

Russia-Ukraine Conflict and the Breaking of Hyperinflation in Venezuela

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Abstract. The purpose of this paper is to analysis the influence of Russia-Ukraine conflict to the hyperinflation of Venezuela. With the implementation of economic theoretical approaches, this paper aims to present a comprehensive overview of the current economic development status of the nation and the causes of the hyperinflation situation during different governmental governances. More importantly, this paper will analysis whether the influence of Russia-Ukraine conflict in terms of oil market fluctuations and geo-political changes can serve as a turning point to the current Venezuela's stagnated economy. Particularly, the impact of the conflict itself to the relations of the United States and Venezuela, and how will it influence the internal economic developments of the nation. To this end, this paper notes that although the conflict can be a turning point to the nation's hyperinflation, Venezuela still requires a long-term economic strategy. This paper is attempting to contribute to the current geo-political environment of Russia-Ukraine conflict while providing potential solutions to Venezuela's economy from a economic perspective.

Keywords: Hyperinflation, Russia-Ukraine Conflict, Venezuela's economic development, Global oil price.

1. Introduction

This paper consists of a comprehensive analysis of the impact of Russia-Ukraine conflict towards the economic status of Venezuela. In particular, the influence of the conflict to Venezuela's energy resource fluctuation, which further affects the hyperinflation of the nation. Latin America has long been regarded as a geo - strategic continent by the United States, Russia, and, more recently, China due to its position, vast natural resource assets, and ecosystems, which includes forests, fisheries, aquatic ecosystems, and groundwater. Venezuela has the world's largest oil stockpile, with 300 billion containers, prompting the US to consider a new strategy toward the country [1].The Russia-Ukraine conflict has jeopardized energy independence while rapidly eroding some old rivalries.

To this end, this paper is designated to analysis the case of Venezuela and the hyperinflation issue of the country influenced by the Russia-Ukraine conflict. This paper will explain the economic developments of the country while synopsisizing the causes of the hyperinflation in Venezuela. Furthermore, the relations between Russia-Ukraine Conflict and the hyperinflation in Venezuela will analyzed. In this regard, the research question should be asked: how the Russia-Ukraine Conflict is possibly changing the hyperinflation in Venezuela?

2. Economic developments of Venezuela

2.1 Current economic status

Venezuela's economic system has depended on petroleum profits to revitalize and broaden other areas of the economy, making "sembrando el petróleo" ("sowing the oil") a nationwide tag line. Nonetheless, Venezuela's massive economic growth was slowed dramatically by volatility in international oil and gas prices and global economic instability in the 1980s and 1990s, as well as national issues such as inflation, misallocation, corrupt practices, and a shortage of skilled professionals. A huge international budget deficit, massive unemployment, population increase, and uncontrolled immigration all put burden on the economy.

Venezuela was in the presence of a full-fledged financial catastrophe as of the beginning of 2021. Since 2014, GDP has fallen by 69.4%, and a high inflation that began in late 2017 has persisted, with an annual increase of 2,960% expected in 2020. Around 5.4 million people, or nearly one-sixth of the nation's people, had fled, attempting to make it one of the nation's biggest migrant emergencies [2]. By early 2020, 9 out of 10 Venezuelans were poor, child mortality rates had raised by more than 40% since 2008, the World Health Organization categorized one-third of the inhabitants as undernourished, and approximately three of the inhabitants had lost weight due to a lack of nutrition [3]. Many preceding policies implemented by President Nicolás Maduro had struggled to anticipate inflationary pressures and financial meltdown. A current regime with shrinking earnings and a significant budget shortfall funded by monetary expansion was at the heart of the issue. Punitive measures imposed by the United States (U.S.), opposing worldviews with the opposition leader, and the continuation of low oil prices are also major causes of the issue.

2.2 Cause of hyperinflation

The cause of Venezuela's economic hyperinflation is rooted in overreliance on oil industry and mismanagement of the economy. During Chávez's 14-year presidency, the economy has been growing at a 3.0% interest growth. Overall inflation averaged 25% over these years, which is not extraordinary by international comparison. Higher oil prices drove this achievement, which increased more than tenfold between 1998 and 2012 [4]. Nevertheless, trade tensions obscured a sharp decrease in productivity, which fell at a 2.2% growth rate. Despite possessing the world's leading oil deposits, Venezuela's oil output has stalled, and the country has lost customer base to other oil producing nations who are taking benefit of superior price levels to generate more petroleum. Therefore, when it comes to Maduro's regime, the government had inherited a complicated fiscal climate, with budget and trade transactions that were significantly overstretched. Regardless of the fact that fuel prices were at an all-time peak, the government sector shortfall remained at 17.0% of GDP in 2012 [5]. While the budget deficit was only 0.7% of GDP, there was significant cash plane, with private industry enterprises relocating USD 8 billion oversea. In order to sustain the stable currency in the head of these stresses, the current regime had amassed significant debt. The nation's foreign debt had increased to USD 132 billion by 2012, up from USD 40 billion when Chávez entered power [6]. Many emerging economies such balance-of-payments disparities would seek humanitarian support from the IMF, but both Chávez and Maduro advocated strongly against the IMF; in fact, the last IMF frequent financial document on Venezuela was in 2004, and Chávez deemed retreating Venezuela from the IMF in 2007.

To this end, the government had no choice but to agree to depreciate the rate of exchange from 4.30 VEF/USD to 6.30 VEF/USD in 2013. The depreciation was probably insufficient—the black market was swapping at 27 VEF/USD at the time—but it was a move in the right direction. However, the current regime also shuttered the secondary financial markets. Now, the nation has shifted from inflation to a hyperinflation status as shown in figure 1.

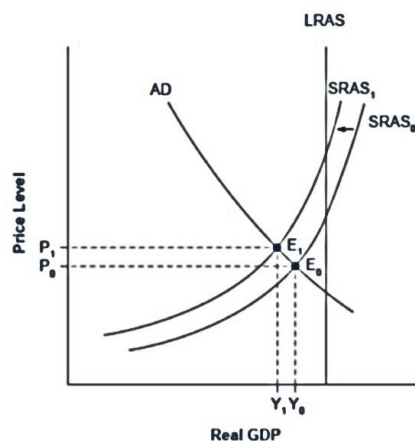


Fig. 1 Inflation curve

According to the Federal Reserve, normal price level is somewhere around 2% or less. This enables a balanced economic growth rate. Hyperinflation is characterized as monthly inflation that surpasses 50% [7]. Even though it acknowledged that this figure is imprecise, the overall concept is that when currency devaluation occurs, prices rise speedily. Inordinate increment in the monetary base, or demand-pull inflation, are frequently to blame. When the quantity of money increases at the same level as real output, the economic system expands through higher prices and production. Nevertheless, markets are presumed to be producing at maximum capacity. This is why the aggregate curve of supply is vertical in the long term in Figure 1. The aggregate curve of supply does not relocate in the long term except if manufacturing technology progresses. This is why hyperinflation caused by monetary expansion has such a spectacular influence on prices. Because price levels will begin to escalate, the more cash the administration prints, the more valueless the money becomes.

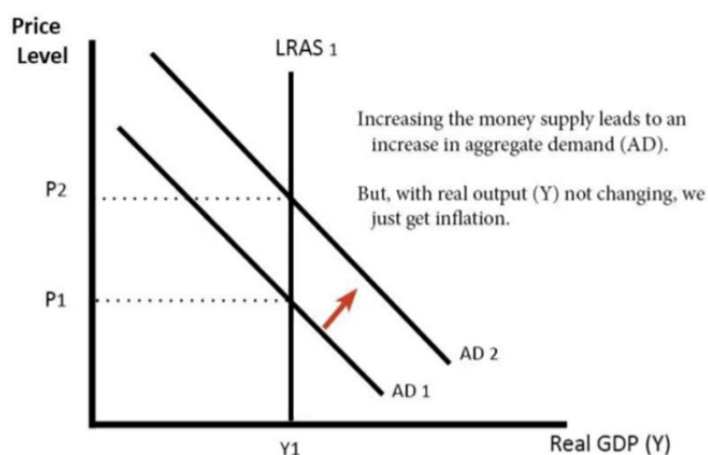


Fig. 2 Hyperinflation & Printing Money

As stated in Figure 2, the general economic theory indicates that when hyperinflation exists in the long term, this means that the devaluation and printing money measures implemented by the government has no increase in output. As a state prints more cash, which it may do for a myriad of purposes, the worth of that money decreases. Apart from effectively raising costs, this has secondary impacts on the market price. In order to maintain their standard of life, employees will increase the wages, resulting in significant cost inflation [8]. Furthermore, as the nation's individuals expect inflationary pressures, they begin to anticipate higher inflation expectations. Indeed, the decision to cancel the SITME mechanism caused havoc in the retailing industry. Importers of non-essential products was using SITME to acquire foreign currency; now they will have to decide whether to go to the black market. As a consequence, both important and non-essential commodities became scarcer and more expensive. Imports fell by 24.8% between 2012 and 2014, while overall inflation climbed from 20% to 56% from 2012 to 2013, and the national capital bank's limited supply index increased from 14.2% to 20.8% over the same period. Food and basic necessities, such as toilet tissue and salt, became scarce. The shortfalls were most severe in products that contribute to price controls, where retail stores have been unable to increase prices to clear marketplaces due to lower supply. This opens the channel for further hyperinflation of Venezuela in the future.

3. The influence of Russian-Ukraine conflict

Only four Latin American countries refused to vote in the United Nations General Assembly campaign to stop Russia following the Russian invasion of Ukraine: Bolivia, Cuba, El Salvador, and Nicaragua. Despite the fact that Venezuela had lost its UN voting power due to non-payment dues since the starting of the year, Maduro define his assistance for Putin in a public address. He commended the latter for defending "that state's tranquility," verifying Venezuela's position as "Moscow's unwavering allied nation [9]." Maduro's hardline stance could derail advancement in the

globally endorsed talks in Mexico City between his administration and Venezuela's political opponents, which started last year. The conversations could have resulted in some sanctions relief for Venezuela in return for Maduro guaranteeing the prerequisites for the forthcoming national campaign in 2024. Maduro had termed off the conversations in October, and Washington had implored him to resume them. That progression appears to be narrowing as Russia's disunity with the West, particularly the United States. In the meantime, expeditiously rising petroleum prices associated to the Ukraine conflict have strengthened Venezuela as an OPEC representative. Since even as prices have risen dramatically in recent times, OPEC has refused responding to lower them. This implies that, in the near term, Maduro's resort of sanctions remission less urgent.

Furthermore, the Venezuelan administration was unable to obtain its own account balances in Russia due to the absence of Russian banks from the SWIFT global system and the breakdown of the Russian ruble [10]. Furthermore, Russia's vast oil exports to China may diminish Venezuela's less important oil supplies to the very same nation. Nonetheless, as recent past has shown, Maduro can outmaneuver adversity by rearranging trade relationships. Russian petroleum accounted for approximately 8% of US oil shipments, or approximately 670,000 bpd. In general, because its output is much smaller, Venezuela cannot cover for the US commodity prices that is no longer procured from Russia. While Venezuela generates 700,000 to 800,000 barrels per day, Russia used to produce around 11 million barrels per day and trade nearly 7 million [11]. As a result, even if the US sanctions were lifted against Venezuela, the impact on the global economy would be negligible in the near term. Therefore, the incentives for the US to lift sanctions are decreased while further diminishes Maduro's intention of pushing the conversations with the US. Venezuelan petroleum could momentarily replace Russian oil utilized by US processing facilities in the Gulf of Mexico. Nevertheless, the cost of crude is ascertained by the global markets, not by what Venezuela can outsource, which is inadequate in the near run. The United States could produce the same results by continuing to increase oil exports or persuading Gulf states to do the same. To this end, it is not surprising that the Venezuelan government would choose to stand with Russia as it chooses to serve its national interests in the short term.

Indeed, the reason beyond Maduro's statement as well as other Latin American countries' position can be understandable as it can serve as a turning point to Venezuela's economic developments. Since skyrocketing oil price can further increase Venezuela's export earnings of oil, while the government can ease the pressure of consistent national debts. Increasing oil prices could advantage Maduro in the temporary, but their long-term consequences will be realized as raising inflationary pressures which are already high.

4. Possible Solutions

4.1 Collaboration with the US & dollarization

By interrupting Russia-Venezuela connections, Biden could gain a geostrategic benefit. Furthermore, United States could assist in the development of a blueprint for Venezuela's democratic transition and regularization, and a relatively stable Venezuela could halt the migrant influx into neighboring nations. Furthermore, US-Venezuela talks could encourage policy changes in either petroleum industry to relieve output and international businesses' activities and could be the beginning of combating the other strong links Russia and China have evolved with Latin American regimes.

Also, the potential bilateral cooperation can lead to the dollarization of Venezuela. It is crucial to recognize that the nation has already experienced informal dollarization. Venezuelans have been beginning to experience monetary alternation since the price of the Bolivar fell. Furthermore, the millions of migrants who have left the nation have been mailing around \$4 billion per year to their households who remain in the nation [12]. It should be mentioned that the funds returned are in US dollar bills. It was prohibited to transact in dollars without special government permission until May of 2019. That is when Maduro lifted bank foreign-currency controls, enabling the dollar to openly

disperse alongside the Bolivar [13]. This has stemmed in the nation's informal dollarization, with a sampling of seven major cities revealing that 53.8% of money transfers in the first 15 days of October 2019 were in dollars. "I don't see it as a bad thing... this practice that they call 'dollarization'", Maduro said, citing the economic advantages of dollarization [14]. The difficulty for the United States is determining how to persuade Congress and the American people that this tactic is beneficial. The Republican Party and Trump have never questioned Russia's presence in Latin America. At the same period, oil firms are significant Republican Party contributors and may be engaged in actions in Venezuela. The wider populace in the United States is aware of the growing petrol prices. Many Americans may be inclined to endorse, or at least not object to, normalization of relations with Venezuela if it is constituted as a critical ingredient to reduce the prices [15]. As a result, whether the Biden government takes further actions toward normalization of relations with Venezuela will be determined in part by the path of internal economics and politics.

The challenge Maduro may face is determining how to advertise this U-turn to his supporters. For the last 20 years, the nation's socialist governments have maintained an anti-neoliberal discourse of the United States versus Venezuela. This tale also connects popular resistance to a US plot to undermine Venezuela's aspirations. A national democratic option was not preferable through this perspective. Nevertheless, in the turbulent year 2022, ideological discourses may give way to more practical necessities.

4.2 Financial reform

Another solution for the Venezuelan government to diminish hyperinflation while retain Bolivar as the national currency is to conduct a comprehensive national reform. A consolidation strategy to decrease hyperinflation must be developed. Although the current regime has made some efforts to repair the Bolivar, far more must be accomplished. Without the need for a detailed strategy, the general populace will never rebuild trust in their administration, rendering any changes ineffective. Fiscal modifications and foreign funding are the core tenets of a strategy to revise the Bolivar and decrease inflationary pressures in Venezuela.

Firstly, during a hyperinflationary installment, the fiscal modifications for monetary crisis would be to utilize restrictive monetary policy. This contains reducing the government's spending, tax increases or broadening the revenue base, limiting the national capital bank's ability supply relaxation to the state-owned and government-owned businesses, and price deregulations [16]. Nevertheless, considering Venezuela's simultaneous humanitarian disaster and the administration's prolonged absence of assistance in recent years, it is critical that the nation undertake budgetary redistribution rather than austerity measures. Venezuela will be allowed to provide critically necessary assistance to its residents by redistributing wasteful spending to more essential welfare programs. Secondly, A large-scale consolidation strategy to repair Venezuela's economic system will necessitate foreign funding. This is especially true considering that public expenditure must persist constant, if not increased, to protect the population from further danger caused by monetary policy changes. International aid can take the shape of loan payments or international assistance and will be utilized to maintain price stability, offer additional relief to residents, funding liabilities, share values in the sustainable development of reform efforts, and protect monetary pegs, if they are executed. International financing should not be viewed as a replacement for institutional reforms.

Also, a long-term. Reinvigorated regulatory and administrative structure, and significant infrastructure invest in public petroleum refineries and manpower are required for a subsequent increase in Venezuela's petroleum products as the nation's largest income source [17]. The country still needs to create more URV (real unit of value) beyond oil industry. In order to stay independent in natural resource reliance, the nation requires a transformational economic scheme that covers different dimensions of Venezuela's economic developments, while the general populace needed to see that price levels were stabilizing over time. Admittedly, as time passed, people came to accept that high inflation was a "cruzeiro major problem," not a URV issue; financial circumstances had been established to ensure URV market stability, and there was no more reckless money creation.

5. Conclusion

In summary, it can be certified that the Russia-Ukraine conflict can serve as a turning point to the current hyperinflation status of Venezuela, attributed to the increase of international oil prices as well as other benefits brought by geopolitical interactions. Attempting to negotiate with the US would benefit Maduro greatly. If the United States lifts its punitive measures, increasing Venezuela's oil supply is far more appealing than supporting a worldwide separated Russia. These agreements provide him with an unforeseen and intangible acknowledgement of his worldwide contested governance. The essence of the mutual requirements, nevertheless, determines the outcome of the bargaining. Nevertheless, in the long term, the nation still requires a comprehensive strategy to obtain sustainable economic developments. The paper has made contributions to the economic recovery of nations which are over relying on natural resources, while providing scopes for further development of studies in this field. Although due to limitations of time and resources, this paper is unable to conduct more thorough research on subject.

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