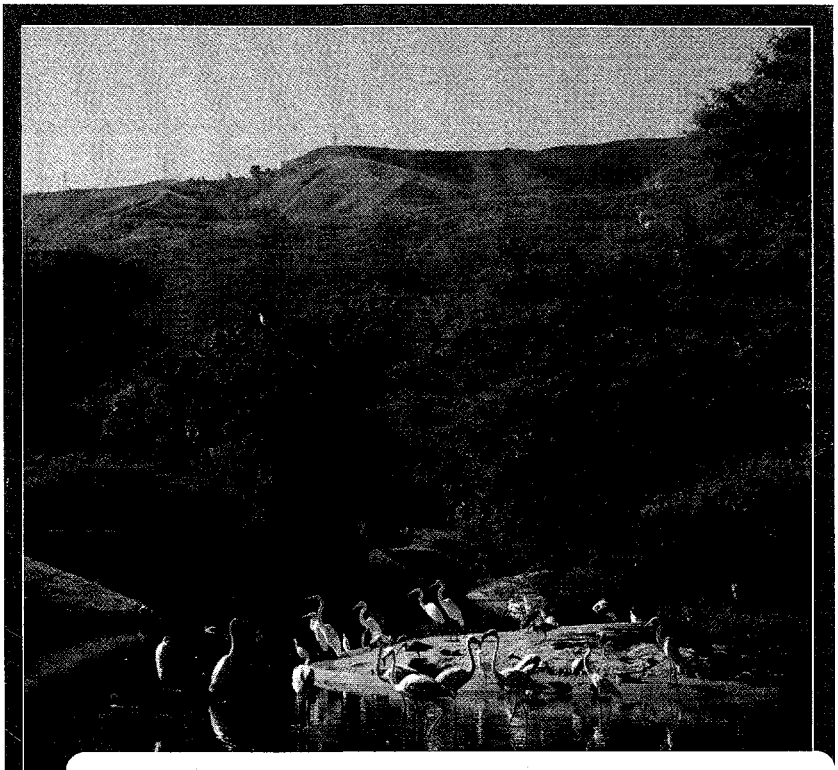
VENEZUELA AND THE WORLD BANK

PREPARING FOR THE FUTURE



VENEZUELA AND THE WORLD BANK
Preparing for the Future

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The design on the chapter opening pages is taken from the coat of arms of Venezuela. It represents twenty strands of wheat, which symbolize the twenty states of Venezuela. Courtesy Embassy of Venezuela, Washington.

The cover photograph shows birds on a sandbank on the Orinoco delta. Venezuela is one of the ten countries in the world with the greatest biodiversity.

This booklet was prepared by the staff of Country Department I, Latin America and the Caribbean Regional Office, the World Bank.

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FOREWORD

Venezuela joined the World Bank in 1946 and received its first loan in 1961. In the 1970s the relationship changed owing to oil price increases. Venezuela repaid its outstanding World Bank obligations and loaned some of its oil profits to the World Bank to support lending to other member countries. Then, during the 1980s, oil prices collapsed, income fell, and the situation was exacerbated by poor economic policies. Consequently, in 1989 Venezuela began to borrow again from the Bank.

The Bank renewed its lending to Venezuela with the firm conviction that the 1989 reforms of President Pérez would lay a foundation for sustainable growth and development and would reduce the effects of widespread poverty. These policies replaced a model of government intervention and control that had failed not only in Venezuela but throughout the world because it stifled private initiative, reduced savings and investment, lowered living standards, and allowed government services and public infrastructure to deteriorate.

The reform program of the Pérez administration has been one of the most forward-looking in Latin American. The program moved quickly and firmly to restore productive incentives and to introduce programs that, when implemented, can alleviate poverty and improve public services. Adjustment

programs are not instantaneous, and they entail social costs as economic balances are restored. But the longer adjustment is postponed, the greater the costs inflicted on a society. Venezuela cannot return to the illusory prosperity it enjoyed during the oil boom of the 1970s but with continued sound economic management, it can achieve a sustainable prosperity based on its human resources and its natural resources.

The World Bank has supported these reforms through lending, policy advice, technical assistance, and cofinancing. This booklet describes the Bank's assistance in the first stages of Venezuela's adjustment and discusses areas in which we hope to strengthen the Bank's collaboration with the Venezuelan government to assist it in achieving its economic and social objectives.

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1. Venezuela and the World Bank

Venezuela joined the World Bank in 1946 and received its first loan in 1961. Between 1961 and 1974 the Bank disbursed $342 million from thirteen loans to Venezuela. In 1974, following the rise of oil prices, Venezuela's average income rose to $1920, and Venezuela required no further loans from the World Bank. In fact, the Government of Venezuela made loans to the World Bank in the form of buying more than $500 million worth of World Bank bonds.

With the decline in oil prices, and following several years of inappropriate economic policies, Venezuela's average income declined, and in 1986 the Executive Directors of the World Bank renewed Venezuela's eligibility to borrow. During 1986–88, Bank staff visited Caracas to prepare diagnoses of economic and sectoral problems and to discuss recommendations with the government. Following the election of Carlos Andrés Pérez, Bank staff worked closely with Ministers to review policies and to prepare loans which would support programs of economic reform and structural change.

The World Bank Group's contribution to Venezuela since program reactivation has taken a number of forms, including lending, technical assistance, economic and sector studies, and facilitating the cofinancing of investment projects. Most of these interventions are made by the World Bank through government

A bridge over the Orinoco River. Maintaining and rehabilitating Venezuelan infrastructure is a World Bank priority.

agencies. A Group affiliate, the International Finance Corporation, makes loans and provides assistance directly to Venezuela's private sector. Another affiliate, the Multilateral Investment Guarantee Agency, offers investors guarantees against noncommercial risks and advises on policies and regulations to facilitate foreign investment. Chapter 6 describes the World Bank Group in detail, and the appendix provides answers to commonly asked questions regarding its operations.

Economic Policies for the 1990s and Beyond

The economic policies of the Pérez government sought to free the economy from excessive state controls and allow a freer functioning of markets. The reform program is far-reaching, and it has received support from both the World Bank (through five adjustment and four sectoral loans valued at $1.7 billion (billion = 1,000 million) and the International Monetary Fund (IMF), through a $5 billion Extended Fund Facility. The principal elements of the reform and its accomplishments to date are reform of the exchange rate system and trade, fiscal reform, financial

sector reform, improved social policies, reform of state owned enterprises, reduction of external debt, and reform of agriculture.

Exchange Rate System and Trade Reform. The government adopted a unified, market-based exchange rate, abolished all exchange controls, and began a comprehensive trade reform supported by the Bank's Trade Policy Loan ($353 million). It has eliminated most import controls, simplified the tariff schedule and lowered the maximum rates, and eliminated the export subsidy from most items. Trade regulations, including the duty drawback and temporary admissions schemes, have been reformed to eliminate opaque and arbitrary trade practices. To participate more effectively in international trade, Venezuela has acceded to the General Agreement on Tariffs and Trade (GATT). Foreign investment restrictions were reformed, nearly all economic activities were opened to foreign investors, and all restrictions on remittance of dividends and technology contracts were removed.

Fiscal Reform. In 1989, the government implemented measures to control public spending and raise revenue. The central government's spending on current transfers and fixed capital formation were curtailed. Public enterprises' revenues rose as a result of large domestic price increases for petroleum products, electricity, aluminum, steel, iron ore, fertilizers and imported livestock feed. Congress passed legislation to reduce rates and expand the bases for corporate and individual income taxes, and it is considering legislation to introduce a value added tax. These reforms have been supported by the Bank's Structural Adjustment Loan ($402 million).

Financial Sector Reform. From October 1985 to March 1989 interest rates were fixed at 9 and 13 percent for commercial bank deposits and loans, respectively. These ceilings reduced savings and contributed to capital flight. Since February 1989 the financial system has been progressively liberalized, and most interest rates are market-determined. The government is strengthening supervision of the financial system and has privatized three publicly owned banks. These reforms have been supported by the Bank's Financial Sector Adjustment Loan ($300 million).

Improved Social Policies. To ensure that subsidies will help only those who need them the most, the government moved from indirect, generalized subsidies to direct, targeted social programs. It eliminated indirect food subsidies and started the Food Grant Program in September 1989. Significant progress has been made in the Food Grant Program, Community Based Day Care Centers, and the Maternal and Infant Program as well as in new, targeted programs such as the milk and cereal vouchers. The Bank's Social Development Project Loan ($100 million) supports the extension of these programs.

Reform of State Owned Enterprises. The interministerial committee on restructuring and privatization has approved about 60 holdings for privatization. During 1990—91 the government privatized seven holdings, including the international airline (VIASA), the phone company (CANTV), three banks, a shipyard, and a sugar refinery. Privatization is being supported by the World Bank's Public Enterprise Reform Loan ($350 million). Other state-owned enterprises are being restructured to increase their efficiency and competitiveness.

Reduction of External Debt. A program of debt and debt service reduction (including new money) was completed in December 1990. The program affects about $19.7 billion of commercial bank debt. Options offered to the creditors include: principal discount bonds; par bonds with below-market interest rates; temporary interest reduction bonds; cash buybacks; and new money and debt conversion bonds. The package has support from the World Bank's Interest Support Loan ($150 million), the IMF, and bilateral sources.

Reform of Agriculture. Agricultural trade was substantially liberalized, although nearly 40 percent of agricultural output remains protected by prior licenses which will be phased out. The subsidy on fertilizer prices has been reduced to 30 percent of export opportunity cost, and retail price controls have been retained for only four items. Agricultural credit subsidies are being phased out, and the state monopolies on exporting coffee and cocoa are being eliminated. The government is increasing water invoicing with the aim of eventually recovering fully the operational and maintenance costs. The Bank's Board has

authorized an Agricultural Investment Loan ($300 million) to support modernization of the sector.

Economic Prospects

Venezuela's medium- to long-term prospects are favorable. Venezuela is a major oil exporter and is rich in other natural resources Even more important, its economic reforms are promising. The economic reform program restored internal and external balances, and the 9.2 percent growth in 1991 was the highest in the world. The government is deepening the reforms through improving the efficiency of the financial sector, restructuring and privatizing public enterprises, and accelerating the trade liberalization. As the reforms show positive results and investment expands, gross domestic product (GDP) growth is projected at about 5–6 percent during the early 1990s, while inflation is expected to be moderated. Sustained growth of production and exports will sharply reduce the $25 billion public debt burden and improve creditworthiness over the medium term.

Assistance Objectives

The government's program seeks to maintain internal and external economic balances, improve efficiency, and achieve sustainable growth with equity. The government deserves credit for its accomplishments in structural adjustment. The World Bank supported Venezuela's abrupt break with its past. The structural reforms have been sustained for three years, and remaining reforms in most areas are gradual, but the direction has been set. There is little left in terms of rapid, "stroke-of-the-pen" revisions of regulations and procedures. What remains is a long-term agenda of legislation, new institutions, rebuilding institutions to conform to new policies, eliminating incompatible institutions, and developing programs which protect the poor against the adverse effects of the transition. This work has been time consuming in every country where it has succeeded, and to support this work, the World Bank's

program has shifted from adjustment lending toward investment lending, research, and technical assistance.

The Bank's program is directed at helping the Venezuelan government maintain economic stability, promote equitable income distribution, and establish a basis for expanding prosperity. For Venezuela to reach these goals, it must continue to address four economic issues: macroeconomic management, opening the economy and developing the private sector, strengthening public institutions and improving infrastructure, and supporting human resource development and income redistribution.

Macroeconomic Management. Venezuela's past economic crises and sectoral problems have resulted from poor economic policies, especially when there were increases or decreases in petroleum revenues. Between 1974 and 1982, there were unexpected oil revenues equal to about two years' GDP. Petroleum exports rose from $3 billion annually during 1968–72 to $11 billion in 1974. They peaked again in 1980–81 at $19 billion and declined to $8 billion in 1988. During 1974–88, year-to-year changes (increases or decreases) were as high as 13 percent of GDP, and they averaged 5 percent of GDP.

Economic policymaking under such conditions poses special challenges, both in the boom years and in the periods of collapse. The instability and unpredictability of petroleum prices and exports have—through the exchange rate and fiscal and monetary policies—affected every sector of the economy. While the petroleum resources offer opportunities which are the envy of many other nations, their size and role must be clarified. Petroleum is only one- fourth of GDP; it cannot grow indefinitely; and it is not by itself a sustainable basis for economic development. Effective institutions and better policy analysis and implementation are important for sound fiscal management, to avoid future crises, and to distribute and invest the petroleum rents more efficiently and equitably.

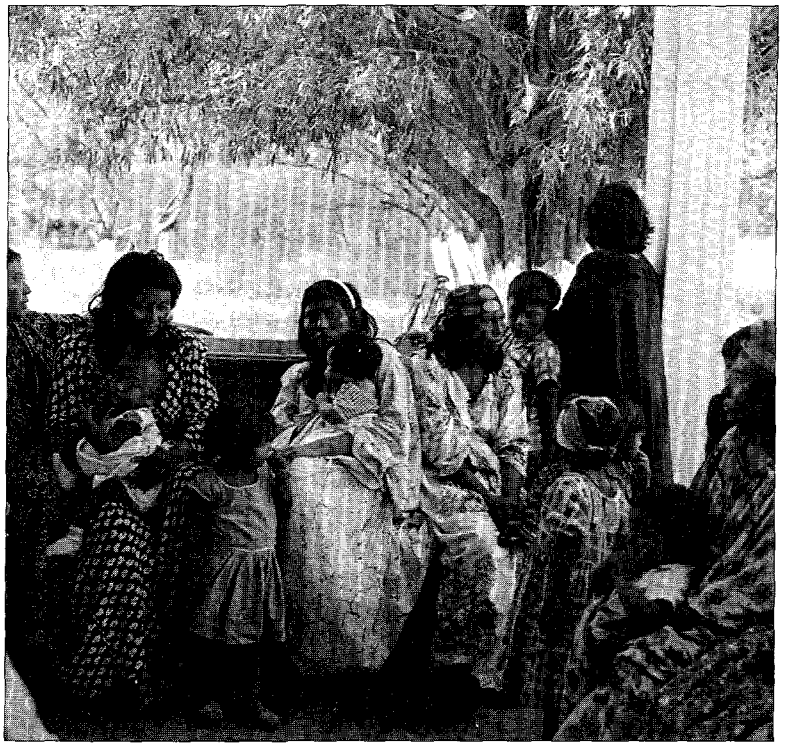
Opening the Economy and Developing the Private Sector. Petroleum revenue, properly managed, can provide resources for sustained growth but—in an economy where three-fourths of GDP is generated by the non-oil sector—it is not, by itself,

the most important means of development. Growth of the non-oil sector is necessary for any long-term development strategy, and that growth can best be accomplished by the private sector. Government policy before 1989 had viewed the state-owned "basic industries" as the engine of growth, with private enterprises directed into downstream activities within a managed, isolated economy. This theory of economic development failed not only in Venezuela but throughout Latin America. A private, non-oil sector—operating in an open economy which fosters internationally competitive enterprises—offers the best prospects for sustained development.

The promising, well-designed reforms of the Pérez government—trade, financial, deregulation, privatization, pricing of publicly produced goods—have begun to establish an open economy which will reduce the role of government and reward private initiative, but the reforms must be sustained and deepened and important activities remain for successive governments to analyze, debate, and implement.

Strengthening Public Institutions and Improving Infrastructure. The Venezuelan government in the 1980s lost its capability to perform the functions which are the responsibility of any government. As a result of this neglect, today production and delivery of public goods is too costly and their quality is low because of weak institutions and a decaying, obsolete infrastructure. Government has *grown* during the initial stages of adjustment, but public agencies, overstaffed with unqualified and poorly trained employees, cannot analyze policies or design and manage programs and projects to translate policies into action. The federal government is reducing the number of ministries while decentralizing responsibilities for many goods and programs, and this provides an opportunity to improve the quality and responsiveness of government services. But without stronger local governments, problems could become worse. The government at all levels needs to adopt modern and transparent systems of planning, programming, budgeting, execution, and control in order to be more accountable to the electorate.

Human Resource Development and Income Distribution. Poverty is a significant and persistent problem, despite Venezuela's



The World Bank's Social Development Loan supports infant and maternal health care and nutritional programs.

relatively high per capita income and substantial public spending, which averaged 30 to 40 percent of central government expenditures in the early 1980s—in the social sectors. Living conditions deteriorated during the last decade as per capita GDP fell every year from 1978 to 1988. In 1989, 53 percent of Venezuelans were living in poverty with incomes less than twice that required to purchase a minimum food basket. Income distribution favors the wealthy: the top 30 percent receive 62 percent of household income and the bottom 30 percent receive nine percent. For Venezuela to achieve its social and economic potential, the government must find new methods of assisting the needy and strengthen social programs for all Venezuelans.

The government and the Bank are working to resolve these issues through broadly based reforms which affect the entire economy (chapter 2) and through sector-specific reforms (chapter 3).

2. General Reforms

International Trade Policy

One of the most profound policy changes of the Pérez government was the reform of international trade policies. Between 1984 and 1989, Venezuelan importers and exporters were burdened by the system of multiple exchange rates, allocations through RECADI, import licenses, and tariffs as high as 135 percent. State-owned enterprises had import monopolies for products similar to those they produced. There was a subsidy to compensate exporters for the overvalued exchange rate, but it was unpredictable and insufficient to encourage an export-based economy. The economy was plagued by periodic shortages of imported inputs and spare parts. The internal market was too small to take advantage of economies of scale for many items, and manufacturers, protected against competition from the world market, had no incentive to improve efficiency, product quality, or to lower their prices.

In 1989, RECADI was abolished, the exchange rate was unified and adjusted by market forces, export prohibitions were eliminated, and the government began a gradual program to phase out import licenses and to reduce tariffs. The government reduced the export subsidy and negotiated membership in the GATT. These changes will transform the Venezuelan

The World Bank supports the comprehensive reform of Venezuelan foreign trade policy and the restructuring and decentralization of ports management through structural adjustment loans.

economy from one which was closed to the international market to one which can become an active participant, to the benefit of consumers and producers alike. The trade reform, together with reforms of investment regulations, will encourage new investment—both foreign and domestic—which will increase the demand for Venezuelan labor.

The World Bank supported these reforms through its Trade Policy Loan. This loan also provided technical assistance for studies of Venezuela and the GATT, customs administration and trade facilitation, anti-dumping and anti-subsidy legislation, industrial regulations and incentives, agricultural trade, and duty-drawback and temporary admissions regimes.

Privatization and Restructuring

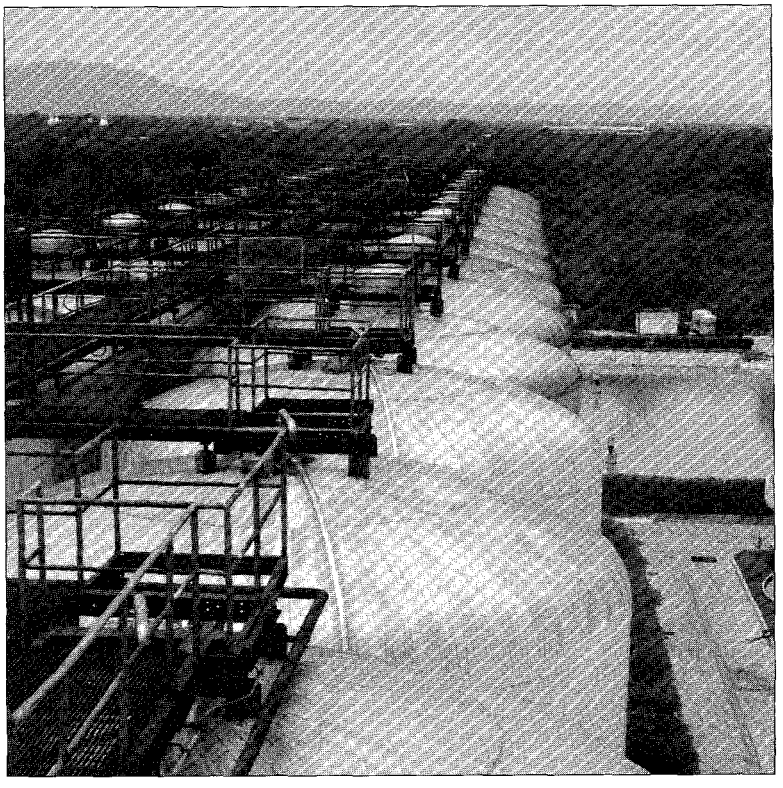
The government dramatically changed its role in industrial policy between 1970 and the mid-1980s. In 1970, state-owned enterprises accounted for 4 percent of industrial value added, but by 1986 they were 42 percent, concentrated

in petroleum refining, nonferrous metals, iron and steel, and chemical and petrochemical products. In addition, some service subsectors like telecommunications, shipping and port handling, and postal services were monopolized by the government and became major obstacles to private sector development and trade expansion. By the end of the 1980s there were roughly 125 commercially oriented state-owned enterprises, many of which depended on government transfers.

The Pérez government initiated a public enterprise reform program to reduce public sector dominance in the economy, improve the efficiency of public enterprises, and reduce the drain on public finances. The reforms have involved privatization and restructuring of a number of major enterprises, phased adjustment of prices of public enterprises' good and services to economic levels, and reductions in government transfers.

By the end of 1991, the government had privatized seven holdings, including the national telephone company (CANTV) and the international airline (VIASA). These transactions yielded roughly $2.4 billion in cash proceeds, much of which will be used to finance the government's social programs. In addition, the government liquidated the national ports agency (INP), privatized cargo handling, and transferred responsibility for administering the ports to new regional port authorities. Major restructuring programs, involving varying degrees of privatization, are also underway in several other public enterprises, including INAVI (housing), IPOSTEL (postal service), INOS (water and sewerage), CADAFE (electricity), SIDOR (steel), IMAU (trash collection) and VTV (television).

The World Bank has assisted the government's privatization and restructuring initiatives through the Public Enterprise Reform Loan. This loan supported policy reforms to reduce public sector dominance in the economy, improve the competitive environment for the private sector, and increase the efficiency of public enterprises. This program is expected to improve the efficiency, productivity, and profitability of those enterprises remaining in the public sector, as well as strengthening public finances. In parallel, it will improve



The restructuring and privatization of state-owned enterprises is a World Bank priority in Venezuela and throughout the world.

incentives and opportunities for private production, commerce, and investment.

In addition to the national oil company, Petroleos de Venezolana, S.A. (PDVSA), the main enterprises remaining in government hands are the basic industries (mining and metallurgy), which are controlled by the Corporacion Venezolana de Guayana (CVG) group. Expansion of the privatization program would provide important economic benefits in the 1990s. It would generate additional funds for the government's social programs and also provide the needed investment capital for planned expansion programs in the public

enterprise sector. Privatization would also improve industrial competitiveness and efficiency.

Banking and Finance

Because of the policies of the 1980s, when the Pérez administration took office the financial system had several impediments: (1) excessive regulation of interest rates and credit allocation; (2) a large number of government-owned financial intermediaries (banks and development funds), many of which were either bankrupt or poorly managed; (3) public uncertainty about the Central Bank's operations with the public sector and the financial system, which made it difficult to evaluate credit policies and undermined the Central Bank's ability to carry out effective monetary policy; (4) a weak institutional and regulatory environment and inadequate supervision of financial institutions; and (5) weak financial conditions of many private financial institutions and inadequate mechanisms to deal with ailing banks.

To overcome these distortions, the government began a financial sector reform program which sought, in the short term: (1) to liberalize the financial policy environment (interest rates, allocation of credit, foreign ownership, universal banking, and so on); (2) to reduce the government's direct role in financial intermediation (privatization and liquidation of public banks, consolidation of development banks, rationalization of housing finance policy, limiting the Central Bank's role to bank liquidity and monetary management); and (3) to strengthen the competitiveness and financial condition of intermediaries through prudential regulations and supervision, capital standards, and mechanisms for distressed banks. In the long term, the government seeks to (1) liberalize all interest rates and credit controls; (2) restructure the development finance system; and (3) reform the housing finance system.

The World Bank authorized a Financial Sector Adjustment Loan to support these policy reforms. The loan included provisions for an extensive program of technical assistance to

restructure government-owned banks and funds; to assist in developing capital markets; and to strengthen the Superintendency of Banks, the Deposit Insurance Corporation, the National Savings and Loan Bank, the Superintendency of Insurance Companies, and the Central Bank.

Public Administration

Even in market-oriented societies, only governments can enforce rules to make markets work efficiently and provide public goods efficiently. Production and investment will be deterred and development hindered without the institutions and supportive framework of the State to create and enforce the rules, to establish law and order, and to ensure property rights. The government must serve as the people's agent to ensure the adequacy of services such as education, health, and essential infrastructure, particularly when such services are directed at the poor and are not forthcoming from the private sector. A well-educated labor force and adequate infrastructure are fundamental to the quality of private investment. For a government to administer effectively its laws and to translate its goals and objectives into concrete, cost-effective programs, it must be accountable to the electorate, professionally staffed, above corruption, and follow transparent procedures for making decisions and dealing with the public.

The Venezuelan system of public administration will undergo rapid change over the next few years as the government's reforms force it to eliminate old programs and implement new ones. The decentralization of responsibilities from the federal to the local governments will require not only reassignment of existing employees, but more fundamental changes in the nature of government and the skills and training required for its work force.

The World Bank studied Venezuela's public administration and discussed its findings with the government. The study made recommendations to improve the effectiveness of policymaking, civil service pay, and employment policies; and to

expedite the decentralization of government services. The World Bank, which recognizes the importance of public administration, has undertaken further work including more comprehensive studies of decentralization and its fiscal effects, and technical assistance for ministries throughout the federal government. It has also approved a unique $30 million Judicial Infrastructure Reform Loan. The objective of this project is to increase the efficiency of the judicial system by rehabilitating judicial court rooms and buildings, upgrading systems and archives, providing training, and establishing performance benchmarks.

3. Sectoral Experience

Education

The Venezuelan education system is characterized by (1) relatively good access to primary education, with unmet demand for secondary education; (2) low quality of education at all levels, contributing to high repetition and dropout rates; (3) inefficient resource allocation both within and across levels of education (higher education currently absorbs almost 40 percent of all expenditures on education); (4) weak and highly centralized management of the education system; (5) a perceived disparity between the content and/or effectiveness of secondary education and the employment needs of the private sector; (6) lower academic achievement of students from marginal rural and urban schools, which contributes to the perpetuation of social inequities.

Sectoral Studies. The World Bank is studying the education sector to identify policies and investments that could improve human resource development. The study is analyzing government spending on education and the possible effects of alternative ways of reallocating resources to increase efficiency and labor productivity. The principal issues being studied in the education sector are:

Building Venezuelan human resources through fundamental educational reform is an important part of the World Bank's approach.

- *Education Quality.* The study will: compare the quality of the public and private education systems relative to per-student spending; analyze the causes of quality differences; and make recommendations for policies to improve quality without increasing costs.
- *External Efficiency.* Venezuela spends three percent of GDP and about 40 percent of the educational budget on higher

education—higher than any other Latin America country. However, the economic returns to higher education are lower than those to primary or secondary education. The report will analyze higher education reform issues such as cost recovery, incentives for more efficient management, policies toward the private sector, and loan and scholarship programs.

- *Education and the Labor Force.* Venezuelans are concerned that the large share of students who do not finish primary or secondary school are ill-prepared for the work place and are unemployed or underemployed. The study will evaluate employment prospects for dropouts in view of the system of informal vocational training and on-the-job training.

Lending. The Social Development Project is supporting the development and expansion of pre-school education, focused on lower-income urban and rural areas. Coverage of formal and non-formal preschool education will be extended to about 116,000 children from poor and disadvantaged families.

The Bank has also approved a $58 million Student Loan Reform project to rationalize the use of resources in higher education through improved management of the Fundacion Gran Mariscal de Ayacucho, reform of the financing of higher education, and improved training and education of higher-level workers. The project would (1) strengthen and reform the student loan program; (2) improve professional, technical and managerial skills in the private and public sectors; and (3) strengthen policy research on human capital and higher education to guide government reforms in higher education finance and management.

The government and the World Bank are preparing a Basic Education Project to raise the level of student achievement, reduce the incidence of repetition and dropout, and increase graduation rates through improvement in education and administrative efficiency. Toward these objectives, the project would: (1) provide textbooks and other educational materials; (2) improve teachers' skills and classroom effectiveness; (3) improve headmasters' and supervisors' skills in managing schools and monitoring teachers' performance; (4) encourage accountability

and facilitate decentralization by improving the Ministry of Education's ability to formulate policies, monitor quality, and offer timely assistance to address state and local problems.

For the medium term, the Bank gives high priority to decentralizing basic education and providing greater autonomy in school management. The pace of decentralization is politically determined, and not much is known about the capacity of states and municipalities. Project design will be flexible to support decentralization and the Bank will continue to provide technical assistance and policy support to the government. The Bank will support primary and secondary education by providing instructional materials, mini-libraries, curriculum development, and teacher training and evaluation. These interventions should extend to the poorest schools.

In later years, the Bank would support higher education reform with a loan focused on reducing costs through increased efficiency and redistributing costs through the gradual introduction of cost recovery.

Health and Nutrition

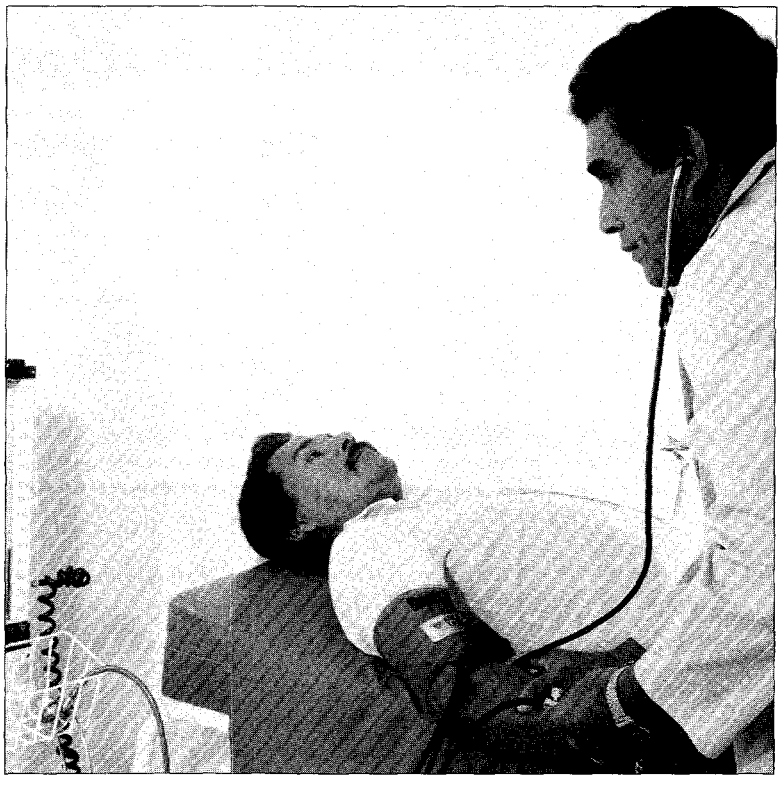
By some indicators, public health in Venezuela is poor. For example, the infant mortality rate is higher than that of Costa Rica, Chile, or Jamaica—countries with lower income levels. Public spending on health fell in real terms over 1983 to 1989, and the government recognizes that cost-effective programs have been neglected and that publicly provided services are too costly, inefficient, and of poor quality. To address these problems, the government proposes to devote more resources to maternal-child health services and endemic disease control and to improve the efficiency and quality of hospital services through rehabilitation and reforms in their organization and management. The government also seeks to decentralize health services to the states and municipalities.

The Social Development Project is assisting the government in developing a social sector strategy to redirect is social expenditures into well-targeted and efficient programs which will improve living conditions for poorer Venezuelans, especially

pregnant and lactating women and young children, while mitigating the adverse effects of the economic adjustment program. The project is also directed at replacing indirect subsidies with efficient, targeted social programs and improving the management of the Ministries of Health, Education, and the Family. Within Health and Nutrition, the project supports rehabilitation and development of the primary health care network, including basic health and nutrition services; information, education, and communications services to promote health, nutrition and education; and improvement of the government's ability to design, plan, and implement social programs and to monitor their effectiveness.

The government and the World Bank are preparing an Endemic Disease Control Project to reduce the incidence and impact of the principal endemic diseases and strengthen the institutions responsible for endemic disease control. The endemic disease control component would support epidemiological surveillance for all control programs; treatment of cases and contacts for leprosy and leishmaniasis; entomological surveillance and vector control to interrupt the transmission of malaria, dengue, and other vector-borne diseases; reducing Chagas disease by rural housing improvements to eliminate the habitat of the Chagas vector; educating individuals and communities on measures to control endemic diseases; and water treatment for cholera prevention. The project will also strengthen management and administration, train professionals, and improve information systems, operational research, and infrastructure.

The World Bank would support the government's objectives of improving the efficiency and quality of services in Ministry of Health hospitals through the Hospital Modernization Project which is being prepared. The improvements would result from reforms in hospital organization and management, financing, and rehabilitation of equipment and facilities. The reforms will improve internal efficiency by increasing occupancy rates, decreasing lengths of stay, and by improving cost recovery to finance operations and maintenance. The proposed reforms also are designed to assure



The World Bank's health sector studies and projects in endemic disease and hospital modernization aim to spread the benefits of good health equitably throughout the country.

regular supplies of essential drugs and materials and to decrease admission waits and the time between admission and therapeutic services.

Over the medium term, World Bank strategy in health and nutrition seeks to support projects aimed at prevention and primary health care; family planning within the context of reproductive health; decentralization of health services by strengthening central and local agencies and improving public hospitals; and cost containment through contracting-out selected hospital services and rationalizing cost recovery for some medical procedures. Since most nutritional programs are linked either to the health or school system, the Bank will

initially approach support for nutritional interventions in the context of lending for education and health.

Urban Development

Nearly 85 percent of Venezuelans live in urban areas, making Venezuela the most urbanized country in Latin America, and urbanization is projected to increase. Rapid urban growth led to a doubling of the number of barrios between 1978 and 1989. More than half the urban population is crowded into these settlements which lack one or more of the basic urban utilities of electricity, water, or sewage and whose residents have no legal title to the land they occupy. Many barrios are located in areas at risk from natural disasters such as flooding, landslides, or earthquakes, and most cities have no system or plan to extend basic utilities, community services, or transportation. Under the government's decentralization strategy, greater responsibility for providing public services will be transferred from the federal to local governments.

Two principal constraints limit the governments' ability to improve living conditions in the barrios. First, because government has been centralized, municipal administrations have not developed sufficiently their capacities for many aspects of planning and administration: (1) resource mobilization; (2) identifying and implementing investment projects; (3) managing urban land (including titling); (4) urban planning; and (5) general administration. Second, the central government's large oil revenues have meant that it was not necessary to introduce the principle of cost recovery for public works. Oil revenues are no longer sufficient to pay for all the services which government seeks to provide and, unless municipalities find new methods to finance public goods through cost recovery, services will not be sustainable.

The World Bank has approved a $40 million loan to assist with upgrading low-income barrios by:

- Improving living conditions by financing the construction of basic infrastructure and purchase of equipment to extend or improve municipal services such as water supply,

sewerage, electricity, drainage, roads, and garbage collection in selected low-income barrios.

- Developing municipalities' planning, administrative, and executive capabilities and making them responsible for project evaluation and monitoring, fiscal systems, cost recovery, and maintenance. The loan will finance material support, technical assistance, staff training and studies of planning, budgeting, financial management, tax administration, municipal cadastres, land titling, and solid waste management.
- Strengthening the administrative and technical capacity of federal institutions which assist municipalities through financing an organizational restructuring plan; developing a management information system; technical assistance for project management; policy studies and surveys; staff training; and vehicles and equipment.

Over the medium term, the World Bank intends to support the government's program of decentralization through relevant policy studies and loans for urban development which would allow a wider scope while maintaining the poverty-alleviation focus of the loan for low-income barrios. The Bank's support will strengthen the administrative, financial, and technical capabilities of local governments to provide urban services more efficiently and with greater accountability.

Water and Sanitation

Availability of drinking water and sanitation services in Venezuela is high relative to other Latin American countries. Eight-five percent of the urban population is connected to centralized water systems and 55 percent to sewerage systems. There are no reliable records on these services in rural areas, but the estimated availability of water does not deviate significantly from that in urban areas, although there seems to be substantial disparities in sanitary facilities.

While network coverage is adequate, service has deteriorated since the 1980s because of inadequate maintenance, low tariffs, centralization, and operational inefficiencies within INOS,

the national agency for water and sewerage. In mid-1990, the government presented a new sector organization with the goals of devolving authority and resources to state and local governments by establishing regional water companies.

The Bank supports policies which would improve government intervention in the sector by establishing a legal and regulatory framework to promote effective competition; develop institutional capabilities and transfer responsibilities from INOS to local and state authorities; develop a tariff structure that enhances the financial viability of local and regional water companies, and promote private participation in providing and managing these services.

The Caracas Water Rehabilitation Project and the Water Sector Rehabilitation Loan underscore the Bank's commitment to enhancing the quality of service in Caracas and other major cities. The proposed loans would finance investments to rehabilitate the basic water supply and sanitation infrastructure, expand coverage based on installed capacity, reduce losses, and rationalize consumption.

Power

Venezuela has excellent natural conditions for power generation, especially at the Guri dam and other sites on the lower Caroní River. The World Bank has had a long-standing involvement in Venezuela's power sector. The Bank began lending in the early 1960s and made four loans totaling $130 million between 1963 and 1969 to finance work on the Guri dam and associated transmission lines and substations.

The legal/institutional structure of the power sector does not favor efficiency and has inhibited private investment. There is no electricity law, and the basis for regulating electric utilities is not sufficiently comprehensive or integrated. Prices have been fixed at levels which, on average, are too low and are seriously distorted: residential and some large industrial users pay much less than the cost of supplying them, while commercial and other industrial consumers pay more. Inefficient use of capital equipment and facilities by the power companies has

also increased costs. These weaknesses have caused three negative consequences: the public power utilities are under severe financial difficulties and require support from the government in the form of equity contributions and direct subsidies; the tariffs have promoted waste and inefficient use of electricity; and while the electricity service in Venezuela has generally been good, the cost of production has been excessive.

The government is adopting new policies to strengthen the sector: establishment of a regulatory agency; privatization or parts of the sector; commercialization of power distribution; correction of pricing distortions; and efficient planning to minimize the costs of expansion. The government and the World Bank are preparing an investment loan for the sector which would focus on reducing distribution losses, overcoming transmission bottlenecks, and making better use of existing thermal generation plants. The loan would be linked to progress on the policy reforms.

Over the medium term, it is important that a strong, independent regulatory agency be created to ensure setting of tariffs on economic and technical bases rather than according to political criteria and to provide fair access to the transmission grid which, in turn, would create the potential for competition in generation. This will also create conditions under which privatization and efficient private sector investment would thrive, and it would open the way for continuing financial support from the World Bank and the IFC.

Transportation

World Bank lending to Venezuela in the area of transportation targets urban transport, highway rehabilitation, and ports.

Urban Transport. Venezuela's rapid urbanization together with a substantial increase in car ownership and low gasoline prices have caused chronic congestion in Caracas and a number of other cities. The Caracas metro has improved the quality of public transportation in the capital, and ridership has increased by 30 percent annually to an estimated 1 million

passengers daily, accounting for about 20 percent of all trips. However, bus service in Caracas and other cities has deteriorated. In the Caracas area, ridership on regular buses has declined to an estimated 10 percent of trips with *por puestos* accounting for 36 percent of trips. Despite the growth of metro ridership, private cars and taxis account for 40 percent of trips in Caracas.

National, state, and municipal governments have overlapping responsibilities for urban transportation, but their actions have not been well coordinated. The Ministry of Transportation and Communications regulates intermunicipal bus fares and taxi and *por puesto* tariffs, including within Caracas. Routes are regulated, and most operating entities have public service obligations. Fares have not kept pace with fuel price increases, causing financial difficulties for many companies, and the number of buses in circulation has declined steadily.

The Interministerial Commission on Urban Transport formed a steering group in 1990 to set transportation objectives and priorities, to review institutions and regulations, to evaluate policies, and to set a governmental strategy. The World Bank assisted by suggesting several elements of a strategy to meet the government's objectives: (1) deregulating fares and routes and promoting private sector participation; (2) providing subsidies for low-income groups; (3) managing demand for road use through user taxes and other restraints and improving traffic management; (4) maintaining and managing urban street and highway networks and planning public investment decisions to integrate all modes of transportation; and (5) reducing or containing the environmental costs of urban transportation.

The 1990 Decentralization Law authorized the transfer to the municipalities of responsibility for urban transportation (excluding the metro). Since municipalities do not have adequate financial resources and technical capacity for these responsibilities, the national government is seeking financial mechanisms and technical assistance to facilitate these transfers.

The World Bank, at the government's request, is preparing a loan to finance improvements in urban transportation in Caracas and six other municipalities. The project will (1) strengthen the agencies responsible for urban transportation; (2) establish funding mechanisms and tariff and cost recovery policies; (3) encourage route and tariff deregulation; (4) improve traffic management and public facilities; and (5) strengthen the network and improve public transportation in low-income areas.

Highway Rehabilitation. The Venezuelan road network consists of 1,500 km of expressways, 25,500 km of highways, and 44,000 km of feeder roads. It carries almost all cargo movements and 99 percent of intercity passenger traffic. Approximately one-third of the network is paved and one-third is surfaced with gravel. The highway system, which was constructed in the 1960s and 1970s, has been improperly maintained and needs extensive rehabilitation. Deteriorated highways raise the costs of transportation to the agricultural and industrial sectors, reduce productivity, and detract from Venezuela's international competitiveness.

Several factors have contributed to the deterioration of the road network. The management of the network, including construction and maintenance, has been too centralized, and road programs have been funded essentially through unpredictable and inadequate allocations from the national budget. This has hampered planning and programming and the development of effective management and maintenance. It has also resulted in poorly designed rural roads that do not meet the needs of local communities or agricultural development. Funding has been directed to new highway and turnpike construction at the expense of maintaining existing roads.

The World Bank is supporting the government's policies to decentralize road management, reform road financing and improve cost-recovery and funding, manage highway rehabilitation and maintenance, and increase private participation in highway operation and maintenance. The Bank is preparing a Highways Management Project to finance highway rehabilitation and preventive maintenance, and it is providing technical assistance in formulating and implementing policy and improving institutions.

Ports. The inefficiency of Venezuela's ports has been a major impediment to international trade and commerce. Until recently, the National Ports Agency (INP) was responsible for providing labor, equipment, and all services within its ports, which handled 90 percent of the general cargo and virtually all container traffic. These activities suffered from low productivity, low equipment availability, and inefficient equipment for container handling. Due to the inefficiencies and restrictive practices in INP ports, shipping conferences often imposed cargo surcharges for congestion and port cost differentials. These costs—estimated at $30–$50 million annually—were passed on to manufacturers and, eventually, Venezuelan consumers. Moreover, the INP was a burden on the national budget, with annual transfers of approximately $25 million in 1989 and 1990.

The Pérez administration has reformed the ports sector and restructured its activities. By the end of 1991, regional port authorities were established, and all administrative responsibilities were transferred from the federal government. All cargo handling and stevedoring activities were transferred to private firms. These reforms, which the World Bank assisted, have had a dramatic impact on ports' efficiency as measured by several indicators (for example, tons per person-hour have nearly doubled from 21 to 40).

Agriculture and Rural Development

Agriculture accounts for less than 6 percent of Venezuela's economy, but its social and political importance is much greater. Rural areas—home to subsistence farmers—are disproportionately poor, and food prices and agricultural self-sufficiency have been prominent political factors. Venezuela can expand and diversify its agricultural production and increase rural incomes. However, much of its productive capacity is either being degraded or depleted or is being misused because governmental policies and institutions have distorted incentives.

The government has introduced policies to strengthen the agriculture sector in the areas of international trade; pricing; marketing and storage; rural finance; public investment planning; and

project preparation, evaluation, and monitoring. Some reforms will need to be deepened, strengthened, and modified over time, but their essential goals are sound: to establish economic policies which neither favor nor penalize the agricultural sector relative to other economic activities. The World Bank supports these reforms, and its goals in assisting the agricultural sector are: (1) to facilitate policy and institutional reforms which strengthen the agricultural sector; (2) to focus government expenditures to promote the broad public interest rather than the well-being of only a few; (3) to help alleviate rural poverty; and (4) to improve natural resource use and management.

The Bank's research program is designed to make it possible to understand how these goals might be achieved most effectively. A study of Venezuelan land markets and property rights will determine how land tenure laws and practices could be reformed to encourage agricultural development. A study of natural resource management will help the government reform its policies and improve its ability to enforce its laws and regulations. The agricultural marketing and storage review will advise on the development of a modern commercial infrastructure.

Each of these studies could lead to one or more World Bank loans to assist the government to act upon recommendations which are consistent with its goals and policies. In November 1991, the Bank authorized a $300 million loan for the agricultural sector in connection with reforms in international trade, pricing, marketing, storage, and rural credit. The loan finances agricultural investments and technical assistance. In the coming years the government may prepare loans for Bank financing for agricultural extension and training, irrigation development, and land markets and privatization of state lands.

A more efficient and outward-looking agricultural sector will contribute to Venezuela's sound management of natural resources and to the alleviation of rural poverty. Improved public management of the sector, by redefining and limiting the government's role and increasing private investment, will be important elements of Venezuela's future prosperity and of the continuing collaboration between the World Bank and Venezuela.

World Bank agricultural lending to Venezuela covers everything from providing basic infrastructure investments and land titling to upgrading extension services.

The Environment

With its tropical climate, 3,000 km of coastline, vastly varied terrain, and multiple subsurface riches, Venezuela has a breathtaking endowment of natural resources, both renewable and nonrenewable. Among its flora are nearly 21,000 species of higher plants. This is the third richest in Latin America after Brazil and Colombia, and 5,000 of the species appear nowhere else on earth. It contains 1,300 species of birds (out of a world total of 9,000) and 40 percent of the 3,300 known species of neotropical birds.

On the surface, more than half the nation is covered with forests or woody vegetation of all altitudes. Underground lie more than

100 years' proven natural gas reserves, deep petroleum beds, iron ore, bauxite, and gold deposits that have been estimated to account for 5 to 10 percent of all gold on earth. Combined with the nation's plentiful water resources and hydroelectric potential, these resources provide a formidable foundation for a diversified, internationally competitive economy.

Venezuela's petroleum resources have had two favorable consequences for the environment. First, the oil boom of the 1970s provided resources which were used, in part, to establish an institutional structure for environmental policy. The government enacted an environmental law, created the first Ministry of the Environment in Latin America, and established national parks and a system of protected areas (Areas Bajo Régimen de Administración Especial, ABRAE). Many nongovernmental organizations (NGOs) were established and have acquired impressive expertise and facilities. Second, the nation's petroleum development and high level of urbanization have kept the rest of the nation sparsely populated, thereby reducing the pressure on other resources.

As a result, Venezuela's environmental problems differ from those of its neighbors and are more similar to those of an industrialized nation. Environmental policies are sophisticated and generally well-designed, and the major problems are in implementation and compliance. The World Bank has studied the problems of environmental management in Venezuela and offered recommendations to improve policy implementation and land and water management. The report also recommended measures to maintain Venezuela's environmental uniqueness and biodiversity, to protect indigenous peoples, to prevent deforestation, to combat air pollution, and to ameliorate unhealthy conditions in urban barrios.

To advance Venezuela's environmental programs, the government is preparing for World Bank financing of a Natural Resources Management Loan with the objectives of implementing the protected areas system, strengthening the government institutions involved in environmental protection, channeling environmental responsibilities to NGOs; environmental education; and supporting studies of tourism and other economic

World Bank project work is directed at preserving natural parks, addressing serious water pollution problems, and managing natural resources on a sustainable basis.

activities which will be compatible with sustaining and protecting the ABRAE resources. The Bank is also assisting the government with the phase-out of the production and use of ozone-depleting substances in the context of the Montreal protocol.

If it succeeds in these programs, Venezuela has the potential to become a model of sound environmental management. Toward this end, the Bank will support the government's ambitious agenda through these and other initiatives, including a review of the environmental impact of sectoral pricing policies and the strengthening of environmental assessments and enforcement.

4. The International Finance Corporation in Venezuela

The IFC's investment strategy in Venezuela is designed to support the private sector as it adjusts to the opening of the economy. The IFC is increasing its role in syndicating and underwriting to enhance the inflow of foreign capital. In addition to several large greenfield projects, the IFC is helping medium-size and small-scale enterprises to establish credit and agency lines to local financial institutions, such as a recent credit line to Sociedad Financiera Mercantil. The IFC is also increasing work in support of privatization and private infrastructure projects.

The IFC's outstanding investments in Venezuela have increased from $10 million in 1988 to $179 million as of mid-1991. The IFC has made investments throughout the economy including chemicals, cement, banking, iron, and steel. The IFC has invested in several new projects as well as helping companies with expansions and restructurings. IFC operations include loans to 16 Venezuelan enterprises, including C.A. Venezolana de Cementos, Operaciones al Sur del Orinoco, S.A., Polipropileno de Venezuela, S.A., Eka Nobel de Venezuela, and Productora de Alcoholes Hidratados. The IFC has taken equity positions in enterprises such as Grupo Zuliano, C.A., and Corimon, C.A., and has assisted many of these and other enterprises by arranging syndications.

The IFC operates in a pragmatic, businesslike manner. There is no standard form of application for IFC financing. A company or entrepreneur, foreign or domestic, seeking to establish a new venture or expand an existing enterprise can approach the IFC by requesting a meeting or by submitting preliminary project or corporate information. After initial contacts and a preliminary review, the IFC will request a detailed feasibility study or business plan to determine whether to appraise the project. The IFC does not have a local office in Venezuela, but individuals or firms interested in IFC financing are invited to contact the IFC directly at its headquarters in Washington, D.C., or through the World Bank's Caracas office.

5. Preparing for the Future

Venezuela's prosperity and the quality of life will depend on how successfully its citizens and government address the four fundamental issues described above: macroeconomic management; opening the economy and developing the private sector; strengthening public institutions and improving infrastructure; and human resource development and income distribution. Programs and institutions which may have worked in the past-may not succeed in the future.

The future will be determined by Venezuela's human and natural resources and by the economic incentives to employ resources wisely. Venezuela is rich in resources, and the government has begun a bold, well-conceived reform program which offers new incentives to use resources more effectively. Reform programs take time, and the unavoidable human costs and dislocations challenge the commitment and resolve of the population and its leaders. However, it took many years for the economy to become as distorted as it was in 1989, and it will take many more to eliminate all the effects of years of misdirected economic and social policies.

The World Bank is a development agency and its perspective is on the medium-to long-term determinants of growth: preparing for the future is the work of the Bank. But long-run growth is a product of a series of short-run decisions. The

Bank can, through its international experience, assist the government of Venezuela in designing and implementing policies, programs, and projects today which will provide for the country's well-being tomorrow by:

- *Getting macroeconomic policy right.* Macroeconomic policy needs to ensure that fiscal deficits are low and inflation is controlled. Appropriate, market-based incentives for saving and investment are essential if domestic resources are to play their part in financing development.
- *Improving the climate for enterprise.* The government must intervene only to ensure adequate infrastructure and institutions and legal framework to ensure the sound development of the private sector.
- *Opening the economy to trade, competition, and investment.* The government has moved swiftly and decisively to open the economy, and maintenance of these reforms will be essential to encourage development of internationally competitive industries.
- *Investing in people.* The government must spend more, and more efficiently, on primary education, basic health care, nutrition, and family planning. That requires shifts in spending priorities; greater efficiency and better targeting of expenditures; and, in some cases, greater resource mobilization.

There are no "right" or "best" solutions to these problems, although there are all too many wrong answers. Only the citizens of Venezuela and their elected government—taking into account their history, traditions, goals, and aspirations—can decide which path they will follow. The World Bank stands ready to advise the government and to assist with policy analysis, planning, project preparation, and financing.

6. The World Bank and Economic Development

The World Bank comprises the International Bank for Reconstruction and Development (IBRD) and its affiliate, the International Development Association (IDA). The IBRD has two other affiliates, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The common objective of all four is to raise standards of living in developing countries by providing financial resources and technical assistance.

The IBRD, established in 1945, is owned by the governments of the 163 member countries. The IBRD's capital is subscribed by its members, and it finances its lending primarily from borrowing in the world capital markets, with repayment guaranteed by the members' governments. A substantial contribution to resources also comes from retained earnings and the flow of repayments on loans. IBRD loans generally have a grace period of five years and are repayable over fifteen to twenty years. They are directed toward developing countries—like Venezuela—which are at intermediate stages of economic and social growth. The interest rate on IBRD loans is set by a guideline related to the cost of borrowing, and it is the same for all borrowers.

The IBRD's charter requires that it lend only for productive purposes that contribute substantially to economic growth in

the borrowing countries. A project must be economically, technically, and financially sound. The loan must pay due regard to the prospects of repayment. Each loan is made to a government or must be guaranteed by the government concerned. The use of loans cannot be restricted to purchases in any particular country. And the IBRD's decisions to lend must be based on economic considerations alone. Decisions on lending are made by the Bank's Executive Directors, and each member votes approximately in proportion to its subscription to the Bank's capital stock. The United States of America has the most votes with about 17.2 percent, followed by Japan (6.1 percent), Germany (4.7 percent), France (4.5 percent), and the United Kingdom (4.5 percent). Venezuela has 1.3 percent of all votes—currently the eighteenth largest among the 163 members.

The International Development Association was established in 1960 to provide assistance for the same purposes as the IBRD, but primarily in poorer developing countries and on easier terms than IBRD loans. IDA's assistance is available only to countries with an annual per capita income of $1,195 (in 1990 dollars) or less, although in practice they have gone to the poorer countries in this group. More than forty countries are eligible under this criterion. The funds used by IDA, called credits to distinguish them from IBRD loans, come mostly in the form of subscriptions, general replenishment from IDA's wealthier members, and transfers from the net earnings of the IBRD. The terms of IDA credits, which are made only to governments, are 10-year grace periods, 35- or 45-year maturities, and no interest.

The World Bank does not make loans directly to the private sector unless they are guaranteed by the government. It is the policy of the Venezuelan government not to provide such guarantees. The only form of World Bank financing to the private sector in Venezuela at present is in the agricultural sector, where World Bank funds are on-lent by Fondo de Crédito Agropecuario.

Loans for the private sector are provided through the World Bank's private sector affiliate, the IFC, established in 1956, to promote growth by mobilizing domestic and foreign capital for the private sector. Membership in the IBRD is a requirement for

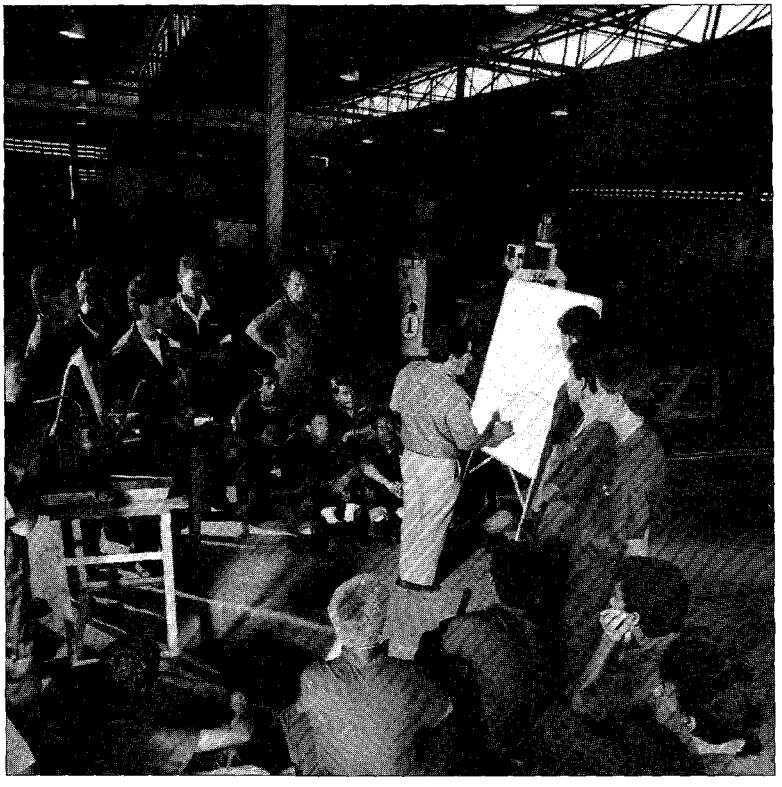
membership in the IFC, which totals 146 countries (including Venezuela). Legally and financially, the IFC and the IBRD are separate entities, but they coordinate their strategies for a country's economic development. The IFC makes loans at market rates and equity investments in private enterprises and does not require government guarantees of its loans. In 35 years of operation, the IFC has provided more than $9 billion in financing for nearly 1,000 companies in 96 countries. Today it is the largest source of direct financing for private projects in developing countries.

MIGA, established in 1988, has a specialized mandate of encouraging equity investment and other direct investment flows to developing countries through mitigating noncommercial investment barriers. MIGA offers investors guarantees against noncommercial risks; advises on the design and implementation of policies, programs, and procedures related to foreign investments; and sponsors a dialogue between the international business community and host governments on investment issues. In 1991, the convention establishing MIGA had been signed by 101 countries, of which 76 had also ratified it.

The World Bank's mission is directed toward policies, programs, and projects which will lead to medium- and long-term growth and development. It is not directed toward short-run problems except to the extent that they interfere with longer-term goals. The World Bank is independent of the International Monetary Fund and the Inter-American Development Bank, but it coordinates its activities with each of them to ensure that they are complementary.

Four Forms of Assistance

The principal work of the World Bank is its lending operations: In 1991 the Bank authorized $16.4 billion in new loans. Since its inception in 1946, it has made more than 5,400 loans for more than $268 billion to 142 countries, including 20 loans to Venezuela for $2.07 billion. However, lending is only one of the Bank's instruments to assist its members; the others are



The World Bank supports institutional development through lending, technical assistance, and training programs.

economic and sectoral policy analysis, co-financing, and technical assistance.

Lending. The World Bank has traditionally financed all kinds of capital infrastructure, such as roads and railways, telecommunications, and port and power facilities. The centerpiece of its strategy emphasizes investments that directly affect the well-being of a developing country's poor by making them more productive and integrating them into the country's economic development. The Bank's work to reduce poverty cuts across sectoral lines and includes investments to improve education, ensure environmental sustainability, expand opportunities for the disadvantaged, strengthen population planning, health, and nutrition

services, and develop labor markets. The Bank's lending in support of economic restructuring in many countries—including five loans to support Venezuela's structural adjustment—is based on the knowledge that structural adjustment is the precondition for restoring economic growth and the cornerstone of successful development and poverty reduction.

Technical Assistance and Cooperation. Because of its worldwide experience and the expertise of its staff, the World Bank is in a unique position to provide technical assistance to nations which seek to reform any aspect of policy or program implementation. The Bank makes direct loans for technical assistance, but it also assists in other ways: finding outside, independent technical experts for short- or long-term work with governments; formal and informal training programs for high- and mid-level government officials; dissemination of research findings; and temporary assignment of Bank staff as advisers to governments. The Bank's Economic Development Institute trains people to create and carry out development programs, and in recent years it has focused its training programs on poverty reduction, human resource development, environmental policy, debt and adjustment, public sector management, and private sector development.

Economic and Sectoral Policy Analysis. The World Bank maintains an active program of studies—on global, regional, national, and sectoral economic issues—to provide the basis for policies and programs which will foster economic development. Where the studies are focused on a single country, the Bank works closely with government officials in designing and conducting the studies and in discussing and circulating the findings. These studies provide a framework for evaluating national and sectoral policies and problems—in the light of a government's goals and objectives—and an understanding of the country's development potential. The research is a basis for continuing policy discussions in which the Bank can advise government officials on the likely outcomes of alternative policies, bringing forth the lessons of experience in other nations. Where indicated, and where there is agreement between the government

and the World Bank, the studies can provide a basis for designing projects which would be financed by World Bank loans.

Co-financing. The World Bank's resources are limited, but it expands its effectiveness by working with other multilateral and bilateral institutions such as the Inter-American Development Bank to secure additional financing for suitable projects.

The World Bank divides the world into seven regions for organizational purposes. The Latin America and Caribbean Regional Office (LAC) is in turn subdivided into four departments covering contiguous countries. Venezuela, Peru and Brazil are grouped in one department. This department consists of about 120 staff members, organized in five divisions: Country Operations, Infrastructure Operations, Energy and Industry Operations, Environment and Agriculture Operations, and Population and Human Resources Operations, all supported by a field office in Caracas. The LAC Regional Office also has a Technical Department, which provides specialized support in all Latin American countries including Venezuela. As needed, the department draws upon specialists from the Bank's vice presidencies for Development Economics, Sector Operations and Policy, and Finance, and upon experts in Technical Departments assigned to other regions.

World Bank Lending: The Project Cycle

Every World Bank loan is unique, depending upon each country's goals, objectives, resources, history, and circumstances. However, each project passes through a cycle that, with some modifications, is common to all. The process demands continuous cooperation between the government and the Bank and a high level of professional expertise to ensure that the project will make a significant contribution toward a country's development.

In Venezuela, the World Bank's principal counterpart agency is the Oficina Central de Coordinación y Planificación (CORDIPLAN). CORDIPLAN works with the World Bank and with the ministries and agencies of the Venezuelan government to formulate a multiyear lending and work program which is consistent with the government's objectives and priorities. The World Bank and CORDIPLAN, together with the affected government agencies,

work together to ensure that each project moves expeditiously through the steps of the project cycle: identification; preparation; appraisal; negotiation and presentation for the approval of the Executive Directors; implementation and supervision; and evaluation. The next several paragraphs discuss these steps.

Identification. The Bank's economic and sector work and the resulting policy dialogue with the government lead to an appropriate development strategy, including policy and institutional changes for the economy and its major sectors. These form the basis for finding specific projects that support the development strategy, that meet sectoral objectives, and that both the government and the Bank consider suitable. At this stage, projects must appear feasible: institutional and technical solutions are likely to be found at costs commensurate with expected benefits. When projects that meet the government's goals are identified, they are entered in the multiyear lending program and resources are committed to subsequent phases of the project cycle.

Preparation. Project preparation covers the full range of technical, institutional, economic, and financial conditions necessary to achieve the project's objectives. Responsibility for preparing a project rests with the borrower, but the Bank takes an active role to ensure that there will be a timely flow of well-prepared projects. This step can take the most time, but since projects represent for the borrower major investments with long economic lives, the time spent in arriving at the best technical solution, in setting up the proper organization, and in preventing problems usually pays for itself several times over.

Appraisal. Appraisal, solely the Bank's responsibility, is a comprehensive review of all four aspects of the project: technical, institutional, economic, and financial. The appraisal report sets forth the findings and recommends terms and conditions of the loan. Because of the Bank's close involvement in identification and preparation, appraisal rarely results in rejecting a project, but a project may be extensively modified or redesigned to correct flaws which could have led to rejection.

Negotiation and Approval. Negotiation is the stage at which the Bank and the borrower seek agreement on measures to assure the success of the project and resolve any differences which may

arise. In the negotiations, the Bank must adapt its general policies to what can reasonably be accomplished in the country, and the borrower must recognize the Bank's requirement that funds be invested wisely in light of its worldwide, professional expertise. When mutually acceptable agreements are reached, they are set out in legal obligations in the loan documents. The project documents are then sent to the Board of Executive Directors for their consideration and approval.

Implementation and Supervision. A project's benefits can be realized only if it is effectively implemented. Implementation is the responsibility of the borrower with whatever assistance has been agreed with the Bank, such as organizational studies, training, or consultants. The Bank's role is to supervise implementation, working with the borrower to deal with problems that arise. The Bank must ensure that the proceeds of the loan are used only for the purposes for which the loan was granted, that the borrower meets all legal agreements, and that procurement of goods and services is carried out in accordance with guidelines in the loan document. These rules provide that most procurement will be through international competitive bidding, but to foster development of local capabilities, preference can be given to domestic suppliers and joint ventures.

Evaluation. The final step in supervision of a project is a project completion report at the end of the disbursement period. This report is a self-assessment by the Bank's staff of the strengths and weaknesses of the project and the lessons to be learned for future projects. The project is also audited by an independent body, the Operations Evaluation Department, and the borrower is invited to comment or prepare its own report. These materials are submitted to the Executive Directors, and the lessons are incorporated into the project cycle of successive loans.

APPENDIX
Questions and Answers about the World Bank

1. How many countries are members of the World Bank Group?

The World Bank Group comprises the International Bank for Reconstruction and Development (IBRD) and its affiliates, the International Finance Corporation (IFC), the International Development Association (IDA), the Multilateral Investment Guarantee Agency (MIGA), and the International Centre for Settlement of Investment Disputes (ICSID). IBRD members currently total 163 countries, while the IFC, IDA, MIGA, and the ICSID have 147, 143, 86, and 102 member countries, respectively.

All fifteen of the former republics of the Soviet Union have applied for membership in the Bank. The Marshall Islands, Micronesia, the Republic of Croatia, the Republic of Slovenia, and Switzerland have also applied for membership.

Following a referendum, Switzerland joined the Bank in May 1992. Switzerland has been a strong supporter of the Bank Group in a number of ways. For instance, it has provided the Bank very generous access to its capital markets; and has contributed to IDA, to special efforts in Africa, and toward funding the cost of Economic Development Institute (EDI) courses.

Membership thus formalizes the already close collaboration between Switzerland and the Bank.

2. What are the prerequisites for Bank membership?

Only members of the IMF may become members of the World Bank. Prior to IMF membership, the Fund obtains information on the economy to determine the initial quota which is subsequently agreed upon by the Fund's Executive Board and the prospective member. The initial subscription to the Bank's capital is linked to the Fund quota. Once the Bank's Executive Board has approved the management's recommendation that a new member be admitted, the Board of Governors votes and elects the new member by a simple majority.

3. How does the Bank know if its operations are a success?

The Bank's Operations Evaluation Department assesses the performance of all lending operations shortly after their completion. In this process, the outcome of each project is compared with its stated objectives at the time of Board approval, taking into account any changes which may have occurred in these goals during implementation. While such performance evaluations provide an opportunity to account for the use of resources and to derive lessons for future application, they also have inherent limitations in terms of assessing longer-term project results and the learning opportunities associated with post-implementation phases. Although actual project investment costs are known at completion, benefit flows are still largely forecasts, and the final impacts of many operations become evident only some years after Bank disbursements cease.

Operations are classified as either satisfactory or unsatisfactory. A satisfactory performance denotes the achievement of significant benefits relative to project costs and the attainment of the objectives defined at appraisal.

In 1990, 359 operations were evaluated, representing $20.6 billion in Bank loans and credits. Sixty-four percent, or 228 operations, achieved satisfactory results. The average economic rate of return for the projects evaluated was 14 percent.

4. What exactly is adjustment lending?

Adjustment lending helps countries to tackle macroeconomic difficulties usually manifested in rising inflation and current or projected balance of payments problems. The Bank's adjustment lending programs are intended to support the transition of an economy to a new, sustainable and poverty-reducing growth path, and are often undertaken in conjunction with an IMF-supported stabilization program. Typical adjustment policies involve reallocating and reducing public spending, opening an economy up to external or domestic competition, freeing prices to allow them to reflect economic values, improving government delivery of infrastructure and social services, and developing the institutions required of a well-functioning market economy, notably a sound financial system.

5. How well have structural adjustment programs worked?

Structural adjustment programs have helped countries increase their exports and overall economic growth. However, the speed of response to structural adjustment varies. There are three clear patterns. Only in a few countries—the Republic of Korea, Indonesia, and Thailand—did the adjustment process involve a swift transition to a new growth path, with only a short recession. For most other middle-income countries, adjustment has taken longer, and there is a period of declining output and labor demand before new sources of growth take them onto a sustainable growth path. Chile, Mexico, and Morocco are typical: such countries started off with worse macroeconomic imbalances—including a heavy debt burden—and more extensive structural problems.

The evidence to date for low-income countries suggests that adjustment lending is a necessary, but not sufficient, condition for transition to a sustainable growth path. While most of this group will continue to need adjustment-related support during the 1990s, this support will pay off in high growth only if long-run development problems are also tackled.

The World Bank works to alleviate poverty and create the conditions necessary for sustained economic growth.

6. How does adjustment lending help meet the Bank's main objective of alleviating poverty?

Adjustment policies help most of the poor, but recessions associated with adjustment often cause temporary welfare declines for some of them. The available evidence on changes in incomes of the poor indicates that adjustment is much better for the poor than not adjusting, and that the distributional effects of well-designed policies often favor the poor.

For example, the analysis for Indonesia and Costa Rica shows that the poor earned higher incomes through the adjustment process. This flowed from expansion in agricultural incomes and increased demand for labor, as relative price

changes (including significant devaluations) and deregulation encouraged expansion of labor-intensive activities. In Ghana, per capita consumption and rural incomes recovered rapidly from the mid-1980s as the country moved from a drastically inefficient, capital-intensive growth path to a more efficient one, accompanied by a major increase in the level of social services.

By contrast, in countries that failed to adjust or adjusted ineffectively, the poor have often done badly. Poverty in Peru worsened between 1985 and 1990 as the government attempted to avoid adjustment. In Côte d'Ivoire, poverty increased in the mid-1980s as weak adjustment contributed to declining incomes, and in Brazil ineffective adjustment led to a substantial worsening of poverty.

7. What are the main impediments to successful adjustment?

In view of the complexities of adjustment, there are many ways in which programs get off track. For example, for many adjusting countries the international economic environment in the 1980s turned out to be worse than expected. Commodity prices declined, the debt problem worsened, conditions in the international capital markets deteriorated as real interest rates remained high, and commercial banks stopped new voluntary lending to most developing countries. The Bank makes major efforts in its research program and policy pronouncements to influence industrial-country policies to avoid such problems.

The Bank's evaluations of structural adjustment programs found that a consistent macroeconomic framework relating fiscal, monetary, and exchange rate policies to macroeconomic policy goals, such as controlling inflation and achieving external account balance and economic growth, is essential. Adjusting countries also need to develop realistic financing plans, implement strong and timely stabilization programs to establish program credibility, stop capital flight, and make structural reforms effective and sustainable.

8. Aren't structural adjustment programs really designed to help debtor countries continue paying their debts?

No. Structural adjustment programs are intended to help countries undertake structural change without disrupting unduly their access to international goods and services. To the extent, however, that developing countries with heavy debt burdens will not grow without debt relief or additional resources in appropriate terms, the Bank is supporting a number of initiatives to reduce the debt burden. It is true that money is fungible, but borrowing countries are required to implement specified economic reforms before structural adjustment loans are disbursed.

9. Why does the Bank lend to corrupt and repressive governments that everyone knows. siphon off aid to personal bank accounts, grandiose schemes, and excessive spending?

Corruption is a two-way street. Many political leaders in countries with serious poverty have amassed extraordinary fortunes. Such abuse adversely affects economic development. Yet, graft on this large scale is not possible without collusion between major private corporations and public agencies. Often the "commissions" are paid by foreigners, and sometimes such activity is associated with foreign aid.

Aid agencies have an important responsibility to ensure that their national commercial considerations do not undermine good economic management in the developing world. Encouraging governments to develop sound public investment programs and respecting the priorities established are important contributions that agencies can make.

Clearly, the main weapon against corruption is to reduce the opportunities for it to a minimum. While the Bank's Articles of Agreement do not permit interfering in a country's internal affairs, transparency of decisionmaking is a safeguard against corruption, waste, and the abuse of executive authority. Competition and deregulation, the removal of unnecessary controls, clear rules, and disclosure are important first steps. The Bank has been assisting borrowers to remove unnecessary

controls and to reduce regulations, to improve domestic and external procurement procedures by using open international competitive bidding procedures, and to make budgets and central bank accounts more transparent. Greater efforts are being made by the industrial countries to ensure that competition for contracts under projects financed by external aid and lending agencies is not a source of corruption and does not contribute to distorted investment priorities.

10. Does the Bank lend to countries when the political commitment to sound development management is weak?

Lending levels have long been responsive to issues of development management and performance. When the commitment to sound development is weak, the Bank normally takes up these issues in its dialogue with borrowers while seeking ways to help the country improve performance in the key areas of concern. This dialogue is supported by economic and sector work. When the dialogue fails, the Bank's own lending to the country is likely to be affected.

11. What has the Bank done so far to incorporate environmental concerns into its work?

Environmental considerations are being handled through activities ranging from helping countries develop national environmental action plans to country economic and sector work, project and adjustment lending, and evaluation. Excluding projects whose environmental costs or benefits amount to less than 10 percent of total costs or benefits, about 50 percent of all projects approved in fiscal 1991 had significant environmental components (about the same proportion as in fiscal 1990), an indication of the extent to which environmental issues are now routinely incorporated in all of the Bank's lending sectors.

In fiscal 1991, 13 of all projects had primarily environmental objectives, with lending totaling $1.6 billion. Projects are considered to be "primarily" environmental if either environmental costs or benefits exceed 50 percent of total costs or

benefits. In fiscal 1990, the Bank approved 11 loans (totaling $403.9 million) to support projects that had primarily environmental objectives, compared to only two such loans in fiscal 1989.

12. Can developing countries afford the costs of environmental protection?

Developing and industrial countries alike continue to be concerned about the cost of environmental protection and the tradeoffs between short-term economic growth and poverty reduction on the one hand, and long-term sustainable development on the other. Clearly such tradeoffs exist, but it is essential to stress that environmental priorities should not be viewed as separate from long-standing development objectives. There are many opportunities for policy reform and investment that meet both economic and environmental criteria. Efforts to provide agricultural extension and credit to the rural poor, primary education, and the provision of sanitation and water supply to urban squatter settlements and poverty-stricken rural areas are both environment-enhancing and poverty-reducing initiatives. Family planning programs are another example. The Bank will continue to give priority to projects and policies that satisfy both objectives. Reduction in the rates of population growth and technical progress are key elements of any long-term strategy. Population, institution building, and human-resource development work will continue to be integral to the Bank's overall environmental program.

13. Is the Bank doing enough in the area of human development?

According to current projections, the Bank will have invested roughly $30.5 billion in human development projects by fiscal 1994. Human development covers lending for education and employment; population, health, and nutrition; and social sector projects. Human development lending has grown tremendously—in terms of dollars, number of projects and number of countries served—since the Bank began these operations in fiscal 1963. In fiscal 1991, it reached a record annual high of

$3.8 billion (17 percent of total Bank lending). Annual lending for human development is projected to grow to $4.9 billion by fiscal 1994. Nearly all the growth will be in the population, health, and nutrition sectors.

14. What is the Bank doing in population, health, and nutrition?

The volume of population, health, and nutrition (PHN) lending in the Bank has been rising dramatically—both in the number of projects and the amounts of loans and credits. The fast upward trend continued in fiscal 1991 with 28 projects, for commitments totaling $1,568 million, a 56 percent increase in the number of operations and a 68 percent increase in loan and credit amounts over fiscal 1990. In the five years (fiscal 1983—87), before the president of the Bank announced that lending for PHN would double over a period of several years, commitments to PHN averaged $205 million. The president, Lewis Preston, announced at the March 1992 "Safe Motherhood" conference he hosted at the Bank that lending for population, health, and nutrition is expected to double to $2.5 billion by 1995.

15. What is the Bank's record on lending for education?

The World Bank is the largest single source of external funding for education in developing countries. To date, the Bank has supported more than 400 projects in 105 countries, with lending amounting to about $13.5 billion. More than $2.5 billion of this total was for primary education.

At the World Conference on Education for All, in Jomtien, Thailand, in March 1990, the president of the Bank pledged to increase education lending by the Bank over the following three years to more than $1.5 billion a year. Bank lending for education and training topped the $2 billion mark for the first time in fiscal 1990. In fiscal 1991, Bank commitments for education projects further increased to $2.25 billion for 26 projects. An additional $500 million were committed for education and training components in other projects. These figures compare

to an average annual lending for education of $755 million for fiscal 1987–89.

Most education projects were aimed at improving the access to basic education, at its effectiveness, at upgrading the quality of training in the vocations or sciences at the secondary and tertiary levels, and at improving the planning and management capacity of the education sector.

16. Is the World Bank seriously committed to women in development?

The Bank is concentrating on improving women's productivity as the main way to help them, thereby contributing to poverty reduction, economic progress, slower population growth, and other development objectives. The Bank's five women in development (WID) priorities are: education, reproductive health care, agricultural services, credit and other support for women entrepreneurs, and labor-force participation. Where appropriate, the Bank is also looking at women's productivity in forestry, water supply and other sectors, as well as related legal issues.

The fast pace of WID progress continued in fiscal 1991, with about 40 percent of Bank operations containing specific recommendations for action to integrate women into the development process. Percentages for fiscal 1988, fiscal 1989, and fiscal 1990 were 11, 22, and 30, respectively. In fiscal 1991, all PHN and most projects in the small-scale enterprises sector addressed women's concerns, as did more than half of agricultural projects, most structural adjustment loans, and about a third of education projects.

17. Why is the Bank interested in working with nongovernmental organizations?

Nongovernmental organizations (NGOs) have become increasingly significant partners in development. The spread of democracy in the late 1980s has resulted in more favorable government attitudes towards citizens' groups and other nonprofit, voluntary organizations in many countries.

The Bank sees an important role in NGOs in helping achieve each of its three main objectives—expanding economic growth, reducing poverty, and protecting the environment. NGOs can help achieve improvements in the quality of poor people's lives, through project work and through representing the interests of their members. NGOs can enhance the social and environmental aspects of projects, in part by helping strengthen the participation of beneficiaries in development planning. In addition, where NGOs have succeeded, they have done so at relatively low cost. Finally, NGOs have repeatedly shown that their programs can target and reach the poor, usually more effectively than public sector-managed program can, often in the remotest geographic areas.

18. Does the Bank fund NGOs?

The Bank seldom funds NGOs directly. NGOs are usually the indirect recipients of proceeds from Bank loans and credits, which a borrowing government has channeled to them as either grants or loans. A government can, for example, provide financing for NGO-designed subprojects under a Bank-supported socioeconomic development fund. A government can also engage an NGO as a contractor or executing agency of a component of a Bank-financed project. Project preparation facility funding has sometimes provided a convenient source of initial financing for NGOs before project funds are disbursed. In all situations, a contractual agreement between the government and NGO concerned is required.

19. What does a "market-friendly" approach to development mean?

World Development Report 1991 (WDR) argues that competitive markets are the best means civilization has yet found to produce and distribute goods land services efficiently. But just as explicitly, the WDR asserts that state interventions are essential for attaining competitive markets. State interventions are particularly important in meeting the basic human and physical infrastructure needs of an economy and in developing institutions

and mechanisms to protect property rights and contracts and ensure ease of entry and exit of firms. The WDR also argues that these interventions should complement the efforts of private enterprise—a policy whose value is amply demonstrated by the impressive successes of the East Asian economies—at the same time taking care not to unduly distort pricing signals.

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