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According to the Central Bank (Banco Central de Venezuela, BCV), consumer prices increased by 45.9% last year, marking the highest annual inflation rate in Venezuela since 1989. At the same time, the GDP dropped by about 1% in 1993, largely due to excessive interest rates throughout the year. Although the economic outlook for 1994 is more positive, it remains to be seen if president-elect Rafael Caldera who takes office in February is willing to impose the austerity measures considered necessary to reel in the government's budget deficit.

From 1989 to 1991, a broad austerity program launched by then-president Carlos Andres Perez to lower the country's soaring fiscal deficit managed to pull Venezuela back from the brink of hyperinflation. Under Perez's conservative program which included steep cuts in public spending, new taxes, and rate hikes for most public services annual inflation dropped from 81% in 1989 to just 41.8% in 1990, and then to 30.7% in 1991. Nevertheless, constant political instability including massive riots in the capital in 1989 and two coup d'etat attempts in 1992 impeded the government's ability to push the austerity program forward. By the end of 1992, the fiscal deficit had grown markedly again, leading to a small but significant jump in inflation that year to 31.9%. Then, throughout the first half of 1993, the corruption scandal which forced former president Perez to resign in May virtually paralyzed all government economic initiatives.

Among other things, the Perez administration was unable to win legislative approval for two proposed taxes a new value added tax (Impuesto al Valor Agregado, IVA) and a business assets tax both of which were considered essential to cut the fiscal deficit. In addition, record low international prices for oil last year slashed government income, since petroleum accounts for about 80% of Venezuela's export earnings. As a result, the fiscal deficit soared to some US$5 billion in 1993, equivalent to nearly 7% of the GDP. That, in turn, reignited inflation. According to the BCV, consumer prices grew 45.9% last year, representing a 14 percentage point jump over 1992 and the highest annual inflation recorded in Venezuela since Perez launched his economic program in 1989. Venezuela now has the third-highest inflation rate in all of Latin America, after Brazil and Uruguay. Moreover, the BCV reports a 1% decline in the GDP for 1993, representing a sharp drop from the robust 6.8% expansion recorded in 1992. On the one hand, political instability throughout the year reduced confidence among potential investors.

According to the Foreign Investment Superintendent (Superintendencia de Inversiones Extranjeras, SIEX), the value of all new foreign investments in Venezuela in the first 11 months of 1993 plunged by 52% compared to the same time period in 1992, dropping from US$557.2 million to US$267.09 million. In the same time periods in 1991 and 1992, new foreign investments had grown by nearly 250%, from US$161.4 million to US$557.2 million. On the other hand, the government maintained interest rates above 70% throughout most of the year to soak up excess liquidity and avoid capital flight. Although such tight monetary policies managed to slow the decline in foreign reserves and permit only a moderate 18.5% devaluation of the national currency, the excessive interest rates

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greatly depressed economic activity. For 1994, the economic outlook appears more positive, but most economists agree that any recovery will be slow and painful, and will largely depend on the willingness of president-elect Rafael Caldera to pursue the austerity program begun by former president Perez.

The International Monetary Fund (IMF), which in November compiled a report on perspectives for the new year in Venezuela, predicts that inflation in 1994 could drop to about 25%. But to achieve that goal, the IMF warns that the incoming government must enforce the new IVA and business assets taxes both of which took effect on Jan. 1 while allowing gasoline prices to rise during the year to reduce government subsidies. Interim President Ramon Velasquez's administration, which took office after Carlos Perez was forced out, managed to pass the IVA in September. The IVA which is basically a 10% sales tax charged to consumers already partially took effect in October when the government imposed the tax on wholesalers. Under the law, however, retailers were supposed to begin charging the IVA as of Jan. 1. The Velasquez government also negotiated legislative approval for a 1% tax on business assets, to take effect simultaneously with the IVA. Until now, it was unclear if president-elect Caldera would rescind the IVA, since he opposed the tax during the campaign period for last December's elections.

Caldera had argued that, rather than an indirect tax on consumers, the government should raise direct taxes on higher income groups through income tax reforms. Nevertheless, in early January, spokespersons for Caldera said the new government would uphold the tax once taking office since the Velasquez administration had reformed the law to reduce its impact on lower income groups. Under the reforms, 17 basic food goods will be exempt from the tax, as well as an array of other essential products and services, such as medicines, books, transportation, fuel, and education. In addition, all luxury goods will be charged 15% to offset loss in revenue from the exemption lists.

"The decision to broaden the list of products to be exempt from the IVA while increasing the rate charged on luxury items basically resolves the problems which Rafael Caldera criticized four or five weeks ago," said Julio Sosa Rodriguez on Jan. 2, one of the president-elect's economic advisors. The IMF estimates that the IVA could bring in some US$2 billion in extra revenue in 1994, equivalent to between 2.5% and 3% of GDP. To achieve the IMF's goal of 25% inflation, however, the Caldera administration would still have to raise gasoline prices enough to earn the government another US $1 billion this year, which, together with the IVA and business assets tax, could reduce the fiscal deficit to between 2% and 3% of GDP.

Still, even if the new government manages to lower inflation, economic recovery will likely not set in until at least 1995. The IMF, for example, predicts that the economy will contract by at least another 1% to 1.5% this year. Indeed, most economists expect only a moderate increase in foreign investment in 1994, since most investors will likely prefer to review the new government's policies and wait to see if political stability returns to the country before risking their capital.

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