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***QUICK X-RAY OF THE  
CHÁVEZ GOVERNMENT:  
EXPENDITURE BALLOONS.  
ECONOMY BOOMS***

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**THE CLIENT**

There is no way of knowing from the data released by the Public Sector just how much cash this administration is pouring into the Nation's economy. We have had to create our own indicator to better calculate the scope of fiscal expansion under this Government – and it has been massive. In today's Dollars it stands at 33% of our Gross National Product, and the worst of it is that growth is being kept up there in the sky thanks almost entirely to oil income. Therefore it is not sustainable.

**The restricted nature of  
Restricted Public  
Spending data**

Over the last two weeks we have been analyzing this Government's spending habits in its main areas - the Central Government itself and the Restricted Public Sector (RPS) - and have identified three basic premises:

1. Public expenditure has increased faster than fiscal income.
2. Dependency on oil income has grown, making fiscal management more vulnerable than ever to the whims of the international oil market.

- The shrouds surrounding fiscal administration make it more and more difficult to analyze.

In respect of the last point, perhaps the best example is RPS. Numbers published by the Ministry of Finance for the public sector as a whole are *net*; therefore we cannot estimate the size of PDVSA expenditure, nor that of any other non-financial public – not to mention the almost impossible task of analyzing the execution of resources by the National Development Fund, FONDEN.

### A ballpark figure for massive public spending

Because of this, *Ecoanalítica* has created its own indicator to measure just how much cash has been injected into the economy during the administration of President Chávez between 1999 and 2006. We are calling it **Real Growth in Expenditure (RGE)**. RGE shows us the *whole* RPS, but rather like a “black box”, with money going in and money coming out, without seeing what is happening inside to the procedures and relationships among the different entities that make up the public sector.

The RGE tells us how RPS grows, by measuring the inter-annual variation in the financial deficit in US\$ millions plus the sum of the inter-annual variation in total income (oil + non-oil), also in US\$ millions.

We have used the inter-annual variation in oil exports to determine oil income, because PDVSA releases only net figures.

<b>RESTRICTED PUBLIC SECTOR</b> ( MM US\$ Current)	1999	2000	2001	2002	2003	2004	2005	2006
Differential - Non Oil Income	2.496	801	1.799	(4.656)	(1.819)	7.174	7.427	8.500
Differential - Oil Income	4.557	11.139	(6.129)	(213)	497	10.842	15.198	10.369
Differential - Total Expense	(4.929)	(4.612)	11.178	(4.429)	(1.515)	(2.575)	(2.745)	7.955
<b>Real Growth in Expenditure</b>	<b>2.124</b>	<b>7.328</b>	<b>6.848</b>	<b>(9.298)</b>	<b>(2.836)</b>	<b>15.441</b>	<b>19.879</b>	<b>26.824</b>

Sources: Ministerio de Finanzas and Ecoanalítica

## Unprecedented fiscal expansion

Using our RGE indicator we find that only two years of President Chávez' administration have seen a restrictive fiscal policy. We are referring here to the years 2002 and 2003, which were precisely the years of greatest political and economical turmoil.

However, in net terms we find that fiscal expansion between 1999 and 2006 was US\$ 66.3 billion, which, seen in terms of the GDP estimated for 2007, is equivalent to 33.3 GDP points. Unfortunately we do not have access to the RPS figures for preceding years, but we believe that this explosion in public spending is unprecedented in recent economic history.

## Fiscal expansion grows day by day; it is therefore unsustainable

Looking at the data, we have noted three periods:

1. 1999-2001, with a moderate expansion of US\$ 16.3 billion, for an average annual expansion of +/- US\$ 5.4 billion;
2. 2002-2003, with a fiscal contraction of US\$ 12.1 billion. This is the only period of fiscal contraction during the government of Chávez; and
3. The 2004-2006 period, with its fiscal expansion of US\$ 62.1 billion, for an annual average of +/- US\$ 20.2 billion. In other words, fiscal growth over the last 3 years is almost *4 times greater* than the 1999-2001 three-year period.

With these results, and fiscal spending growing in real terms over time, it is patently evident that this situation is not sustainable. This sad truth is upheld by one singular detail: during the years 1999 to 2006, oil-derived fiscal expenditure accounted for fully 70% of net total expansion. Put in another way, a huge rise in oil prices brought a spectacular knee-jerk increase in fiscal spending. This confirms our thesis on Central Government and RPS expenditure data.

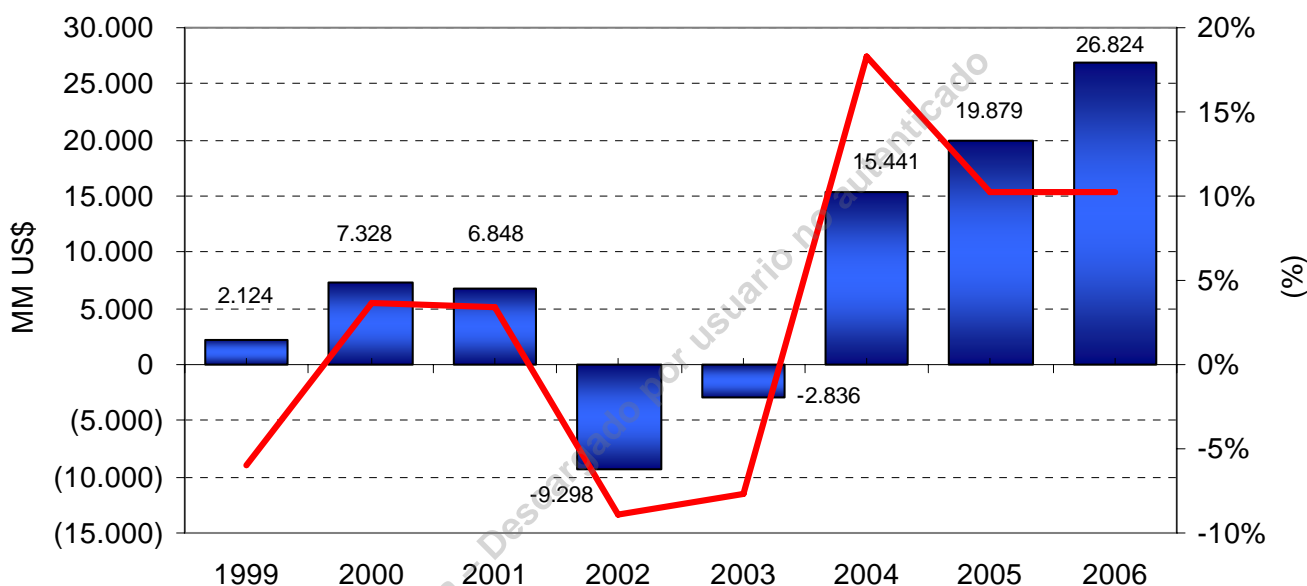
Venezuela must do all it can to neutralize any direct blows to its own economy that are thrown by a fickle international oil market. To do this it has to bolster and redesign a Stabilization Fund that can absorb and pacify these shocks coming from the oil market.

## The economy grows; thanks to the State

This may sound obvious, but it is not wrong to state that the excellent performance of Venezuela's economy, insofar as growth is concerned, is being fired by the State and its expansive fiscal policy. You can see quite clearly how the economic tide ebbs and flows, in perfect

synchronization with the gestures and swings of fiscal policy. 2004 warrants a separate analysis, since our economy grew significantly, mainly due to the rebound effect from the profound contraction of the two previous years.

### Real Growth in Expenditure and GDP Growth



Sources: Ministerio de Finanzas and Ecoanalítica

### Can't say nobody told you!

It is terribly clear that Venezuela is sitting astride a time bomb, but that the ticking clock still leaves us time to maneuver. If, for instance, we are faced with a medium-term scenario of substantially lower oil prices, fiscal imbalance will start to rear its head, serving as an echo chamber for the other sectors of the economy.

This would not be a sudden knockout blow, but would take place gradually while the Government uses up the plentiful resources it has in sundry funds, *postponing* the Day of Judgment, but not *avoiding* it. The main correction will be seen in the currency exchange rate, since although depreciation would greatly improve the Government's balance sheet, it would be very costly in terms of inflation and real growth.

## Weekly Report

The quality of the fiscal belt-tightening implemented in Venezuela, which is based on recurring corrections to the exchange rate and permanent expense cut-backs, has not only imposed a perpetual state of fiscal stress, but has been extremely costly in terms of growth and the relentless impoverishment of the people.

We Venezuelans are heading for a rude awakening from our dream of being a “strong country” - as the Central Bank has taken to saying – to find instead a nation of dangerous imbalances, bereft of any major improvement in its quality of life.

### Economic Tips

**We are withdrawing from the IMF and the World Bank, but in our own good time.** Straight from the mouth of President Hugo Chávez, “*con calma*”, he said. *Ecoanalítica* understands that a Finance Ministry team of advisors is working on reducing the economic cost of this political decision.

**Reserves grow.** On June 13, Gross International Reserves held by the Central Bank stood at US\$ 24.797 billion, an increase of US\$ 533 million over the previous week.

**Money supply (M2) grows.** On June 1, M2 stood at VEB 117.5 trillion, an increase of 1.3% over the week before and, nominally, 1.1% down, year-to-date.

**Foreign Policy magazine: Bolivar weakest currency on earth.** According to this magazine, increased spending, hand-in-hand with the nationalization policy, have given the Bolivar a headache this year, and it has depreciated by 21% since January, the greatest loss of value from among a sampling of 72 countries followed by Bloomberg. Obviously, *Foreign Policy* finds it impossible to understand how people can go around talking about a “*Bolívar Fuerte*” with all that’s going on, or why, miraculously, the “*locha*”<sup>1</sup> will banish monetary instability.

**Unofficial or parallel Dollar upwards of Bs. 4,000.** During the last three weeks the parallel exchange rate has behaved erratically in shallow market waters, therefore

<sup>1</sup> Venezuelans’ nickname for a 12.5 cent coin of the 70s, now resurfacing as the “*nueva locha*”.

**Ecoanalítica** foresees instability in the unofficial price of the US currency, without venturing to predict tendencies.

**New tax system.** José Gregorio Vielma Mora, Superintendent of the SENIAT (the tax collection agency), has reported that the Government is planning to launch a socialist tax system that is “fairer on the people.” He explained that in the package of regulations to be decreed under the Enabling Law (*Ley Habilitante*), there is a draft Capital Gains Tax Decree-Law that will affect individuals whose income and patrimony amounts to more than 25,000 Tax Units, now equivalent to VEB 941 million. This proposal is to substitute the original idea of a capital gains tax that would be triggered when income surpassed 15,000 Tax Units (VEB 564.4 million). Vielma Mora stressed that even though fewer people would pay the tax, collections would not be affected, since the volumes for this concept are not very high. The main residence will not be taxed, and in the case of cars, the tax will only apply if a person owns more than two vehicles.

**Reference interest rates fixed.** In June, new rates were set for vehicle credits: 15.94% when using the “balloon” quota mechanism; 13.03% if the vehicle is used professionally; and between 12.75% and 14.35% for the tourism sector. These new rates are slightly lower than those of May.

**Fedecámaras says inflation may reach 20%.** José Luís Betancourt, President of Fedecámaras, the umbrella employers’ organization, stated recently that “the economy is suffering from a structural sickness that is aggravating inflation. The Government’s policy has been to boost demand but not to encourage the production of goods and services, and this has conspired to make products more expensive and more difficult to find. Thanks to this, we now have an inflationary economy.”

**More parallel funds make it increasingly difficult to control public finances.** During his latest Sunday chat<sup>2</sup> President Hugo Rafael Chávez announced the creation of new funds. The first of these is to be the Food Fund and the second will be a special fund for federal territories that need injections of cash to rescue them from situations of backwardness and insecurity.

**Banco del Sur.** Banco del Sur will be officially founded during the ceremonies taking place at the MERCOSUR Presidential Summit towards the end of this month in Paraguay. Representatives of Argentina, Bolivia, Brazil, Ecuador, Paraguay and Venezuela entered into this agreement at a technical meeting that Chile attended as an observer. According to the draft, each of the member countries of the new financial

<sup>2</sup> The President addresses the people every Sunday afternoon in his blanket TV broadcast “¡Aló Presidente!”

entity will put up identical amounts of capital and will therefore enjoy identical representation.

**Minister Cabezas: “Venezuela Country Risk upturn due to media smear campaign.”** This was a recent assertion by Rodrigo Cabezas, Venezuela’s Minister of Finance.

## OIL TIPS

**OPEC approves social investment.** The OPEC Fund has earmarked US\$ 1.85 billion for so-called “concessionary loans” (“soft” loans for technical assistance) that will benefit 81 medium- to low-income countries over the 2008-2010 period. The information was given by Venezuelan Finance Minister Cabezas.

**PDVSA to take over control of 18 oil rigs in three months’ time.** José Luis Parada, Western Division Exploration & Production Manager at PDVSA, stated that 10 of the 18 rigs have already passed into the Corporation’s hands upon expiry of private company operating services contracts, whilst the remaining eight are to be recuperated within the “next two or three months.” He added that 46 rigs will be functioning in this region by the end of this year.

**Maracaibo, hydrocarbons capital of the world.** The XVIII Latin American Petroleum Show (*Exposición Latinoamericana del Petróleo*) will take place shortly, bringing together over 830 companies from 30 countries, half of which are Venezuelan. 21 Mixed Companies (*Empresas Mixtas*) formed under the new national political model, will also be present. The organizers reckon that some 30,000 visitors will be coming in to see the 250+ exhibition stands.

## BUSINESS SECTOR TIPS

**Shortages getting worse.** Grains have disappeared from the shelves of the Capital’s formal markets. Items as common as black beans<sup>3</sup>, lentils and chickpeas have become luxury articles for Venezuelans because they are so difficult to find. The only option open to the adventurous is to shop at the street vendors’ markets, but you have to pay far more than Government-ordered prices. A kilo of black beans can go for

<sup>3</sup> Fried black beans - *caraotas negras* - are a basic ingredient of Venezuela’s national dish, *el pabellón criollo*.

between VEB 6,000 and VEB 8,000 on the informal market, almost 400% more than the VEB 1,440 per kilo published in the Official Gazette.

**Venezuela's joining MERCOSUR now "more difficult".** These are the words reported by the daily paper *Folha de Sao Paulo* to have been said by Luis Ignacio ("Lula") da Silva, President of Brazil. Brazil's Congress has to approve Venezuela's full accession to MERCOSUR, and recent declarations by President Chávez have obviously done little to help this process along.

**Trade relations with Colombia strengthened.** Rafael Oropeza, Food Minister of Venezuela, has met with Colombia's Ambassador to Venezuela, Fernando Marín Valencia, to look into the possibility of importing into Venezuela certain foodstuffs that form part of the basic food basket (*cesta básica*), thus helping to relieve the seasonal shortages that are affecting people in Venezuela, articles such as eggs, cooking oil and sugar, among others.

**Obligatory portfolio percentages exceed credit demand.** According to statements made by Víctor Vargas, President of the Bankers' Association, the policy used to direct the assignment of credit portfolios should be focused on the needs of each different sector. At present, a percentage is simply assigned against the total loan portfolio, but this includes a component of consumer credit and trade credit, and all economic sectors do not necessarily develop equally over the same period of time. What has happened is that the pie has grown so much that demand has become insufficient.

**CANTV and EDC may return to the Stock Exchange.** In representation of the Caracas Stock Exchange, its President, Víctor Flores Rojas, has presented a project to the Telecommunications Ministry and to the EDC (Electricidad de Caracas) for reincorporating the shares of CANTV and EDC to the local stock market. Flores explained that the bases proposed for reincorporating EDC contemplate an initial redistribution of between 30% and 40% of shareholders' equity. In the case of CANTV, the reincorporation could start with a unification of the types of shares, which could be done by issuing preferred shares for workers and any remaining Class A and B shareholders, through a share swap.

**Nelson Belfort elected President of the Chamber of Radio Broadcasters and Genaro Méndez reelected President of FEDENAGA (National Federation of Cattle Farmers).** Both appointments are for the 2007-09 period.

## **Weekly Report**

**Conflicting numbers coming out of MERCAL.** The People's Ministry of Food sold 110 million kilos of food nationwide, according to General Rafael Oropeza, its head. This expansion contradicts other reports of a significant contraction at MERCAL.

**Gran Hotel Puerto La Cruz operator has concession revoked.** Operations will now be handled by a State company. Concessions of Hotels Del Lago, Intercontinental Valencia, Guayana and Cumanagoto also being reviewed.

**Radio Caracas Televisión (RCTV) looks towards broadcasting over cable TV channels.** Commentators close to the sector report that negotiations were held last Tuesday. It is still not clear how near to an agreement they are, since it was apparently just an initial encounter with Net Uno and DirecTV. Marcel Granier, President of RCTV, said that "this is still far from being resolved; there are many obstacles, and at this moment we continue to fight for justice at the hands of the Supreme Tribunal of Justice and to have the closing of RCTV declared null and void."

**Food Ministry authorizes May exports for 6,000 tons of rice.** The Government has established that a "Domestic Demand Satisfied" certificate has to be applied for in order to export food. Current inventories cover 3.5 months' internal demand.

### **Political Tips**

**Hugo Chávez makes a surprise trip to Cuba.** He met with his colleague Fidel Castro for six hours - in a spirit of "brotherhood and solidarity" - as the meeting was described in a terse official communiqué read over Cuban TV last night.

**New President for the Bank of the Treasury.** Giral Michelangeli, CADIVI Board member, has replaced Blagdimir Labrador as new President of the Bank of the Treasury. Apparently, this change has caused friction between the Finance Ministry and the President of the Republic.

**The drive to collect the signatures needed to activate recall referendums is planned for this weekend.** At *Ecoanalítica* we believe it will be practically impossible to collect the minimum number of signatures required for activating any recall referendum by means of the infrastructure ordered by the electoral authority, because of its main restriction, which consists in atomizing the voting centers.

**Four governors and fifteen mayors are free from the collection of expressions of intent to activate recall referendums.** The National Electoral Council (CNE after its Spanish initials) approved the reconsiderations and dropping of requests for recall

referendums against the governors of the States of Falcón, Jesús Montilla; Guárico, Eduardo Manuitt; Monagas, José Gregorio Briceño; and Sucre, Ramón Martínez.

**Venezuela included in the list of 25 countries that violate union freedom.** The 96<sup>th</sup> International Conference of the International Labor Organization (ILO) urged the Government to meet its pending commitments to the Organization concerning free labor expression, particularly in regard to the “participation and intervention of the National Electoral Council in the election of unions and guilds in Venezuela.”

**New meeting between the foreign ministers of Colombia and Venezuela on June 22 and 23 in Cartagena.** Araújo and Maduro, who met in the Colombian Capital last June 5, will review the themes they touched on then and also the bilateral integration mechanisms.

**ONIDEX to issue new electronic ID cards starting in the first quarter of 2008.** Pedro Carreño, Minister of the Interior and Justice, confirmed this during the opening ceremony of the new ONIDEX office in Barcelona, State of Lara. The new ID card will have an identification chip and the user’s electronic signature.

**Moratinos reiterates concern over non-renewal of RCTV license.** Spain’s foreign minister guaranteed that everything had been done at the Executive level to convince the Venezuelan authorities to review their decision.

**Swiss businessmen in favor of dialog with Chávez during upcoming visit.** The Swiss right wing and its business sector are in support of a possible visit by President Hugo Chávez to their country, since it would be an ideal moment to discuss face to face with him the situation of Swiss investments in Venezuela. The invitation to the head of state is an initiative of the Institute of Public Law of the University of Fribourg, which wants to make a presentation to Chávez of how the instruments and mechanisms of direct democracy function in its country.

**Hunger strike ends.** A hunger strike by inmates at the Tocarón Penitentiary was called off on Wednesday. According to reports, a representation of the prisoners reached an agreement with the prison authorities. Colonel Eduardo Bracho, prison director, said that the prison will increase the number of vehicles needed to transport prisoners to and from the Courts and also make an effort to speed up the judicial procedures.

**Submarines.** According to the newspaper *Kommersant*, Hugo Chávez, President of Venezuela, will be putting the final touches to an agreement to purchase 9 new

Russian submarines during a visit to the country in June. The source made no reference to the approximate cost of this potential purchase.

**The Manuitt Affair again on the agenda.** The Directors of the National Assembly have ordered the Secretariat to locate the definitive report filed by the Internal Affairs Commission in 2005, which implicates the Governor of the State of Guárico in cases of human rights violations. The report is to be submitted to the Directorate of Parliament in order that it be evaluated and circulated among the members of the legislative body and then discussed in full session.

**Secretary-General of the OAS ready to visit Venezuela.** José Miguel Insulza has said he is quite prepared to head a mission to Venezuela to discuss the RCTV question, if the member countries so request.

**Venezuela's military expenditure N° 6 in Latin America.** In 2006 the country spent US\$ 1.8 billion on armaments. This is less than bordering countries such as Colombia or Brazil.

**The Federation of Student Centers of the ULA (University of the Andes) no longer controlled by pro-government students.** 22 of the total 26 positions are now held by students that are not pro-government.

**United Socialist Party of Venezuela still enlisting members.** President Chávez has ordered an extension to the registration process for militant hopefuls with his new Government party (*Partido Socialista Unido de Venezuela – PSUV*). The final number of registries cannot be audited.

**Rodolfo Sanz, new President of BANCOEX.** The Vice Minister for Latin America and the Caribbean, Dr. Rodolfo Sanz, will shortly be assuming his new duties as President of Venezuela's Bank of Foreign Trade, following his appointment by President Hugo Chávez to "comply with a normal change of position within this process," as explained by the Vice Minister.

**Caracas-La Guaira viaduct being surfaced.** Isidro Rondón, Vice Minister of Infrastructure, has reported that asphalt work has already begun on the northern lanes of the viaduct, and at the same time the lateral defenses are being filled at a rate of 45 meters per hour.

**Trolmérida to start up shortly.** Florencio Porras, Governor of Mérida, has stated that the first section of the Trolmérida Mass Transit System will begin operations on Monday, June 18, with a total investment in Line 1 of US\$ 224 million.

## ***Weekly Report***

Presidential Decree authorizing the creation of the State company *Corporación para el Desarrollo Científico y Tecnológico* (CODECYT, S.A.) published in Official Gazette N° 38.703.

Presidential Decree authorizing the creation of the State company *Bolivariana de Gestión para la Reparación y Construcción de Embarcaciones, S.A.* (BOGESA) published in Special Official Gazette N° 5.381.

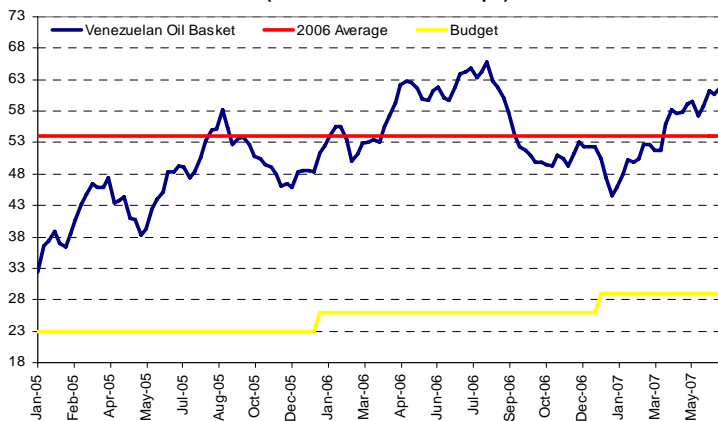
Presidential Decree authorizing the creation of the State company *Bolivariana de Puertos S.A.* (BPSA) published in Official Gazette N° 38.703.

*Pico y Placa* hours may be reduced by 1/2 hour. This will mean that traffic restrictions known as *Pico y Placa* (literally "*Rush-Hour and Registration Plates*") will no longer apply from 6:30 – 9:30 a.m., but from 6:30 – 9:00 a.m.

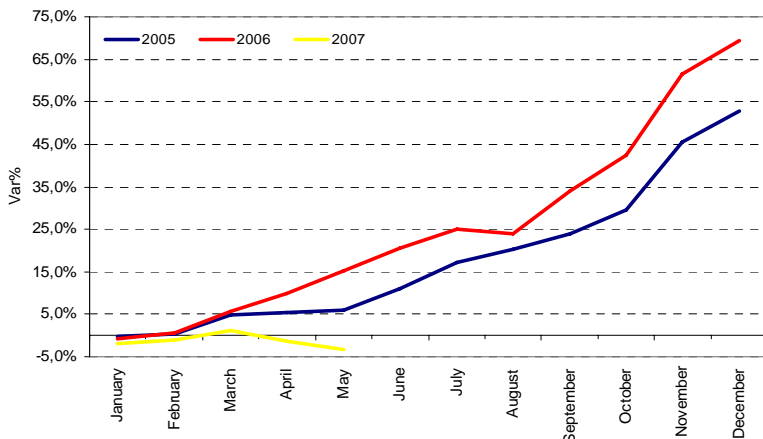
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# ECONOMIC OVERVIEW

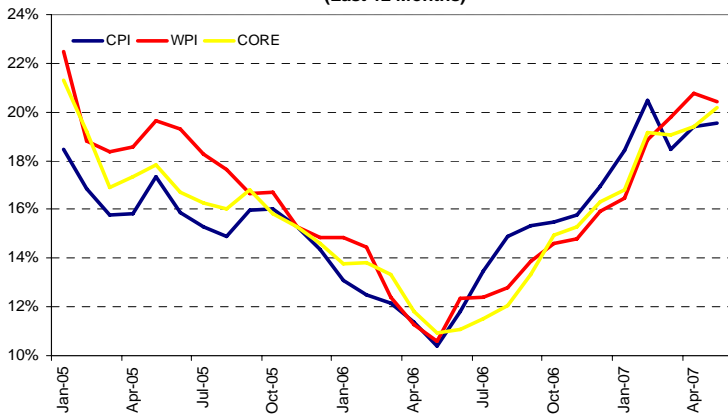
**Oil Price**  
(Venezuelan Basket US\$/pb)



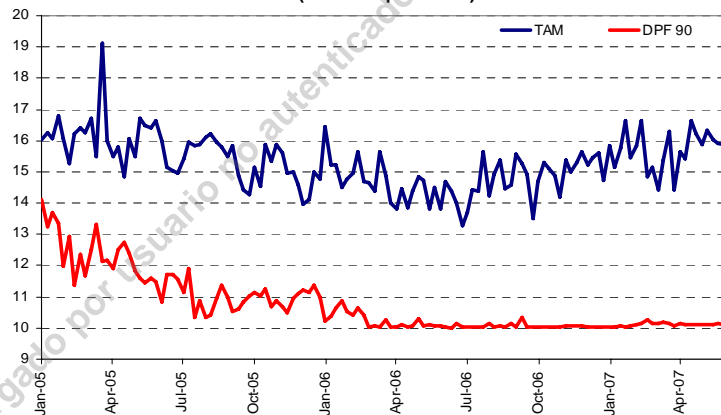
**Real Expansion (M2)**



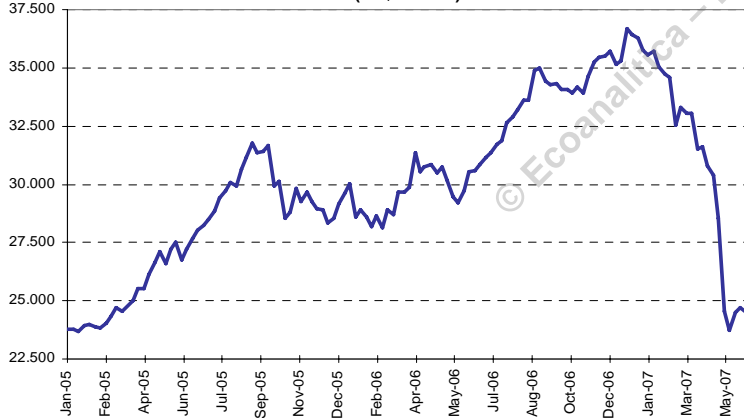
**Inflation**  
(Last 12 Months)



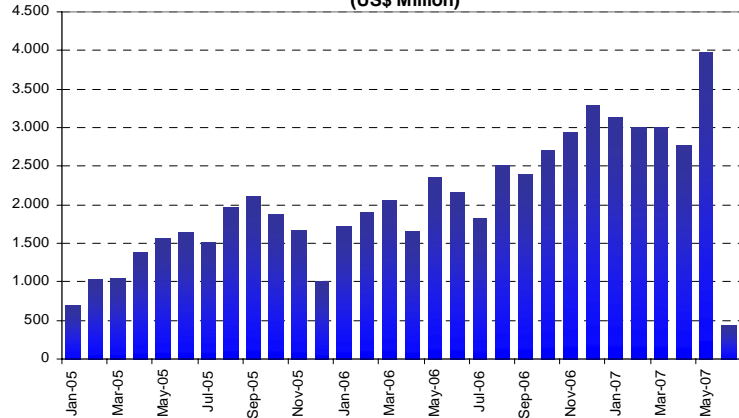
**Interest Rate**  
(Six Principal Banks)



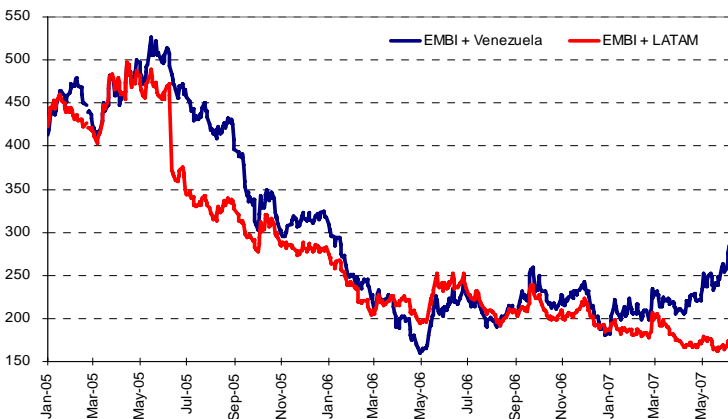
**Fx Reserves - BCV**  
(US\$ Million)



**Disbursement**  
(US\$ Million)



**EMBI**



**Central Government**  
(VEB Billion)

