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***DOES THE CHÁVEZ  
ADMINISTRATION HAVE  
FISCAL PROBLEMS?***

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The new taxes introduced by the SENIAT could be hiding cash-flow problems for the Republic, with a voraciously spending State, forcing tax collectors to increase tax revenues by any means possible. However, the problem seems to be another. The new taxes would have a negative affect on inflation, contradicting the Government's actions up to know and hindering their efforts to meet the 12% inflation goal at the close of 2007.

**The SENIAT established  
new taxes**

The Administration has recently established a new financial transaction tax (ITF) through the SENIAT, and it has increased the tax rate of cigarettes and liquor. The Administration has also announced that in the next few months it would introduce a modification to the income tax as well as present a new luxury or selective consumption tax.

**Set-off the alarms**

These announcements were interpreted by some as signs that the Government doesn't have as much revenue as it has been leading on, and that it urgently needs to generate additional resources in order to

cover the fiscal deficit facing a significant increase in public spending during the last quarter of the year.

## **We have a different opinion**

At **Ecoanalítica**, we have a different opinion concerning this issue. We insist, and continue to state, that the Administration is not in any kind of fiscal trouble nor on the brink of a fiscal crisis. Not only can the Administration count on ordinary revenues, but it can also count on the extraordinary revenues which surpass US\$60 billion, including PDVSA, BANDES, *Banco del Tesoro*, and FONDEN.

## **Something else is motivating the SENIAT's decisions**

The new taxes, announced in the midst of the market's expectations to hear announcements concerning the exchange rate issue, hide two problems that directly affect the SENIAT and not the Administration.

## **1<sup>st</sup> problem: The Administration is voracious**

In the first place, independently of the fact that the Administration decided to reduce the VAT by 5 percentage points, which led to a VEB7.3 trillion loss in fiscal revenues, the SENIAT is still being pressured to meet the non-oil tax revenue collection goals established for this year as well as next year. Consequently, the SENIAT has been forced to look for new sources of tax revenue. According to our estimates at **Ecoanalítica**, in what's left of the year, with the new financial transaction tax and raising the taxes on cigarettes and liquor, the Government can collect around VEB1.6 trillion: VEB1.1 trillion with the financial transaction tax, and VEB500 billion with the cigarette and liquor tax adjustment.

If the financial transaction tax were to be maintained in 2008, it could end up collecting around VEB4.2 trillion; which won't solve all of Vielma Mora's problems and keep President Chávez happy, but at least it will help.

## **The SENIAT under pressure**

On the other hand, in the 2008 Budget, in terms of the distribution of resources, the tax revenue collected by the SENIAT is earmarked to cover near 60% of the revenue to be distributed, while oil contributions are expected to be lower. Of course, we're referring to ordinary oil contribution here. Spending in 2008 is expected to be around VEB 137.5 trillion, while debt is being estimated at VEB 9.9 trillion. This means that ordinary spending will be at VEB 127.6 trillion and according to preliminary figures, tax revenue contributions, including refund certificates, will be at VEB 75.8 trillion, while ordinary oil contributions will surpass VEB 51 trillion.

## It will be more

The SENIAT has always used the strategy of underestimating tax revenues, which is why we think that non-oil tax revenues will be greater than VEB 76 trillion. In 2008, the SENIAT could be collecting around VEB 80 trillion, if the new tax changes are approved.

## 2nd problem: The oil nationalization affected the SENIAT

The other reason that the SENIAT has to introduce new taxes is because of the migration of operators and operation agreements of the Orinoco Oil Belt to the status of mixed companies. The income tax that these companies paid, most of them transnational, won't be going to the SENIAT anymore but directly to PDVSA. This change directly affects the income tax revenue collection goal that the SENIAT had. According to **Ecoanalítica** calculations, because of this, the SENIAT could expect to lose around US\$4.78 billion (VEB 2.2 trillion) in income tax revenue. But, as one can see, this won't affect the Administration's fiscal revenues, since what the SENIAT isn't collecting the oil industry is.

## To date, SENIAT tax revenue collection is dropping

During the first nine months of the year, the SENIAT has collected VEB 44.1 trillion in taxes, which represents a nominal increase of 16.4% but a 1.5% drop in real terms compared to the same period of the previous year. In accordance to what we have said before, the greatest drop concerns income tax, dropping 7.5% while VAT collection dropped 2.0%. Due to the boom in imports, custom's collection shows a real increase of 10.9%. According to our calculations, SENIAT tax revenue collection for 2007 is at around VEB 62 trillion.

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NATIONAL TAX COLLECTION (VEB Billions)		SEPTEMBER		
	2007	2006	Var %	Real Var %
<b>TOTAL</b>	<b>5.143</b>	<b>4.262</b>	20,7%	4,7%
<b>Income TAX</b>	<b>1.971</b>	<b>1.310</b>	50,5%	30,6%
<b>Tax</b>	<b>1.512</b>	<b>1.565</b>	-3,4%	-16,2%
<b>Customs</b>	<b>1.483</b>	<b>1.248</b>	18,8%	3,1%
<b>Others Incomes</b>	<b>176</b>	<b>139</b>	26,8%	10,0%
<b>Debit Tax</b>	<b>0</b>	<b>0</b>	0,0%	0,0%

  

NATIONAL TAX COLLECTION (VEB Billions)		JANUARY- SEPTEMBER		
	2007	2006	Var %	Real Var %
<b>TOTAL</b>	<b>44.097</b>	<b>37.885</b>	16,4%	-1,5%
<b>Income TAX</b>	<b>15.918</b>	<b>14.563</b>	9,3%	-7,5%
<b>Tax</b>	<b>13.958</b>	<b>12.049</b>	15,8%	-2,0%
<b>Customs</b>	<b>12.874</b>	<b>9.827</b>	31,0%	10,9%
<b>Others Incomes</b>	<b>1.347</b>	<b>1.122</b>	20,0%	1,6%
<b>Debit Tax</b>	<b>0</b>	<b>324</b>	0,0%	0,0%

Sources: SENIAT and Ecoanalitica

**For now, it's not about cash-flow problems**

As you can see, the new tax structure doesn't have to do with fiscal problems but with a voracious Administration that is always on the look out to increase revenue so as to not have problems when it comes time to spend. If the Government could count on a coordinated effort between PDVSA and the Ministry of Finance (SENIAT), it wouldn't have to be increasing taxes in the middle of an oil boom, like the current one, with oil prices over US\$60 per barrel. Besides, the idea of increasing taxes goes against the Government's aim to reduce inflation. A case in point being the financial transfer tax which we find excessive and will affect a company's operational costs which in turn will have a negative impact on inflation.

**Before a State with a voracious fiscal appetite, increasing the collection of non-oil tax revenues is not necessarily a positive thing**

On a number of occasions we have commented on the need to reduce the fiscal account's dependency on the ups-and-downs of the oil market. You achieve this by increasing non-oil tax revenue collection and/or by reducing spending. During the last four years, the Government has taken significant strides towards improving the collection of non-oil tax revenues. However, it has done so and at the same time also progressively increased spending, leaving the country in an even more vulnerable fiscal position. Within this context, where the Administration simply wants to straddle a larger and more inefficient State, meddling not only with the domestic economy, but also with other economies in the region, tax reform is clearly negative. Another constant factor that can be argued, given that money is

fungible, is related to how the increased tax revenue collected from taxes paid by Venezuelans is squandered through the purchasing of Argentinean bonds and bonds from other Latin American countries or the financing of different items in other countries of the region.

## Economic Tips

**2008 National Budget.** The 2008 National Budget Bill submitted by the National Budget Office (ONAPRE) to be approved by the National Assembly is for a total of VEB137.5 trillion. The Special Debt Law was submitted for VEB 9.9 trillion. Both laws will ultimately be appear expressed in *bolívares fuertes* (strong bolivar), in other words VEF137.50 billion and VEF 9.900 billion respectively. The ONAPRE also submitted the 2008 Yearly Operational Plan and the Multi-Annual Budget Framework.

**This year's spending is already at VEB139 trillion.** The Finance Commission of the National Assembly in almost 10 months has approved VEB24 trillion in supplementary appropriations, increasing allocation for this year by 21%. The original 2007 budget was for VEB115.2 trillion and with the appropriations it increased to VEB139.1 trillion, and this amount could well increase as there are other appropriations that have yet to be granted with regard to labor payments.

**No more bonds.** Minister of Finance, Rodrigo Cabeza, announced that there will be no more bond issues in 2007 in order to drain the existing liquidity from the Venezuelan economy. Cabeza answered with a clear "No" when asked if there would be another *Bono del Sur*. With regard to a possible issue of PDVSA bonds, he said that his office had yet to receive any instructions concerning such an event. The minister said that the commercialization of titles in the securities market is still being evaluated.

**What could come?** The Minister of Finance continues to evaluate the possibility of issuing short term notes in the stock market. In fact, there may be an announcement this week concerning this subject. With regard to the assets that would be offered, the Government has yet to define its position. Some want to continue with issuing structured notes, others wish to consider new very short term (3 to 6 months) issues, and a third group wish to issue TICC.

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**New PDVSA issue?** Concerning a PDVSA issue, the information that we have suggests that it won't be for this year. The PDVSA bonds will be held over for next year and the plan is that the issue will be for US\$15.00 billion. Furthermore, it's important to point out that the local financial market doesn't have the capability to absorb seen before. The current levels of excess liquidity are at US\$10.00 billion, and being that this is so, and that there are controls on interest rates with maximum ceiling levels set, introducing a big issue of debt to be paid in bolivars could have a negative effect on the system.

**CADIVI hits record levels.** From between January 1<sup>st</sup> to October 4<sup>th</sup> 2007, the Commission for the Administration of Foreign Currency (CADIVI) has authorized more than US\$30.00 billion, an amount that surpasses the total authorized during all of 2006, announced Manuel Barroso, president of CADIVI. According to Barroso, "the Commission's authorization of foreign currency has increased by around 64%." He pointed out that in September 2006, the daily average of foreign currency authorizations was at US\$132 million, while in September 2007 this average increased to a total of US\$173 million.

**Commerce leads.** At the close of the month of September, the food sector has been granted foreign currency for US\$1.78 billion, while health has been granted US\$1.60 billion. Meanwhile, the automobile sector has received US\$3.01 billion and commerce for US\$2.94 billion.

**Barter economy has started in Falcón state.** Starting on Sunday, October 14<sup>th</sup>, the José Leonardo Chirino community, located in the mountain region of Falcón state, will try out the economic system of bartering. The symbolic currency that they will use in order to facilitate the exchange of goods will be called the "Zambo."

**Shipment of *bolívares fuertes* (strong bolivars) arrived in Venezuela.** The shipment of *bolívares fuertes* (strong bolivars) arrived from Sri Lanka on October 12<sup>th</sup>. The containers were delivered to the capital city escorted by 10 blue Hummers and 30 motorized divisions of the DISIP. The new currency will have seven denominations of coins: a one, five, ten, twelve and a half, twenty five, and fifty cent piece. And the bills will be in the following denominations: two, five, ten, twenty, fifty, and one hundred strong bolivar. It's expected that the Central Bank of Venezuela (BCV) will announce the characteristics of the new bills and coins very soon.

**Colombia joins the *Banco del Sur*.** The President of Colombia, Álvaro Uribe, publicly requested that his country be allowed to join the *Banco del Sur*, without this meaning that it was rejecting the World Bank, the Inter-American Development Bank, or the International Monetary Fund, according to statements made by the Head of State.

Uribe continued to say that his country has been treated well by these financial institutions, but that his country must also show loyalty to Latin American integration.

**SENIAT investigates.** The Superintendent's Office of Banks sent a notification around to the financial institutions which requires them to "respond directly to the superintendent's office of the SENIAT" in a period of time no greater than five working days, "a list of natural persons that had an average of monthly movements in their bank accounts of VEB400 million during 2006." The information must include: name, I.D. number, address, account type and number, and monthly amounts managed. The tax superintendent, José Vielma Mora, announced in a press release that "the purpose of the measure was to verify the 2006 income tax statements of high-income natural persons."

## OIL TIPS

**Slight increase.** The price of a barrel of Venezuelan oil increased slightly going from US\$73.16 to US\$73.19 this week, an increase of just US\$0.3 cents. So far, the Venezuelan basket's average price for the month of October of US\$73.18 is slightly under the close of the previous month. The yearly average price for 2007 is currently at US\$60.25 per barrel.

**PDVSA and its subsidiaries in the hands of the State.** With the reform of article 303 of the Constitution, according to the information released up until now by the National Assembly, the State will not only keep the totality of Petróleos de Venezuela's shares, but also the shares of all its subsidiaries which currently represent more than 190 companies based domestically and abroad.

**Production drops.** According to oil market monthly report figures published by OPEC, Venezuelan oil production showed a slight decline of almost 30,000 b/d, going from 2.38 million b/d in the month of August, to 2.35 million b/d in September. The report also mentions that during the month of September, a total of 73 wells were registered as active in contrast to the 78 wells registered active in August.

**The domestic market is a headache for PDVSA.** According to a study about international markets and the oil sector performance done by economist Ramón Espinasa, domestic crude consumption increased to 780,000 b/d at the close of the third quarter 2007. This figure is 56% over the 500,000 b/d consumed five years ago.

**PDVSA continues to diversify.** By mandate of the Ministry of Energy and Petroleum and in the interest of improving the quality of the electric service, the Planta Centro thermoelectric generating plant, located in Carabobo state, will be operated by PDVSA, which “must invest and carry out a development plan” with regard to this facility, in accordance with what was published in the *Gaceta Oficial* number 38.785.

**Law concerning migration to mixed company published in the *Gaceta*.** The National Assembly published the law concerning the Effects and Process of Migrating to a Mixed Company from the Association Agreements of the Orinoco Oil Belt and the Shared Risk and Profits Agreements in the *Gaceta Oficial* 38.785 dated October 8. This regulation, of just six articles, declares null and void all oil business agreements that were still in effect and orders to transfer to the mixed companies with State majority shareholdings the interests, shares, and the participation in those businesses that the private companies which didn't reach an agreement with the State had.

**Lukoil oil company considering to build plant in Venezuela.** In an interview with the newspaper Vedomosti, Leonid Fedun, vice-president of Lukoil, stated that the company is still considering building a crude oil refinery plant in Venezuela. He also stated that the company is planning to acquire a refinery on the west coast of the United States.

**Exxon optimistic.** Even though the North American oil giant ExxonMobil introduced an appeal for arbitration before the International Centre for Settlement of Investment Disputes (ICSID) to settle the suit it has with the Venezuelan Government, it continues to search for a negotiated solution considering that this could resolve the matter much quicker, said ExxonMobil president, Rex Tillerson.

## BUSINESS SECTOR TIPS

**Antonio Ricaurte gas pipeline inaugurated.** The presidents of Ecuador and Colombia asked Venezuelan President, Hugo Chávez, to return to the Andean Community of Nations. This took place during the inauguration of the Antonio Ricaurte gas pipeline between Colombia and Venezuela. The President of Ecuador, Rafael Correa, made the petition public before the Venezuelan leader and said that if this entity didn't work in a year's time, then they would all leave the Community. This first stretch of the Antonio Ricaurte gas pipeline has historic importance, not only because

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it is Pdvsa Gas' first work outside the national boundaries, but also because it marks the beginning of a project that will reach all the way to Panama. The gas pipeline between Colombia and Venezuela stretches 222.2 km (138 miles) and its construction has required an investment of US\$325 million.

**Venezuela-Cuba.** The presidents of Cuba and Venezuela signed 14 cooperation agreements regarding energy and food. The agreements include the installation of a petrochemical plant in Cuba to produce resins and fertilizers and a subsea fiber optic cable that will run from La Guaira to Siboney.

**CANTV increases reserves.** The president of CANTV, Socorro Hernández, announced that to the VEB833.00 billion that had been deposited in the reserve fund by the last board of directors, the current board is adding VEB300.00 billion more. These resources will serve to meet the responsibility that the company has with 10,093 retired, pensioned, survivors, and inheritors of former company employees. 8,000 are retired and pensioned, more than 1,000 are surviving family members of employees, and the rest are for deceased members that have benefits that will be inherited.

**Communal Councils in charge of *rancho* replacement.** The plan to replace *ranchos* (shanty, slum housing), previously headed by the *Vuelvan Caras* Mission will now be carried out by the Communal Councils, according to information coming from the Ministry of Housing.

**More trucks supplying Lara, Portuguesa, and Barinas state.** Last week, the number of trucks that supply Lara, Portuguesa, and Barinas state increased by almost 100% going from 130 trucks that normally supply this region daily to 250.

**Computers at risk.** The computer technology sector was under attack last week by spyware programs and generalized disinformation. 70% of personal computer users maintain their antivirus programs up-to-date, and 33.8% that had antivirus protection were infected.

**Wheat shortage affects the production of derived goods.** The drop in wheat production of some of the exporting countries due to drought or flooding, redirected the demand to the United States, which have pressured international cereal prices. The pasta industry only has enough raw materials to cover 50% of the demand.

**Agriculture industry pays the consequences.** Due to the extreme delays being experienced at the Puerto Cabello docks during the past few months, companies from the balanced food for animal sector paid US\$14 million in additional shipping charges

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because ships bringing in raw materials had to remain anchored in port for more than a month.

**More shortages.** The pasteurized juice industry is also feeling the shortages, specifically with regard to oranges to satisfy the demand for concentrated juices.

**Mercal too.** Due to the budget deficits faced by the MERCAL network, they too have begun to have shortage problems in some of their stores with products like rice, milk, sugar, vegetable oil, and pasta.

**Border toll conflict between Venezuela and Colombia is over.** The Foreign Minister of Colombia, Fernando Araujo, announced that the conflict that has kept an important border road to Venezuela closed for the last two weeks was solved last week. The toll booths which caused all the road to be blocked and violence protests were moved to another area. However, Venezuelan members of the Committee announced that the road continues to be blocked and that they are waiting for the Colombian Government to deliver an official document that in fact confirms that the toll booths have been moved in order to end the conflict.

**Banesco increase its presence abroad.** *Banesco Banco Univesal*, that has had a presence in Panama for 15 years, announced the opening of seven new offices in said country.

**Consumption at full throttle.** According to the Central Bank of Venezuela (BCV) figures, the volume of wholesale and retail sales increased by 35%, between July 2006 and July 2007. The items that increased the most during that period were domestic articles and appliances, (111.63%), textile products (91.97%), and vehicles (62.12%).

**Leaders in Panama.** Venezuela has consolidated itself as the main re-export market for merchandise from Colon's Free Zone, while the restrictions to Colombia remain in place. Free Trade Zone sales to Venezuela in the first semester reached US\$806 million, which represented 20.9% of their total re-exports which for that period reached US\$3.85 billion.

### Political Tips

**A severe reform.** The Mixed Commission of the National Assembly approved the 33 articles of the constitutional reform proposal presented by President Hugo Chávez and

incorporated another 25 resulting from a public inquiry, of which the most polemic one for the day was article 337 which eliminates the right to information and due process in the event a state of emergency were declared. Carlos Escarrá (AN), José Albornoz (PPT), Juan José Molina, and Arcadio Montiel (Podemos) were the representatives which abstained with regard to eliminating the guarantees provided for in the Constitution.

**The campaign started.** The Zamora campaign command will be introduced with the appointment of a central committee made-up by Jorge Rodríguez, as a possible chairperson; Diosdado Cabello, in charge of mobilization and organization; Darío Vivas will plan the street events; Carlos Escarrá will be in charge of coordinating political movements; Gabriela Ramírez will be in the electoral commission; Willian Lara, Andrés Izarra, and Helena Salcedo will coordinate the media; Liís Reyes Reyes will organize the states; and Francisco Ameliach will lead the Carabobo command. So confirmed sources from within the organization, who said that everything was set and ready for the launch of the campaign. They also said that the slogan will be "*Ahora Sí*" (Now Yes).

**Venezuela and Cuba, one single Government.** In a telephone conversation between President Chávez and his Cuban counterpart during the last *Alo Presidente* broadcast, Chávez highlighted the work his Government is doing along with the Island Administration, saying later that: "We're one single Government."

**Freedom of the press is at risk in Latin America.** The Inter-American Press Association stated that freedom of the press in Latin America is at risk due to the supposed influence of the Venezuelan Government that is trying to export a model that is "similar to the Cuban dictatorship."

**CNE confirmed that there are 5 candidates recalled.** The final results of the recall referendums held on Sunday, October 7 were announced last night by the president of the National Electoral Council (CNE), Tibisay Lucena. The mayors of the Atures municipality (Amazonas), Mireya Labrador, and of the San José de Guaribe municipality (Guárico), Manuel Parao, backed by the MVR, and their colleges Luis Linares from Anzoátegui (Cojedes) municipality; Pedro Morillo from Sucre (Falcón) municipality, backed by AD and Copei, as well as the legislator from the *circunscripción 1* of Amazonas, Lidia Pulgar, were all recalled.

**Not voting leads to dictatorship.** Rodrigo Cortez, sub-secretary of Foreign Relations for the National Action Party (PAN), and a representative of the Mexican Congress pointed out during his speech at the *Primero Justicia* Conference that "not participating in an election awards a certain legality to dictatorial governments...".

**Against the shortages.** The director of Datanálisis, Luis Vicente León, stated that in the latest surveys carried out by his company, 69.3% of the population considers that it is necessary that the Government and the private sector reach an agreement to deal with the shortages problem, while more than 60% of the population considers that the Government should adjust the prices of a number of regulated products in order to guarantee their supply. The survey reflects that the most critical product lacking is milk which reflects a 70% shortage.

## Other Tips

**It doesn't look good for US business.** Studies done by Reuters show that the number of U.S. business executives that consider that the economy of the country and of the world will weaken in the next six months is greater than those who don't. A joint study made by the Business Council and The Conference Board institute found that 44.3% of a total of 61 CEO's predicted that economic conditions in their own industry will get worse in the next six months, while 16.4% expect it to get better. 39% believe conditions will stay the same.

**Ecuador in OPEC again.** Ecuador will once again be a member of OPEC as of November and it will ask Venezuela to assist in its renegotiation of contracts with foreign oil companies which extraordinary profits were cut from 50% to 1%, announced Ecuadorian President, Rafael Correa. Ecuador was a member of OPEC for 19 years and stepped down in 1992 due to a failure to comply with a quota system. It left a debt of US\$5.2 million. Ecuador is the fifth largest Latin American oil producer, extracting around 506,000 b/d of which 49% is extracted by foreign companies.

## ECONOMIC OVERVIEW

