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***WHAT ECONOMIC MODEL IS  
HIDDEN BEHIND THE  
CONSTITUTIONAL REFORM?***

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The country is currently debating between approving or not the new Constitution, which entails a radical change regarding its predecessor. In this report, with the help of Victorino Márquez<sup>1</sup>, we analyze the economic changes contained in the constitutional reform project that will be voted soon in a referendum.

**The current Constitution leaves a certain action margin for economic activity**

1999 Constitution, which is still in force, doesn't rigidly define the socioeconomic regime. It sets forth general principles of social justice, efficiency, free competition and initiative, productivity and solidarity without any ideological dogmatism concerning the roles of market and state. It also avoided an extreme and exclusive view of the socioeconomic system. In other words, 1999 Constitution (C99) lays the foundations for an economy based on the respect for individual action. This economic model, even though it grants a certain pre-eminence to the state, also allows for the development of the market.

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## **C99 is flexible concerning the economic regime**

C99 provides for the development of a mixed economy up to a social market economy. It also foresees different degrees of State involvement in the economic activity, prohibiting only extreme models (economic liberalism and Socialism or Communism). Therefore, its most outstanding feature concerning this point is its amplitude which is the reason why it is fit for governments with different ideological currents.

## **How has the economy operated within the framework of the current Constitution?**

Since the C99 approval, the Venezuelan economy has gone through different stages, with their most outstanding features being the following:

1. Price control and freezing of a wide range of products and services, particularly since 2003, after the end of the so-called "oil-strike."
2. "Arranged" purchases of companies, in some cases preceded by regulatory suffocation. Furthermore, the government has supported the emergence of new modalities of production and property, such as cooperatives, social production companies, and the Socialist nuclei.
3. The expansion of the public business sector that competes with the private sector (co-initiatives).
4. Nationalization of companies that ceased to operate (state-cooperatives partnerships; co-management), upon declaring them of public interest.
5. Migration to the mixed company status (with the State as the majority stockholder) of oil service agreement and strategic associations. This process has been replicated in the electric power and telecommunication (CANTV) sectors and mining.
6. Eradication of large extension of lands tenure through the administrative reclamation of waste lands.
7. Labor firing prohibition.
8. Exchange control, interest rate ceilings, and the establishment of loan quotas.

## **The constitutional reform proposal strongly restricts the private sector action margin**

According to the rationale of the current constitutional reform, the new Constitution that is about to be approved must include elements that consolidate the rupture with the “bourgeois capitalist” model. Therefore, it has to “dismantle the super-structure that underpins capitalist reproduction both at the constitutional and legal level as well as at the ethical level.”

In contrast, the President Chávez’s project is aimed at laying the bases for a new production model that allows the People’s Power to control production and distribution of goods and services. Thus, what is being proposed is the “construction of Venezuelan Socialism as the only way towards the redemption of our people.” Furthermore, the text of this new Constitution allows us to infer that it will not be permanent, but that it represents only a transition stage, in which a socio-productive model based on a mixed economy will be established where property of strategic means of production will be in the hands of the State and social economy companies will play a preponderant role within the national economy.

The current reform proposal recognizes private property “provided it is not intended to exploit and impoverish other citizens” and it evolves within the framework of a new honest business culture purely devoted to working with the state and workers. Moreover, recognizing private property doesn’t imply that the State will promote it, because there will be other property modalities, the ones that will be supported by the State with a view to constructing the so-called new Socialist model.

## **The new model is based on an all-mighty State**

The Constitution reform project comprises 5 aspects which are worrying from the economic viewpoint:

1. The suppression of economic freedoms and the promotion of the “intermediate” productive model.
2. The pre-eminence of State property and the marginal character of private property.
3. Centralized planning of the economy.
4. Elimination of BCV’s autonomy.
5. The creation of new social security funds plus the establishment of new bureaucratic instances that will increase fiscal management rigidity for the coming years.

## The State will have the last word

Putting the constitutional reform project aside, the model proposed by President Chávez at this stage of his government is trying to mark the transition towards a centralized planning model, starting with the design of the central map of the economic structure, both public and private, in order to plan and control the construction of the “Venezuelan Socialist model.”

This way, the State, inefficiently in our opinion, will articulate and coordinate the domestic production exchange and distribution mechanisms, based on the needs of the people and the real production costs per branch, sector and productive unit, in order to fix fair prices. This is nothing more than intensifying control mechanisms that have resulted in shortages and additional pressures on prices and have clearly proven to be unsuccessful.

## What has been being implemented in practice is now provided for on paper

Concerning the BCV issue, it has to be pointed out that the elimination of its autonomy is a fact that has been occurring for some time now. According to the reform, the BCV is a subject of public law *without autonomy* for the formulation and implementation of the corresponding policies. Its functions will depend on the overall economic policies and the National Development Plan, in order to attain the *higher objectives of the Socialist State*. Concerning international reserves, these will be managed by the BCV, *under the administration and direction of the President of the Republic*. The President himself will establish the amount of surplus reserves that will be earmarked for the missions and investment funds of the National Executive (i.e. FONDEN).

## The new Constitution is rigid

At *Ecoanalítica* we are convinced that the constitutional reform proposal defines a rigid socioeconomic organization model: “Venezuelan Socialism is the only path for the redemption of our people.” This project establishes a socioeconomic transition model (mixed economy) that will eventually give way to a fully Socialist economy.

This reform basically creates a new socioeconomic order different from that of the mixed economy, which has been developing between 1999 and 2007. In this new order, social property and economy are the rule and private property and initiative are the exception. In addition, since a transition stage is being defined, it could be expected that once it is concluded, another constitutional text will be written with the definite characteristics of the 21<sup>st</sup> Century Socialism.

## **Weekly Report**

### **There's still much in the making**

However, the new economic model will not be completed with the reform. Laws passed within the framework of the Special Powers Law (in force until August 2008) will be shaping and solidifying the new model. It could be expected that laws susceptible to change would include: Law on Expropriation, Social Economy Law, Mercantile Code, Law against Unfair Competition and Antitrust, Labor Organic Law, Public Service Law, and Law for the Financial Institutions, among others.

### **The challenge is fostering private investment**

While at *Ecoanalítica* we are certain that the government will not abolish private property or establish a Communist regime in the short run, we also believe that the constitutional reform will create problems for the private sector and will be a fundamental factor hindering private investment. As it has been happening over the last years, the lack of private investment will be compensated for by public investment through a clearly expansive fiscal policy and an increase in imports. In our opinion, the government's priority for 2008 should be creating confidence so that investment of new capitals can be reactivated with the establishment of new industries in the country; otherwise, this model has its days counted since it isn't viable in the long term.

## **Economic Tips**

**FM announces measures to curb parallel exchange rate increase.** The minister of finance, Rodrigo Cabeza, announced new debt issues, both domestic and foreign. In the Minister's opinion, these issues are aimed at reducing liquidity and raising funds for refinancing domestic and foreign debt service. However, at *Econanalítica* we consider that the true cause is to alleviate pressures on parallel exchange rate which is close to VEB7,000:\$. Based on the information gathered, this program will be implemented in three different ways and in two stages (last two months 2007 and first quarter 2008):

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- A primary placement of Venezuelan domestic debt titles through weekly auctions for around VEB500.00 billion during both stages on the Caracas Stock Exchange.
- A primary placement of international Venezuelan titles (this is another edition of the famous bolivar-USdollar bonds) which will be carried out in two processes: the first one for a nominal base amount of US\$750 million in long-term titles combined with medium-term local bonds; and a second one for an estimated nominal base amount of US\$600 million of short-term international titles combined with medium-term local bonds. The announcement of the “Venezolano I” is included in this mechanism
- For the third week of November a placement of around US\$1.20 billion in short-term titles has been announced to be placed through weekly issues of between US\$100 billion and US\$ 150 billion in US-dollar titles combined with an equal value amount of local bonds.

**Limited effect.** Cabeza pointed out that these placements will be used to cover domestic and foreign debt repayment and they will generate resources to lower the Republic's foreign liabilities. In *Ecoanalítica's* opinion, these measures, especially the third one, are going in the right direction. However, given the private sector's level of expectations and the exchange market's significant differential, these measures don't seem to be enough and therefore they will have a limited impact.

**Another bond.** The government fixed at 114% the minimum price for the combined bond offer of US\$1.5 billion that will be placed this week. Of the global issue, known as “El Venezolano I,” US\$750 million correspond to a Eurobond maturing in 2038 and the other half, denominated in bolivars, is made up 50-50% by Vebonos maturing in 2014 and 2015. Investors have to place their purchase offers stating their preferred price, which has to be higher or equal to the minimum acceptance price of purchase orders of 114%.

**New debt management.** Public credit director, Luis Dávila, pointed out that the FM will be authorized to carry out borrowing operations in 2008 up to a maximum amount of VEB18.6 trillion. This total is earmarked to attain different objectives. The first one includes transactions for VEB7.5 trillion that will serve to raise funds and pay principal and interests of debt maturing the next year. It also calls for refinancing and restructuring operations of the existing debt up to VEB8.7 trillion. Finally, the Public Credit Direction is considering disbursements and contracting new investment projects, mainly through bilateral and multilateral entities, of the order of VEB2.4 trillion.

**Foreign debt to increase.** The public credit director states that foreign debt will close at US\$27.04 billion and domestic debt at VEB35 trillion in 2007. Next year projections indicate that domestic debt will remain unchanged, whereas foreign debt will increase up to US\$29.75 billion. Luis Dávila maintains that foreign debt will increase mainly due to scheduled disbursements earmarked “for infrastructure and development projects that are currently being executed.” At the end of this year, the country’s total debt will account for 21.3% of GDP and based on estimates it will go down to 19.6% of GDP in 2008.

**Higher spending in August.** According to the BCV, spending was at VEB8.9 trillion in August, up 43% compared to the same month last year. Fiscal revenue increased just 16%. Furthermore, when fiscal management for the first eight months of 2007 is analyzed, it can be observed that the spending contracting trend is maintained because it decreased by 5% in real terms with respect to the same period last year. Fiscal revenues also fell 5%, especially in the wake of the 16% drop in oil prices. So far this year, central government posts a deficit of just VEB170.00 billion and has financing requirements of VEB8.4 trillion, of which 77% were covered with Treasury funds.

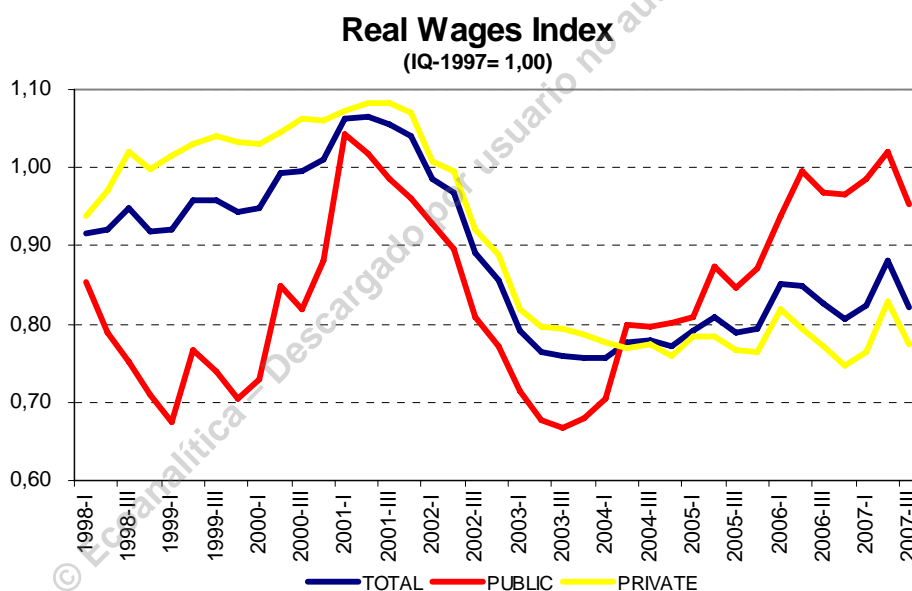
FISCAL BALANCE CENTRAL GOVERNMENT (VEB Billions)	August 2007	August 2006	Nominal Variation	January- August 2007	January- August 2006	Nominal Variation	Real Variation
Total Revenue	10.948	9.447	16%	76.108	67.767	12%	-5%
Non-Oil Revenue	4.661	3.791	23%	39.625	30.447	30%	10%
Oil Revenue	6.287	5.656	11%	36.411	36.697	-1%	-16%
Central Bank Earnings	0	0	-	71	624	-89%	-90%
Total Expenditure	8.856	6.175	43%	76.278	67.631	13%	-5%
Primary Expenditure	8.221	5.596	47%	71.218	62.149	15%	-3%
Interest Payments	635	579	10%	5.060	5.481	-8%	-22%
Domestic Debt	244	228	7%	2.106	2.144	-2%	-17%
Foreign Debt	391	350	12%	2.954	3.338	-11%	-25%
Fiscal Balance	2.092	3.272		-170	136	-225%	
Primary Balance	2.727	3.851		4.890	5.618	-13%	
Non Oil Balance	-4.195	-2.384		-36.653	-37.184	-1%	
Debt Amortization	0	44		8.264	5.439	52%	
Net Monetary Injection	3.366	893	277%	39.901	38.098	5%	-12%
Financing Requirements	-2.092	-3.228		8.434	5.303	59%	
Foreign Debt	10	66		32	226	-86%	
Domestic Debt	437	1.184		2.062	1.188	74%	
Treasury Bonds	437	1.184		2.062	1.184	74%	
Treasury Debt	0	0		0	4	-100%	
Others	-2.540	-4.478		6.340	3.888	63%	

Sources: BCV and Ecoanalítica

**Food basket price exceeds one million bolivars.** The CENDA monthly report stated that food basket for the month of October 2007 was at VEB1,006,134, representing

an increase of VEB36,659 (3.8%) compared to September. It is explained that the most significant price increases were observed in cooking oil (8.4%); milk, cheese and eggs (6.8%); fruits and vegetables (6.8%) and fish (5.3%).

**Deteriorating real salaries.** The relative price estimated between the Salary Index and the Consumer Price Index (IPC) shows a 1.6 percentage point drop, going from 97.8% to 96.2% at the close of the third quarter, according to data provided by the Central Bank of Venezuela (BCV). This means that workers' wages and salaries are enough to pay for a number increasingly lower of products and services of the basic basket based on which the BCV measures inflation.



**SENIAT is considering to modify ITF.** The National Tax Superintendent, José Vielma Mora, announced that SENIAT is considering the possibility of charging the tax on financial transactions to those operations that are currently exempted, at a lower rate than 1.5%. "1.5% rate is serious; it brings about problems for the banks due to certain transactions; then we are considering the possibility of levying a 0.2% or 0.1% tax instead of 1.5% for some operations. The idea is for banks not to lose and for us to collect taxes without creating a financial or economic crisis," adds Vielma Mora.

**ITF translates to an increase in costs.** The Tax on Financial Transactions (ITF), in force since last thursday, would imply "an increase in final costs of the productive

chain close to 8%,” according to estimates provided by CONINDUSTRIA in its forum Macroeconomic Outlook for 2008.”

**New labor scheme will affect businesses.** Nelson Maldonado, chairperson of the National Commerce and Service Council (CONSECOMERCIO) warned that if the retroactive character of social benefits is concreted, the impact on workers will be atrocious because the costs it implies are huge.

**Christmas bonuses published in the *Gaceta Oficial*.** The Presidential Decree ordering the payment of 90-day Christmas bonuses for the centralized public administration workers was published in the *Gaceta Oficial* No. 38,800.

## OIL TIPS

**A new record.** The “unexpected drain of the U.S. commercial oil stocks” provoked a new escalation in oil prices this week, reaching the Venezuelan oil and by-product basket and average price of US\$83.53 bbl, up US\$4.98 (6.3%) from the average corresponding to last fiscal year. The basket closed in October at an average of US\$76.52, thereby reaching the average for 2007 US\$61.07 bbl.

**PDVSA fulfils its commitments.** PDVSA is planning to transfer US\$39.92 billion this year to the Administration, according to the Minister of Energy and Petroleum and president of PDVSA, Rafael Ramírez. It is expected that US\$6.7 billion of this amount will be deposited in the FONDEN coffers, whereas US\$9.67 billion will be transferred as Income Tax and US\$16.7 billion as royalties.

**No OPEC meeting.** Despite de behavior of prices, PDVSA’s president, Rafael Ramírez, ruled out the possibility that an emergency ministerial meeting would take place on the sidelines of the 3<sup>rd</sup> OPEC Heads of State and Government Summit scheduled for November 17-18 in Saudi Arabia.

**Petroanzoátegui and La Ceiba no longer exist.** Since no one of the private partners to the Petroanzoátegui (former Petrozuata) strategic association and the risk and profit sharing agreement La Ceiba came to an agreement to complete their transformation

into mixed company, these two businesses cease to exist, upon being directly absorbed by PDVSA.

**Petrobras out of the Mariscal Sucre Project.** The Brazilian state-run oil company, Petrobras, decided not to participate in the off-shore natural gas project, Mariscal Sucre, which exploitation could represent the origin of the gas which would be transported through the Southern Gas Pipeline.

## BUSINESS SECTOR TIPS

**Conflictive Venezuela.** The business sector in Latin America is facing serious problems with Venezuela, because this country is permanently reported before the International Labor Organization, pointed out the Secretary General of the Ibero-American Business Organizations (OIE), Antonio Peñalosa.

**Demand in the manufacturing sector to exceed supply in 2008.** After analyzing the 2008 economic outlook, representatives of the national manufacturing sector assured that this sector "won't be able to overcome the gap between supply and demand for goods." Based on figures corresponding to the non-oil industry, the differential between placement and acquisition of products on the domestic markets is currently over 30%, said Ricardo Baquero, deputy president of the Venezuelan Industrial Confederation (Conindustria).

**Important LOT changes.** The Labor Organic Law (LOT) will be changed within the framework of the constitutional reform proposal, not only to include retroactivity of severance payments and the cutback of workday, but it will be fully reviewed. This review will also include the issues of penalties for employers that disrespect their workers' labor rights.

**Liquor stores report a 30% drop in sales.** After the enactment of the Decree-Law on the Partial Reform of the Tax on Alcohol and Alcoholic Beverages Law three weeks ago, liquor stores have been reporting a 30% drop in sales due to the increase in prices of national and imported liquors, because the decree provides for a 15% tax for beer and wine on the product final sale price, whereas taxes for the other alcoholic beverages range between 10% and 20%.

## Weekly Report

**Significant shortage levels.** The Executive Director of the National Association of Supermarkets and Related Businesses (ANSA), Luis Rodríguez, pointed out that food supply in these businesses is at 75% and 80%, on average. He also explained that product turnover, mainly those that are scarce, such as milk, cooking oil, sugar, and black beans, is higher because these products disappear before of the supermarket shelves. According to the ANSA Executive Director, products like cheese, chicken, and eggs are those with supply critical levels.

**Mercal limited.** The president of Mercados de Alimentos (Mercal), Félix Osorio, reported that there are no shortages in the state-run Mercal network, and assured that the *Alimentación* Mission is in compliance with the commercialization plan in these businesses. Osorio explained that the Mercal network has a limit, because it can only commercialize 130,000 tons of foodstuff per month, distributed throughout 115,000 outlets all over the country, and cannot sell more because they depend on the purchase schedule of the *Corporación de Abastecimientos y Servicios Agrícolas* (CASA).

**Mercal increases cooking oil price.** The price of one liter of cooking oil sold at Mercal was increased by 18%, due to the increase of raw material prices. With this increase, however, the price is still 62% below the prices charged by private businesses.

**A steep drop is expected.** The new automobile policy was already published in the *Gaceta Oficial*. Sources of the automobile industry stated that the measure was "less serious" than expected, because the number of vehicles to be imported is not subject to a pre-established equation. Some experts of this sector pointed out that next year the market conditions will be stated clearly. This market has an artificial demand resulting from high consumption and it will possibly come back to some 250,000 units, a figure that reflects its natural size.

**MIBAM to install auto part plant.** The Ministry of Basic Industries and Mining (MIBAM) is currently analyzing all the details concerning the installation of a plant for the manufacture of parts and spare parts for the automobile sector, which will be processing Venezuelan inputs and will use its production to meet local demand.

**High consumption of medicines.** According to Datanálisis figures, Venezuela is the first country in terms of consuming medicine in Latin America. According to figures analyzed by this firm, average consumption in the region ranges between eight and ten boxes of medicine per year, per capita, whereas for Venezuela it is estimated at 18 units.

**New cars to be fueled with gas.** Article 10 of the joint resolution of the Ministries of Finance, Light Industries and Commerce, and Energy and Petroleum, published in the

*Gaceta Oficial* No. 38,800, dated on October 31, and which is the first one of a series of provisions that will set the conditions under which the Vehicle Natural Gas Program will be developed, establishes as follows: "Imported passenger, load and public transportation vehicles and those domestically assembled starting from January 1, 2008, will have to be fitted with devices to indistinctively run on natural gas for vehicles (GNV) and liquid fuel before their being sold to the public."

**CAN is discussing Venezuela's return.** Presidents of the Andean Community will meet this week in Santiago to analyze the possible return of Venezuela to the integration process it abandoned early last year, announced the Bolivian minister of foreign affairs, David Choquehuanca. The encounter will take place as an activity on the sidelines of the Ibero-American Summit.

**Mercantil changes image.** Mercantil Servicios Financieros, a corporation that includes Banco Mercantil, Commercebank, Merinvest, Seguros Mercantil and subsidiaries abroad, will invest US\$10 million in its change of image which, as explained its CEO, Gustavo Marturet, will take six months to be completed. Mercantil Servicios Financieros CEO expressed that the logotype, now refreshed, will be used by all companies belonging to the corporation, including those located in Panama, Switzerland, Cayman Islands, and other places worldwide.

## Political Tips

**Campaing for the referendum.** According to the National Electoral Council (CNE), the constitutional referendum campaign that began on November 4 will be in force until midnight November 30<sup>th</sup>.

**Chávez threatens.** President Chávez warned those "*desesperaditos*" (desperate ones), as he called those that he describes as being "false students, wealthy, some residents of the eastern part of Caracas, Cardinal Jorge Urosa Savino, and those who are calling upon the citizens not to vote," that he will not allow them to burn down Venezuela. Therefore he gave precise orders to his officials to consider, among other things, whether new student demonstrations are authorized or not, as well as possible penalties for TV stations that in his opinion have been calling upon the people to stage a coup d'etat.

## ***Weekly Report***

**Baduel surprises.** The former Minister of Defense, Raúl Isaías Baduel, condemned the constitutional reform project because it doesn't empower the people, but, on the contrary, it strips people of power. He called upon the people to vote NO because this project is regressive.

**Podemos on the opposition side.** Podemos will officially be an opposition party when it formalizes its registration as one of the NO block voters. It will then join the ranks of parties like Copei, La Causa R, Primero Justicia, Un Nuevo Tiempo, MAS, AD, and Democracia Renovadora; registered as YES block voters are Movimiento de Conciencia de País, Movimiento Liberal and PCV.

**Less support.** Oscar Schemel, director of Hinterlaces pollster, reported that according to recent studies carried out by this firm, the approval of the constitutional reform has dropped from October up until now. The reform support dropped from 43% to 31% in terms of vote intention.

**Approval of 15 laws will be required within the framework of the reform project.** One of the interim provisions of the constitutional reform project establishes that the National Assembly will have to enact 15 laws related to the reform core issues. These laws include the Law for the Promotion of the Socialist Economy, the Central Bank Law, the Crime Code, the Municipal Power Law, the Hydrocarbons and the Education Laws, and the Labor Organic Law.

### ***Other Tips***

**FED cuts back rates.** The U.S. Federal Reserve (FED) cut back interest rates by one fourth percentage point this Wednesday, to 4.5%, in line with the expectations of the analysts. The decision comes after a reduction of half percentage point last September 18<sup>th</sup> and coincides with the disclosure today of the Gross Domestic Product (GDP) figures, which reflect that GDP increased by 3.9% in the third quarter; more than expected.

## ECONOMIC OVERVIEW

