



# Inter-American Dialogue

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### Featured Q&A With Our Board of Advisors

**Q** The Venezuelan government is stoking concerns about its fiscal and economic outlook due to its investment of windfall revenues from high global oil prices in social programs rather than in maintaining production capacity at state-owned oil company Petroleos de Venezuela (PDVSA). What is your forecast for Venezuela when global oil prices, as expected, fall back down to earth?

**A** **Guest Comment: Jose Cerritelli:** "With oil prices above \$41 per barrel and the real possibility that oil prices might not fall much below \$30 per barrel—even in a medium-term scenario of significant lower oil prices relative to where they are today—and with Venezuela's foreign exchange reserves at near all-time record high levels (\$23.5 billion as of Friday), it is at a minimum premature to worry about potential cash flow tightness at the Venezuelan treasury, at least for the next twelve months if not longer. Even if oil prices collapsed tomorrow, which is probably unrealistic, and even if Venezuela completely depleted its foreign exchange reserves, which would take at least many months to do, the government has several instruments to keep its finances under control. And while it may be politically unpopular, raising gasoline prices from below 20 cents per gallon to something like 60 cents (which would still be very inexpensive by international standards) could generate the necessary

resources to keep the Venezuela treasury in the black, especially if this is done in combination with an adjustment in the bolivar exchange rate."

**A** **Guest Comment: Richard Francis:** "The Venezuelan government has significantly boosted social spending over the past few months, which is likely to lead to a fiscal deficit approaching 5 percent of GDP in 2004 despite the significant windfall of oil revenues due to high oil prices. In contrast, many resource rich countries such as Chile, Russia, and Kazakhstan have seen marked

*Continued on page 4*

### PHOTO OF THE DAY



During a meeting at the White House yesterday with Chilean President Ricardo Lagos, left, US President George W. Bush urged Venezuela to hold an "honest and open" referendum. See related story on page 2.

*Photo: White House.*

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## NEWS BRIEFS

**Lula Signs Law Authorizing Shootdown of Drug Planes**

Brazilian President Luiz Inacio Lula da Silva on Monday signed into law a measure allowing Brazilian fighter jets to shoot down planes suspected of smuggling drugs over the Amazon jungle. According to the law, which will go into effect in 90 days, suspect aircraft would be "considered hostile and subject to destruction" if they refuse to identify themselves, do not land, and fail to respond to warning shots. Planes would only be shot down in areas where there are no population centers and where there are "routes presumably used by drug traffickers." The United States has warned that it could limit antidrug cooperation with Brazil if it deems there are not sufficient precautions by Brazil to satisfy US law.

Source: Reuters.

**Japanese Firms to Borrow \$200 M to Finance Mexican Power Plant**

Japanese trading house **Mitsubishi Corp.** on Monday said it and **Kyushu Electric Power Co.** will borrow \$200 million from the Japan Bank for International Cooperation and three commercial banks to finance the Tuxpan power plant in Mexico. The 500 megawatt plant, which will provide electricity mainly to Mexico City, is expected to start operations in September 2006. The total cost of the project is \$300 million.

Source: Mitsubishi company statement.

**Argentine Industry Grows in June**

Argentina's industrial production increased a seasonally adjusted 11.5 percent in June compared to the same month of 2003. Output in June rose 0.8 percent from the previous month.

Source: INDEC.

## Political News

**Bush Urges "Honest and Open" Referendum in Venezuela**

US President George W. Bush said Monday that Venezuela's August 15 recall referendum on the presidency of Hugo Chavez "must be must be conducted in a honest and open way." Speaking to reporters after meeting with Chilean President Ricardo Lagos at the White House, Bush praised Lagos for making "it clear that for the credibility of the current government, they must welcome observers, they must encourage observers, and they must not interfere with the process, so that the people of Venezuela have a chance to express their opinion

seeing the referendum, has said the CNE wants international observers to be present in the country to monitor the vote, but has warned them against interfering in the process. In related news, Bush promised a full investigation into allegations that Washington, DC-based Riggs Bank hid accounts belonging to former Chilean dictator Augusto Pinochet. "I think the people of Chile must know that there will be a full investigation," Bush said. "Riggs Bank is being fully investigated, and they'll be investigated in a very open way."

**Colombia's FARC Rebels Reject Peace Talks with Uribe Government**

Colombia's largest rebel group, the Revolutionary Armed Forces of Colombia (FARC), on Monday said it would not

*Bush praised Lagos for making "it clear that for the credibility of the current government, they must welcome observers, they must encourage observers, and they must not interfere with the process, so that the people of Venezuela have a chance to express their opinion without fear of reprisal."*

without fear of reprisal." The US, Chile, and Brazil are members of a six-nation group that has supported the referendum process in Venezuela. Bush's comments are likely to draw a response from Chavez, who has accused the US of interfering in Venezuelan affairs—including support of an April 2002 coup against his government—and who earlier this year used a vulgar Spanish term to describe Bush as an "idiot." On Sunday, Chavez responded to US calls for a fair vote by asking, "what right do you and your little devils have to pressure us, Mr. Bush," according to Reuters. The presence of officials from the Organization of American States and Atlanta-based Carter Center to monitor the referendum process in Venezuela has been controversial, with the opposition saying they are needed to ensure fairness, while some Chavez supporters have accused them of being biased in favor of the opposition. Jorge Rodriguez, a member of Venezuela's five-member National Electoral Council (CNE), which is over-

conduct peace talks with the administration of President Alvaro Uribe, the Associated Press reported. "We're ready to undertake, with a new administration, the titanic task of building peace with social justice," FARC commanders said in a statement. They denied that a military offensive launched by Uribe had been successful. "For a long time, President Uribe has tried to sell the illusion of the military defeating the guerrillas," the statement read. Uribe took office in August 2002 vowing to take a tougher approach with Colombia's leftist rebel groups and right-wing paramilitary organizations. He has said he is willing to launch peace talks with the FARC on the condition that the rebel group declare a unilateral cease-fire. Military leaders say the offensive against the FARC is taking its toll, and that the FARC will be forced to enter into peace talks with the government in two years. Uribe's term expires in 2006. Although Venezuela's Constitution limits presidents to just one four-year term, the popular

Uribe is backing efforts to amend the Constitution to allow him to run for re-election.

## Company News

### Lloyds Exits Argentina After 140 Years with Sale of Local Unit

British banking group **Lloyds TSB Group Plc** is exiting Argentina after 140 years in the South American country with the sale of its local unit to local bank **Banco Patagonia Sudameris** for an undisclosed price, Reuters reported Monday. Lloyds, which has 35 branches and 670 employees in Argentina and is ranked 26th among Argentine banks in terms of assets, said its exit from the country was part of a global strategy to focus on markets where it has a competitive advantage. "The transaction will further focus the Group on its main franchises, where we believe there are significant opportunities for growth," Lloyds Chief Executive Eric Daniels said in a statement. Patagonia Sudameris has 120 branches, 1,400 employees and assets of \$1 billion. Lloyds is also selling its Colombian unit to Panama-based **Primer Banco del Istmo**. The sale of the Argentine and Colombian units follows Lloyds' sale last year of its Brazilian business to **HSBC Holdings Plc** for \$815 million. Since Argentina's economic collapse in 2002, France's **Credit Agricole** and Canada's **Bank of Nova Scotia** have left the country. Italy's **Banca Nazionale del Lavoro** has also said it plans to divest.

### IMSA Agrees to Sell Car Battery Business to Joint-Venture Partner

Mexican conglomerate **IMSA** said Monday it had agreed to sell its car battery business to a partner, **Johnson Controls**, for \$525 million, Reuters reported. Johnson Controls, the world's fourth-largest auto parts supplier and a joint-venture partner of IMSA since 1998, will also take on an undisclosed amount of the battery business' debt, IMSA said. IMSA, which also has investments in the steel, plastics, and aluminum industries, will use the proceeds from the sale to pay down its debt. "The transaction represents an

## Subscriber Notice

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**Invitation to  
an Inter-American Dialogue Discussion**

with

**Carlos de Icaza**  
Ambassador of Mexico to the United States

Friday, July 30, 2004  
12:30 p.m. - 1:45 p.m.  
Inter-American Dialogue  
1211 Connecticut Avenue, NW, Suite 510  
Washington, D.C.

RSVP to [meetings@thediologue.org](mailto:meetings@thediologue.org)  
Please include your name and organization affiliation.

opportunity to exit the battery business at the right time and to look for opportunities to create value for its shareholders and further strengthen its balance sheet," IMSA Chief Executive Eugenio Clariond was quoted as saying by Reuters. IMSA expects to close the deal this fall. The joint venture, which has a workforce of 3,100 people and operates four manufacturing plants and one lead recycling plant in Mexico, and one manufacturing plant in Brazil, is a major supplier of car batteries in Mexico and South America. Twenty percent of its sales go to automakers, including **Ford Motor Co.**, **DaimlerChrysler AG**, **Volkswagen AG**, and **Nissan Motor Co.**

### Brazil's Embraer Announces Firm Orders with Three Airlines

Brazilian jetmaker **Empresa Brasileira de Aeronautica** (Embraer) announced Monday that three airlines had converted options for a total of 11 aircraft into firm orders. Embraer said US carrier **Trans States Airlines** had confirmed options to

buy seven, 50-seat ERJ 145 jets, while **Republic Airways Holdings** and Luxembourg's **Luxair** and **Republic Airways Holdings Inc.** will buy two 170 models and two ERJ-135 aircraft, respectively. Delivery to Trans States Airlines, which holds options for another 10 ERJ 145 jets, will be completed during the second half of this year, Embraer said. Republic Holdings, which owns **Chautauqua Airlines** and **Republic Airlines**, holds an additional 32 options for the 170-model, according to the Brazilian jetmaker. Embraer, the world's fourth-largest commercial aircraft manufacturer, did not disclose the value of the deals. Embraer Chief Executive Officer Mauricio Novis Botelho expects the company will take sales from competitors based on the lower operation costs of its Embraer 170 and 190 models, according to Bloomberg News. The company is aiming to deliver a total of 160 jets by year's end, an increase from 28 in 2003, Reuters reported. Embraer estimates its total firm order backlog through June 2004 at \$10.5 billion.

**Featured Q&A***Continued from page 1*

improvements in fiscal outturns, partly as a result of high commodity prices. In fact, some governments such as Kazakhstan have conservatively placed part of its oil proceeds into a stabilization fund while maintaining significant

“If oil capacity enhancement is being deprived of resources at the moment, it is only because the president is fighting for his political life and using every tool at his disposal.”

- *Lawrence Krohn*

investments to maintain or even increase production capacity. In the case of Venezuela, investment in the oil sector has likely suffered as a result of higher public-sector spending on social programs. Furthermore, there has been a lack of significant new private investment as well. As a result, oil production could slowly fall. Lower production levels would put the already structurally weak, oil-dependent economy on an even less solid footing. No matter the political outcome of the August referendum and possible early elections, the Venezuelan government is likely to face continued pressures to maintain a high level of social spending ahead of the 2006 presidential elections, resulting in continued fiscal deficits and modestly growing debt and interest burdens. In the meantime, investment in the oil sector could remain insufficient to maintain production levels. Therefore, the economy will likely become ever more susceptible to a severe shock due to falling oil prices. The Venezuelan economy will likely grow by over 8 percent in 2004 (after a substantial near 20 percent fall in 2002-03) as a result of higher oil production levels compared to 2003 and the increased government spending. The medium-term growth prospects, however, are likely at below 3 percent due to a much weakened private sector and the

gradual fall in oil production levels. Any sharp drop in oil prices would likely push the overall economy into a deep recession.”

**A** **Guest Comment: Lawrence Krohn:** "We do not put the skewed allocation of Venezuelan public-sector revenues high on our (admittedly long) list of concerns. There is method in this madness. Venezuelans of all political stripes, from President Chavez on down, realize at some level that Venezuela has little to offer the world beyond its vaunted oil wealth. If oil capacity enhancement is being deprived of resources at the moment, it is only because the president is fighting for his political life and using every tool at his disposal. His 'missions' (stepped-up social spending) are very popular and could indeed propel him to victory. While the referendum could still go either way, the uncertainty it generates is almost certain to be dissipated before oil prices tumble to fiscally uncomfortable levels (which is not imminent). If Chavez survives, his economic policy calculus will quickly change on many fronts; in particular, spending policy will be reoriented toward nourishing the cash cow with which posterity will associate him. If the president is defeated decisively, we can probably infer (though this is always dangerous in Venezuela) that his successor, to be elected only a month later, will be savvy and secure enough not to be tempted by Chavez-style populism."

**Jose Cerritelli** is *Fixed Income Andean Analyst* at *Bear Stearns*.

**Richard Francis** is *Associate Director of Sovereign Ratings* at *Standard & Poor's*.

**Lawrence Krohn** is a *Senior Economist* at *IDEAGlobal*.

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