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***THE ALL-POWERFUL  
CHÁVEZ... ENTER THE ERA  
OF THE "DEMOCRATIC  
DICTATORSHIP"***

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**THE CLIENT**

Since coming to power, President Chávez has received 3 mandates from the Legislative Power in order to legislate. With each new Enabling Law that is approved, the powers granted, the time period allotted for their use, and their scope progressively increase. This latest edition incurs an additional risk: it has been granted at the threshold of a constitutional reform. During the next few months, given the political uncertainty that reigns over the country, private investment will show clear signs of contraction. The key that will determine just how far the president will go with his Bolivarian Revolution, in this new phase of the "democratic dictatorship," is in how much people's support he will receive.

**Venezuela is going through a process of institutional weakening**

It's no secret that Venezuela has been going through an unprecedented institutional weakening process. It's transparently clear that Public Powers are not independent of each other and that those responsible for each Power tend to be rewarded for their allegiance to the Executive Power. There are a number of examples of this: For his faithful service, the first Vice-President of the Republic, Isaías

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Rodríguez, was rewarded with the office of Attorney General; the president of the National Electoral Council (CNE) was appointed a Magistrate to the Supreme Court (TSJ); and last, but not least, one of the key players behind the Recall Referendum in the CNE, Jorge Rodríguez, was just named Vice-President.

### **The president's decision making power is excessive**

President Chávez doesn't abandon those who have been faithful, and depending on what they have done, he rewards them with different positions. Furthermore, with his being so popular and his autocratic style of governing, Chávez maintains great discipline around him. In many of the country's regions, Chávez has the power to make a complete unknown become governor and/or mayor by simply naming the person as candidate of his party. That's why he maintains an ironclad control over his followers.

### **Democracy is being destroyed**

With the passing of time, this power has been growing, and proof of it is the approval of the different enabling laws. According to lawyers, specialists in the matter, an Enabling Law should grant special powers to a president in very specific areas and for a very brief period in times of emergency. This analysis doesn't correspond to the enabling laws approved for President Chávez.

### **More and more power**

Having just reached power, the Chávez's administration petitioned the now extinct National Congress in 1999 for an Enabling Law. It was approved in April and was in effect for 6 months. It is important to point out that when analyzing the decree-law, the purpose and the scope of reforms in different areas were clearly and explicitly spelled out. That first law only encompassed four topics: the organizing of the national public administration, finance sector, tax regulations, and the economic sector.

Then, towards the end of 2000, the Chávez's administration asks for another Enabling Law, but this time valid for one year. This Law is much vaguer than the previous one in terms of its objective and the scope of the reforms to be enacted. In fact, the sought after enabling law would encompass the following sectors: finance, social and economic, infrastructure, transportation and services, citizenry safety and legal assurances, science and technology, and State organization and functions.

## The 2<sup>nd</sup> Enabling Law sparked a profound political crisis

At the time, the parties supporting the Chávez's administration in the National Assembly (AN) controlled around 66% of it.

It's important to remember that within the framework of the 2<sup>nd</sup> Enabling Law the Executive office was able to pass 49 laws. Among the most polemic ones passed are: the Hydrocarbons Organic Law (which increased up to 30% the taxes imposed on private oil companies concerning oil extracting activities, and fixed the State's minimum share in any joint venture at 51%), the Fishing Law (which imposed serious restrictions on trawling and commercial fishing in favor of traditional fishing methods), and the Land and Agrarian Development Law (which allows for the expropriation of land).

Throughout the year which the Enabling Law was in effect, the Government, through the vice-presidency, held a series of talks with the representatives from the private sector in order to incorporate their suggestions into the new laws. However, in the end, all the suggestions made were thrown out and the new laws were strongly rejected by the business sector. They took the Government attitude to be anti-democratic, and the legislative package introduced to be unconstitutional. This was why, FEDECAMARAS called for a 12-hour national strike for December 10<sup>th</sup>, 2001, a strike which turned out to be a success and that was supported by the CTV. From that moment on, the political situation in the country began to deteriorate, ultimately leading to the events which occurred in April 2002.

## The new Enabling Law allows Chávez to pass legislation on anything

The approval of this third Enabling Law has a number of elements worth considering. First, the number of topics to be modified is significantly greater than those allowed under the previous Enabling Laws; the current one covers 11 areas. Second, this latest law will be in effect for 18 months (a year and a half), the longest period ever that a law of this type has been allowed to be in effect.

And lastly, this Enabling Law has been approved within the context of an upcoming reform of the Constitution, a fact which **Ecoanalítica** believes to be the most worrying point of all.

National Assembly Representative and constitutional lawyer, Carlos Escarrá, justified that the president had the right to legislate until August of 2008. He explained that in a first stage, which would last between 6 or 7 months, laws would be decreed based on the current

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terms of the Constitution “in order to expedite and satisfy the needs of the people,” while the rest of the time, laws will be passed based on the constitutional reforms (and without the restrictions of the 1999 Constitution).

According to Escarrá’s, it’s expected that by next March the Commission for the Reform of the Constitution will turn in their final draft and in September the Referendum to approve the new Constitution will be held.

This scenario sets the stage for Chávez to be able to legislate with almost no pre-established constitutional limits. This is a substantial difference with regard to the Enabling Laws that have previously been approved for Chávez and for any other Venezuelan president for that matter.

### **Private investments will continue to be at a standstill**

The private sector started a gradual investment growth process in 2004, thereby breaking with the trend set by years of virtually nonexistent investment. However, after President Chávez’s announcements in January this all changed. In ***Ecoanalítica’s*** opinion, this change from a “democracy by the people and for the people” to a “21<sup>st</sup> Century Socialism” doesn’t leave any room for investment.

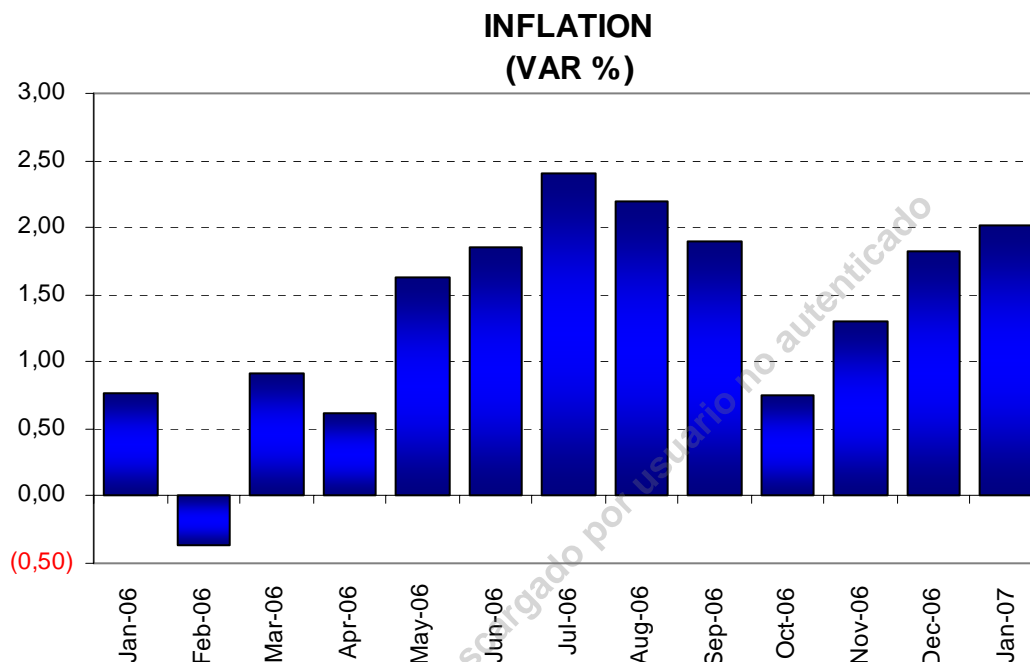
### **The political cost may be all that can stop the process**

In closing, we would like to point out that the only thing that may be able to stop this radicalization process is, if the very radicalization erodes the president’s source of power: his popularity. President Chávez may stop some of these measures from being implemented if he felt that they were diminishing his support base. With regard to the nationalization of CANTV and EDC, for example, the people are very sensitive with regard to the subject of the quality of public services. A noticeable change in quality will only have one culprit, the Government.

## ***Economic Tips***

**January inflation was at 2%.** According to the Central Bank (BCV), the inflation rate for the month of January settled at 2%, slightly higher than the previous month’s 1.8% and also higher than the 0.8% posted for January last year. Non-controlled goods

went from 2.1% to 2.6%. On the other hand, controlled goods registered increases less than the previous month and went from 1.5% to 1.3%.



Sources: BCV y Ecoanalítica

**Atypical behavior.** Traditionally January is a low inflation month because it coincides with a drop in the volume of economic transactions and reduced public spending. The hike in prices is mainly due to the uncertainty generated by the Government's announcements concerning the nationalization of certain companies, as well as the increase in the foreign exchange rate in the parallel market. The CPI's yearly variation was set at 18.4%, much higher than what was registered for the same period of the previous year (13.1%) and the goal that the Government had set for itself of 12%.

**Maracaibo inflation published.** The BCV started to publish Maracaibo's CPI (IPC – AMM) highlighting that in January it only increased by 0.7%, less than what was registered for December 2006 (1.5%), and higher than what was registered for January 2006 (0.4%). On the other hand, the yearly variation of the IPC-AMM settled at 17.5%.

**Good fiscal management in 2006.** The Finance Ministry (MF) stated that during 2006, fiscal revenue was at VEB127.5 trillion (US\$59.30 billion). Of this amount VEB108.3 trillion (US\$50.37 billion) are considered ordinary sources (PDVSA tax

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contribution and SENIAT tax collection), while VEB19.2 trillion (US\$8.93 billion) were considered extraordinary revenue (mainly gross borrowing). This is how Government revenue went up 14.5% in real terms with respect to 2005 total income.

**Oil continues to dominate.** Notwithstanding the Government's statements with regard to how non-oil revenues have surpassed oil revenues, the truth of the matter is that when you break down the resources by their source, resources that originate from oil represent 56% of the total. Funds that originated domestically (non oil), had a 44% share. Oil tax revenue equaled VEB60.5 trillion (US\$28.14 billion) corresponding to income tax, royalties, production tax, and PDVSA dividend. The SENIAT's contributions reached VEB50.0 trillion (US\$23.26 billion).

**Doesn't include extraordinary resources.** It's important to clarify that these resources don't include the extraordinary funds received by the Government which are mostly deposited in the National Development Fund (FONDEN), as well as others resources that are managed directly by PDVSA and BANDES.

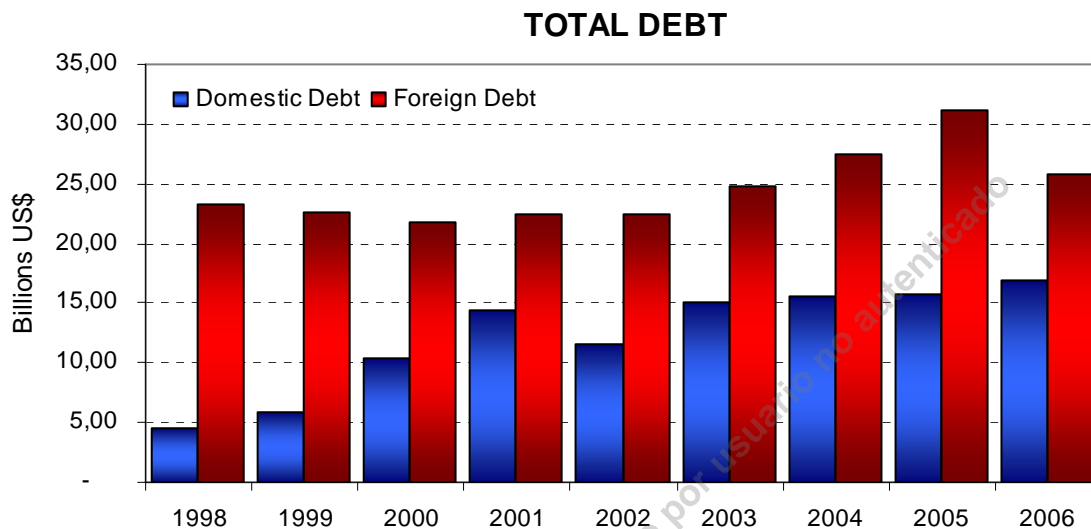
**The surplus was 3% of GDP in 2006.** Taking into account that expenditures reached VEB116 trillion (US\$53.95 billion), the Central Government had a fiscal surplus of VEB11.5 trillion (US\$5.34 billion) in 2006, equivalent to 3.2 points of GDP.

**Domestic debt increases.** According to the MF, the public domestic debt grew from VEB33.7 trillion (US\$15.68 billion) in 2005 to VEB36.2 trillion (US\$16.85 billion) in 2006, up by 7.5%. The increase was due to the raise in national public debt bonds that went from VEB30.2 trillion to VEB34.1 trillion. In contrast, the treasury bills balance (short-term instruments) went from VEB3.2 trillion to VEB1.8 trillion.

**Foreign debt falls.** Foreign public debt, in turn, fell significantly, going from US\$31.20 billion at the close of 2005 to US\$25.84 billion in December 2006. In one year, the Government has cut foreign debt by US\$5.37 billion. This was achieved mainly due to the foreign debt buy-back program that the MF carried out during the first semester of 2006 using FONDEN resources (approximately US\$4.1 billion).

**Multilateral institution foreign debt up.** An important point to mention has to do with the fact that the only foreign debt item that increased was the one having to do with multilateral institutions (World Bank, Inter-American Development Bank (IDB), Andean Development Corporation (CAF), among others). Last year, President Chávez had ordered that they all be paid in full. The debt owed the multilateral institutions increased by US\$321 million. This is not as bad as it sounds though since the loans have very favorable low cost financing terms.

**Total debt cut.** The country's total debt went from US\$46.88 billion at the close of 2005 to US\$42.69 billion at the end of 2006, in other words, a net cut of US\$4.2 billion.



Sources: Ministerio de Finanzas and Ecoanalítica

**The Government clarifies.** The Minister of Finance, Rodrigo Cabezas, stated that the nationalization process of CANTV and EDC will be done in accordance to the Constitution. It's important to highlight that according to Cabezas, "to nationalize doesn't imply to confiscate a company." He also stated that private property will be preserved. "Companies have to continue to function and get along with the new types of socialized production."

**More patches.** Cabezas also pointed out that in order to achieve the goal of maintaining inflation this year at 12%, the Executive office is preparing an anti-inflationary pact. This kind of policy is not new to Venezuela and what it has led to in the past is stricter price control measures which inevitably have led to failure. **Ecoanalítica** is of the opinion that the best way to control inflation is by redesigning fiscal and monetary policy, something which does not seem to loom in the mid term.

**Steps taken to create the *Banco del Sur* (Southern Bank).** The Government has created a commission to create the *Banco del Sur*, and it will be in charge of drafting the institution's project. The commission will be chaired by the Minister of Finance, Rodrigo Cabezas, and its other members will be: Gastón Parra, Jorge Giordani, Rodolfo Sanz, Eudomario Carruyo, and Nelson Merentes. It will last for three months.

## OIL TIPS

**The oil basket is up.** The price of the Venezuelan oil basket last week closed averaging US\$45.96 per barrel, up US\$1.46 from the previous week.

**Contracts would be breached.** Fitch Ratings considers that Venezuela would be in breach of financing contracts for the amount of US\$4.0 billion if the Government unilaterally takes over four crude upgrader projects on the Orinoco Oil Belt. Fitch Ratings says that this is due to the fact that the loans include restrictions on owner assignments and that a violation of these terms could lead to a breach.

**Guyana is also getting oil.** Venezuela will send Guyana a volume of hydrocarbons equivalent to up to 5,200 bd. The agreement signed within the framework of PETROCARIBE will allow Guyana to receive gasoline, diesel, aircraft fuel, fuel oil, and asphalt. The amount agreed to represents 50% of that nation's daily consumption. This makes 10 agreements to date that have been made within the framework of PETROCARIBE and 8 mixed companies have been created to take on a number of binational projects.

## BUSINESS SECTOR TIPS

**Future obstacles for businessmen.** A recent survey of businessmen, members of VENAMCHAM, reflected that economic controls and political uncertainties are considered to be the main issues that will make doing business in 2007 more difficult. 95% of those surveyed indicated that labor matters will impact the company's total costs, while 89% stated that tax matters will also affect total costs. Of those surveyed, 63% belonged to large business, 23% to medium sized businesses, and 14% to small businesses.

**But they will invest.** 61% of those surveyed said that their companies have new investments planned, 27% said that their companies didn't, and 12% didn't answer. Of those who will resort to new resources, 64% said that their expenses will surpass those of 2006, and 41% said that they would be less.

**MERCAL popularity drops.** According to President Chávez's annual address to the nation, the number of people benefited by shopping at MERCAL outlets dropped by 41.5% compared to the number who shopped there in 2005. The report shows that the number of people benefited by the chain of stores in 2005 was 15.7 million, while in

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2006 only 9.2 million people shopped there. According to the same report tonnage of food sold dropped by 11.5% compared to 2005.

**Will be revitalized to help control inflation.** The Government looks to revitalize the MERCAL chain in the upcoming months so that it may be a part of its efforts to control inflation. With this in mind, Government subsidies will increase.

**Increased monitoring of the foreign exchange market.** The Superintendent of Banks Office (SUDEBAN) is contemplating the evaluation of the capital market and banking foreign exchange operations. According to SUDEBAN's head of auditing, Arlex Fuentes, the banks will be asked to submit their local and foreign currency account movements in order to determine if they have been using the official market or the parallel market. The Stock Exchange and brokerage houses will also be asked to submit the same records.

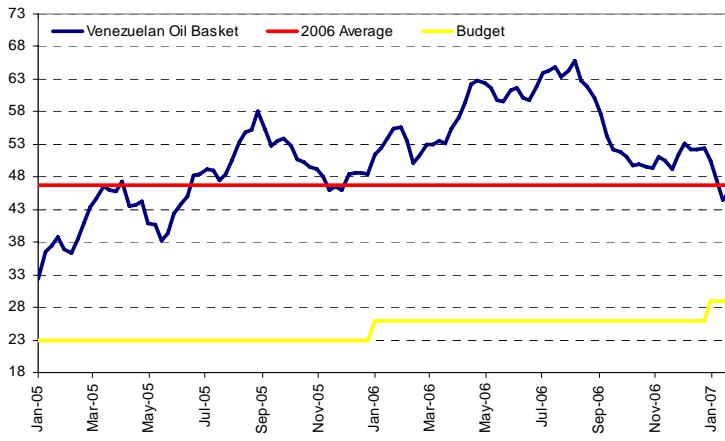
**Allowed operations.** However, it is important to know that the finance system does operate with foreign currency debt bonds as well as with instruments denominated in foreign currency; said movements are set forth in the current Foreign Exchange Law.

**The parallel market is underestimated.** This is what Fuentes says with respect to parallel market operations, because according to his figures, said operations amount to US\$100 million monthly. However, according to other sources within the sector, monthly parallel market operations are much higher and could be around US\$500 million monthly, including public debt bond and ADR operations.

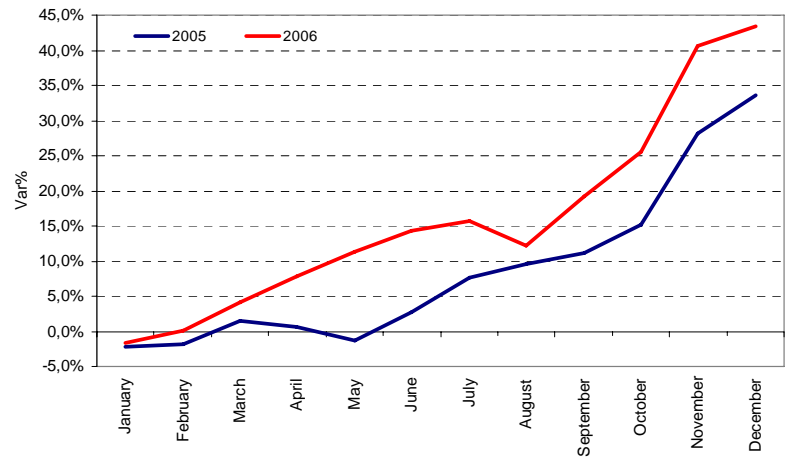
**Increase in power demand.** The OPSIS estimates that this year's power demand could increase by 5.1% compared to 2006. According to this office, the cumulative demand for January is up by 6.3% if compared to the same period last year, and this past December, the system registered a maximum power demand increase of 8.6%, while the cumulative increase for 2006 was 8.3%. The office points out that since March 2006, energy consumption has surpassed the historical high levels previously registered in 2005.

# ECONOMIC OVERVIEW

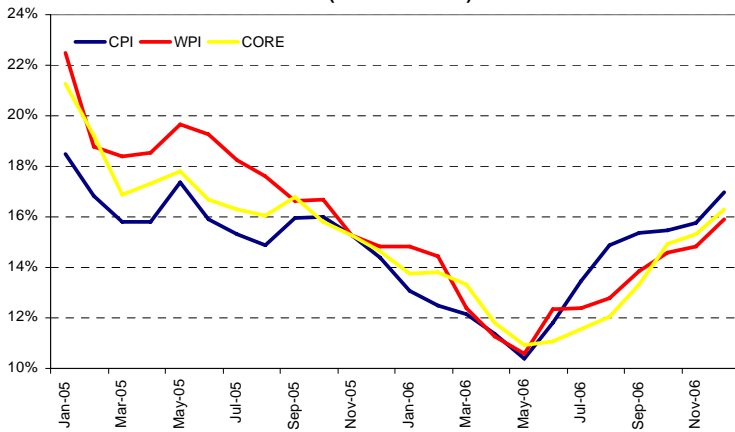
**Oil Price**  
(Venezuelan Basket US\$/pb)



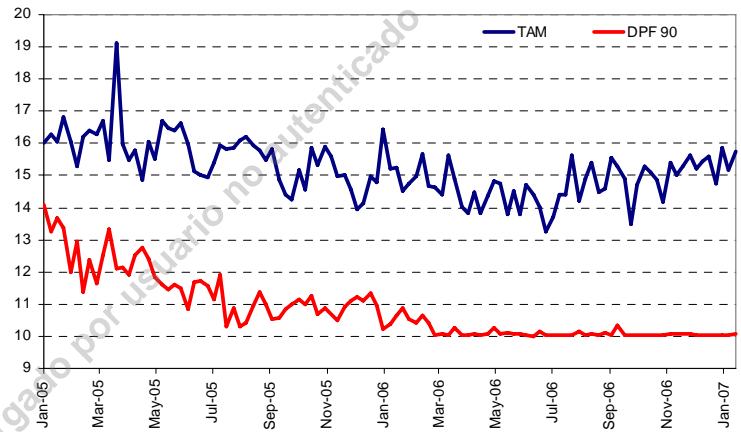
**Real Expansion (M2)**



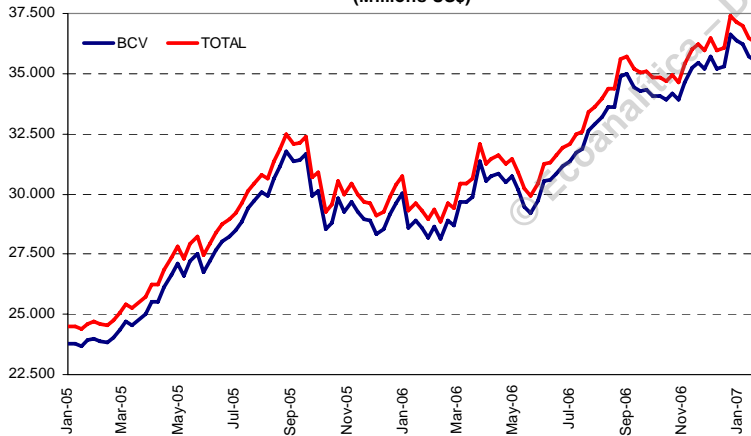
**Inflation**  
(Last 12 Months)



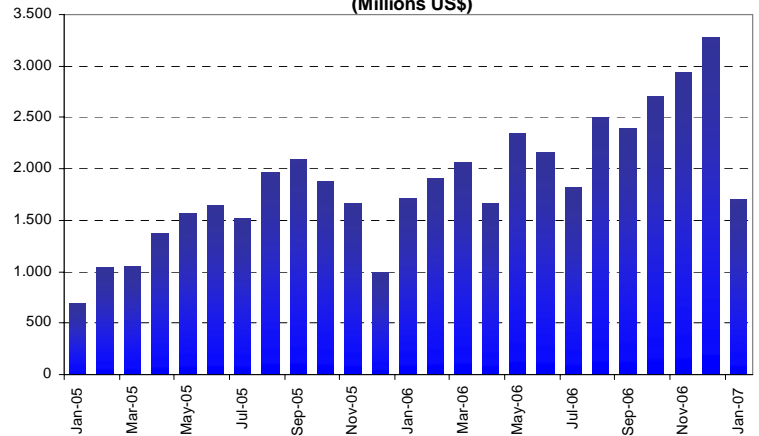
**Interest Rate**  
(Six Principal Banks)



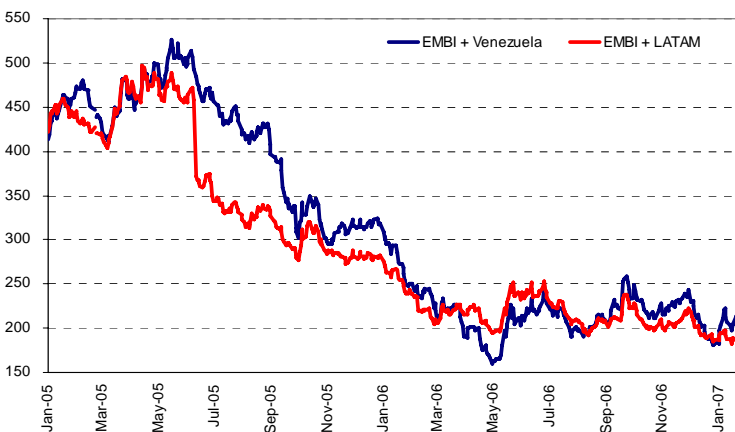
**Fx Reserves**  
(Millions US\$)



**Disbursement**  
(Millions US\$)



**EMBI**



**Central Government**  
(VEB Billions)

