Venezuela announces budget cuts and other financial measures in the wake of OPEC decision

By Alexander Fangmann
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The decision by the Organization of the Petroleum Exporting Countries (OPEC) oil cartel to maintain daily production levels at 30 million barrels per day has exacerbated Venezuela's financial and political crisis.

The country is heavily dependent on the oil sector, which makes up 96 percent of its export revenue, and which it relies upon to fund imports and government spending. With oil prices plunging from around $100 per barrel to around $60 per barrel, budget deficits have risen to unsustainable levels and led to dwindling financial reserves.

The move by OPEC, driven by Saudi Arabia and the Persian Gulf monarchies, is an attempt to undercut the profitability of US-based shale oil producers and force them out of the market. It was opposed by Venezuela, Russia, Angola, Nigeria, and several other countries that require high oil prices to balance their budgets.

Economists believe that Venezuela requires an oil price of $100 per barrel to stabilize its finances—a figure President Nicolás Maduro has referred to as a "fair price"—and the International Monetary Fund estimates that $120 per barrel is needed to fully balance the budget.

A report in the *Financial Times* noted that a Venezuelan economic consultancy estimates that Venezuela loses $700 million in yearly revenue for every one dollar decline in the price of oil, with total revenue falling to $43 billion from $77 billion for the year. The current fiscal deficit, the difference between what the government spends and the revenue it takes in, is thought to be about 17 percent.

Financial markets and analysts have responded, with the trading value of Venezuelan bonds set to mature in 2027 falling to 51.5 cents on the dollar—the lowest in five years. The cost of credit default swaps, which insure bondholders against a Venezuelan default, have risen to 49.51 percent, the highest in the world, reflecting an 83 percent likelihood of Venezuela defaulting on its debt sometime in the next five years.

Venezuela was already reeling from the global economic crisis, with an inflation rate of over 63 percent earlier in the year and shortages of staple consumer goods. After the announcement, the bolivar fell to a new low of 155.8 per dollar on the black market, down 50 percent from the previous month. Foreign currency reserves are at an 11-year low, at $22.3 billion, after the government transferred $1.3 billion in Chinese loans to the Venezuelan Central Bank to shore up finances.

Financiers are demanding swifter action from the Maduro government. Jane Brauer, from Bank of America, clearly upset with the current tempo, wrote, "The Venezuelan government has not been very responsive, not acting fast enough to adjust, and not calming the markets with executable plans to respond to these external pressures."

Phillip Blackwood, a managing partner at EM Quest Capital LLP, was quoted in *Businessweek*, saying, "They've been dragging their feet, but it's inevitable they will have to make adjustments."

On December 2, following the OPEC decision, President Maduro, not one to upset the financiers, announced that in order to "maximize resources," the government would cut the budget by 20 percent in "discretionary and luxury spending," although he claimed that he would not touch social spending or the so-called Bolivarian *misiones*.

"This commission is going to take an axe and chop wherever we need to," Maduro said. In regard to areas targeted for cuts, he said, "I have ordered a revision of salaries of ministers and state enterprises, starting with the president of the republic." With this formulation, among the targets could be workers at PdVSA, the state-owned oil company.

Venezuela has also moved to adjust its currency exchange mechanism, which currently overvalues the bolivar, leading to a parallel black market exchange rate. Maduro recently stated, "We're going to be delivering a blow to the parallel dollar, which does so much damage." The first move in this direction was the recent announcement that gives the central bank the ability to legalize the black market exchange rate. While this would exacerbate inflation beyond its already high levels, it would give the government more bolivars per dollar, allowing it to ease its budget deficit at the expense of workers' living conditions.

At the same time, the government has moved to quickly increase the country's reserves by liquidating assets, including debt owed to it by allies for subsidized oil, and by seeking additional financing from China.

Several sources have reported that Venezuela has effectively ended the Petrocaribe program, which saw the country providing subsidized oil to friendly Caribbean countries on favorable loan terms. According to these reports, Venezuela is selling loan debt owed to it by the Dominican Republic to Goldman Sachs for 41 percent of its value in exchange for a lump-sum payment, and is pursuing plans to do the same with oil debt owed by Jamaica.

Lazard, the investment firm reportedly behind the deal, was the same company involved in plans to sell Venezuela's US-based Citgo refining operations, until the Venezuelan government announced it had abandoned those plans. However, ConocoPhilips, which is seeking compensation for assets nationalized by Venezuela in 2007, is alleging in a Texas-filed lawsuit that Venezuela still plans to sell its US-based subsidiary in order to avoid paying any judgments.

In addition to these measures, Maduro has also dispatched Finance Minister Rodolfo Marco to China to attempt to secure further loans. China has supplied about $50 billion in credit to Venezuela since 2007 in a bid to shore up its energy needs. By agreeing to more loans, Venezuela would be effectively committing to handing over an even larger percentage of its yearly output to China, even as yearly production has declined due to lack of investment in infrastructure.

The massive inflation and shortages of goods have led to a drop in support for Maduro and the ruling *chavista* regime. A November poll by the firm Datanalisis shows approval dropping to only 24.5 percent, down 5.7 percent from September and 26 percent from just after his election in April of last year. According to the poll, 85.7 percent of the population believe the country is heading in the wrong direction.