) the renegotiation of the external debt; (b) the urgent need to maintain balance of payments and financial conditions compatible with the service of that debt; and (c) a resumption of economic growth through a policy that would make the Venezuelan economy less vulnerable to external events like those of 1982.

In view of oil revenue prospects similar to those of the previous year, the increasing external debt service, and the virtual drying-up of external sources of credit, the Government deemed it essential to achieve a balance of merchandise of sufficient size to cover the expected deficits in the service and capital accounts of the balance of payments while maintaining adequate levels of international reserves. For that purpose it decided to continue exchange controls, quotas of permitted imports, and the list of prohibited imports. It increased the effective devaluation by establishing a market with an exchange rate of 7.5 bolívars to the United States dollar and shifted a large number of non-essential imports to that new market (an exchange rate of 4.30 bolívars to the dollar was kept for essential foodstuffs, drugs, and certain debts and an exchange rate of 6 bolívars to the dollar, for the exports and imports of the petroleum industry).

In the area of public finances, the immediate tasks were the elimination of the Central Government deficit in the face of increasing public debt service payments, and the cushioning of the impact of the recession. To begin with, the exchange measures were expected to substantially increase fiscal revenue.



Even so, it was deemed necessary to trim the budget to amounts compatible with the expected revenue and the increase in the debt service. This entailed limiting or reducing current expenditure wherever possible, eliminating subsidies, containing increases in wages and salaries in the public sector and, especially, reducing investment programs.

To contain the spread of inflationary pressures, no across-the-board wage and salary increases were granted to offset the price increases due to corrections of the exchange rate, the elimination of subsidies, and the correction of the previously distorted public prices and rates. On the other hand, the Government required employers to grant transportation and lunch vouchers to all workers whose income was below a certain level. In addition, it increased the minimum wage and continued the policy of promoting collective bargaining.

Monetary policy sought to maintain adequate levels of liquidity by taking into account the restrictive fiscal policy, the effect of the expected changes in international reserves, and the excess monetary reserves of the banking system at the beginning of the year. Concurrently, the authorities decided to intervene in determining interest rates to encourage the channeling of credit to priority activities such as agriculture and construction. When liquidity became tight in the second half of the year, the Central Bank expanded credit resources by (a) rediscounting; (b) the temporary purchase of public debt bonds held by commercial banks; (c) the purchase of mortgage bonds from the portfolio of the National Urban Development Fund; (d) the granting of advances to the Mortgage Center (Central Hipotecaria); (e) the purchase of certificates of deposit of the National Savings and Loan Bank; and (f) an increase in open market operations. However, the net effect of those measures was to limit credit expansion.

## Outlook

The prospects of an economic recovery in 1985 are limited. Oil revenue will remain virtually unchanged because of the limitations imposed on oil production by OPEC and the prevailing weakness of the international market for hydrocarbons. In addition, the service on the external debt is expected to continue to rise.

Because of the relative stagnation of oil revenue, a possible increase in revenue can only be expected from the Government's share in exchange profits, while the service on the public debt will limit other Government expenditures. This means that, in view of the difficulty in substantially reducing operating expenses, the severe restrictions on Central Government investments and on public investments that receive Government support, will continue for at least one year.

The changes needed in the agricultural sector to initiate a significant expansion of output have not been made. The construction sector faces a weak public investment program and a large surplus of unsold houses. Commerce may be expected to continue depressed, as will domestic demand, while

imports will probably continue to be restricted. The output of certain agricultural products and of manufacturing is likely to show some growth as long as those sectors have unused production capacity that can take advantage of the favorable conditions offered by import substitution and the external markets. The modest GDP growth expected, combined with the low levels of investment anticipated, point to continued high levels of unemployment, which in turn could again help to depress real wages.

## Sources of Data in the Statistical Profile:

### Area:

Organization of American States, *América en Cifras 1972—Situación Demográfica: Estado y Movimiento de la Población*.

### Population:

The information for the following items was furnished to the IDB by the Presidencia de la República, *Informe Social 1982*:

Birth Rate (per one thousand inhabitants)

General Mortality Rate (per one thousand inhabitants)

Infant Mortality Rate (per one thousand live births)

Years of Life Expectancy

Literacy Rate

Total: Information furnished to the IDB by the Oficina Central de Estadística e Informática (OCEI), February 1985.

### Labor Force:

Banco Central de Venezuela, *Anuario de Series Estadísticas*, 1983.

### Real GDP:

1982-83: Information furnished to the IDB by the Banco Central de Venezuela, February 1985.

1984: IDB estimate based on information furnished by the Banco Central de Venezuela, February 1985.

### Central Government:

1982-83: Banco Central de Venezuela, *Boletín Mensual*, January 1984.

1984: IDB estimate based on information furnished by the Banco Central de Venezuela, February 1985.

### Money and Prices:

Information furnished to the IDB by the Banco Central de Venezuela, February 1985.

### Exchange Rate:

International Monetary Fund, *International Financial Statistics*, March 1985.

### Balance of Payments:

1982-83: International Monetary Fund, *Balance of Payments Statistics*, (magnetic tapes).

1984: IDB estimate based on information furnished by the Banco Central de Venezuela, February 1985.

### External Debt:

The information for the following items was furnished to the IDB by the Gobierno de Venezuela, February 1985, except 1984 data which were estimated by the IDB:

Total

Disbursed debt

Debt-service (interest and amortization)

Debt-service ratio

Debt-interest ratio

Debt-service (interest and amortization) as percentage of exports of goods and non-factor services.

Interest as percentage of exports of goods and non-factor services.





→ Venezuela file?

January 3, 1986

Mr. Armeane Choksi (Room N-623):

Re: VENEZUELA - Technical Assistance for a Trade Policy Study

The Government of Venezuela has requested the Bank's assistance, on an urgent basis, in carrying out a Trade Policy Study, the draft terms of reference for which are attached.

I would be most grateful for your comments and suggestions on the TOR. Could you let me or Mr. Ruderfer (X 73401) know if your Division would be prepared to assign staff on a reimbursable cost basis, to help with the proposed Study? The Government wants this Study to get underway as soon as possible so I would appreciate your letting us know if and when someone from your Division could be available for this purpose. For your information, this Study is now part of the Bank's FY86 technical assistance program for Venezuela.

Given the urgency of this matter, I would appreciate receiving your Division's comments on the terms of reference prepared if possible by Thursday, January 9, 1986.

Many thanks.

Spiros T. Voyadzis 

cc: Mr. Demetrios Papageorgiou (CPD) (N-626)  
Mr. Alan Gelb (DRD)  
Mr. William Tyler (LCP)

ERuderfer:rjm

E-509/86      December 26, 1985  
Spanish (Venezuela)  
LC2            ENMcM:jb

Dr. Leonor Filardo de González  
Executive Director  
The World Bank  
Washington, D.C.

(Preliminary) Terms of Reference for  
World Bank Technical Assistance  
to the Government of Venezuela on Trade Policy

1.            Justification

The policy of import substitution and development of domestic production that the Venezuelan State has been pursuing since 1958, against a background of abundant financial resources derived from petroleum, has over the past 25 years been translated into a series of implicit and explicit incentives for economic activities, encompassing trade, tariff, tax, labor and financial policy measures.

During this period, the broad lines of industrial policy have been directed toward encouraging production within the country of the largest possible volume of imported goods, employing a dual mechanism for this purpose: tariff policy measures, designed to reserve the domestic market for locally produced goods, and a tax bonus for goods produced for export, designed to offset the comparative cost differential between the domestic market and the international market.

The effects of this industrialization policy on the economy have been very significant in terms of building up a large modern industrial sector and generating employment. However, the process has been limited in terms of the external balance and efficiency, low degree of specialized production, and poor articulation within industry and with other sectors of the economy.

A. The Venezuelan Economy, 1983-1985

Starting in 1983, the combination of a series of factors that gave rise to a balance of payments deficit, a fiscal deficit and severe domestic recession brought about far-reaching changes in the economic policies Venezuela had hitherto been pursuing.

In the short term, the adjustment program implemented by the National Government, at a time when earnings from petroleum were down sharply, sought to correct the major disequilibria and reactivate the economy. Within this adjustment program, the following measures are worthy of special mention: change in exchange rate, severe import controls, renegotiation of external debt, and elimination of the public-sector deficit.

The economic policy decisions listed above, forming part of the short-term adjustment program, had far-reaching repercussions on the entire productive sector, largely through two instruments: exchange-rate policy and tariff and quasi-tariff\* policy.

The process of industrialization through import substitution has been encouraged by changes in relative prices and quasi-tariff controls, and nontraditional exports have likewise been favorably affected, largely as a result of the system of differential exchange rates and the existing system of tax incentives.

B. Long-Term Policies

Even though the short-term adjustment measures taken by the National Government have produced satisfactory results in re-establishing both external

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\*T.N.: Política para-arancelaria in Spanish -- exact meaning unclear.



equilibrium and fiscal equilibrium, there is need -- for the long term and having regard to the national and international setting of Venezuela's economy and the prospects that lie ahead -- to adjust the Government's policies and instruments to the priorities of the development strategy adopted by the country.

To secure balanced and sustained economic development and reduce the external vulnerability of the economy, the following steps are required:

- (a) Formulation of a policy to promote the production of tradable goods, based on the exploitation of comparative advantages and on principles of efficiency and productivity, designed to further the development of a properly articulated and efficient industrial sector.
- (b) Formulation of a trade policy that will serve as an instrument of creative support for the policy outlined above and promote selective substitution of imports and sustained growth in nontraditional exports.

2. Objectives and Activities of World Bank Assistance

The technical assistance to be provided by the World Bank under its program of cooperation with the Venezuelan Government would help to support the Executive Branch's activities in formulating an industrial policy and a trade policy along the lines set forth above.

Having regard to the fact that we shall shortly have available a study on comparative advantages in the industrial sector (currently being prepared by Boston University's Center for Latin American Development Studies - CLADS), the technical assistance from the World Bank would primarily be focused as follows:

First, clarification and investigation of the links between current policies and instruments and the behavior of the various branches of industry, in order to measure the differential impact of each of these instruments.

Second, the World Bank's technical assistance would contribute, on the basis of the foregoing, to the design of a rational system of tariff and quasi-tariff protection and export incentives, having regard to the objectives being pursued, based on the exploitation of comparative advantages, efficiency and productivity.

A. Assistance Activities

1. Design of a dynamic information-gathering and decision-making system that will make it possible to determine the effects of all of the current policy instruments on the behavior of the various branches of industry.
2. Assessment of the current system of tariff and quasi-tariff protection.
3. Support in formulating a new system of industrial protection and incentives that will seek to convert the current system of predominantly quasi-tariff protection into one of tariff protection.
4. Measurement of the effective level of protection enjoyed by the various branches of industry.
5. Assessment of the sector's institutional framework.

B. Types of Experts Required

To carry out the activities proposed above, it is felt in principle that the following experts would be needed from the World Bank: an expert on tariff matters, an expert on calculating effective protection levels, and

an expert to design the information-gathering system described under item 1 of Activities.

Regards,

Dr. Francisco García Palacios  
Director General of CORDIPLAN

Caracas, December 20, 1985  
Telex No. 899  
OP/MV