

Analysis of Venezuela's Government Action against Hyperinflation

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Abstract. During these years, Venezuela had the longest hyperinflation in history. Government debt rises as a result of both higher social benefits and falling oil prices. As a result of the government's massive liabilities, the government decides to create additional money, which causes hyperinflation. Thus, this paper discusses the three main Venezuelan government actions and their effect. The research shows that both price control and creating new currency did not result in a decrease in hyperinflation. The fixed exchange rate can decrease a small amount of inflation. However, it costs the government a large amount of money to sustain. In short, Venezuela can benefit from using other countries' currencies and changing to its own currency when its economic condition is stable. Furthermore, current economic conditions are beneficial to Venezuela's oil industry. Since US restrictions are no longer in place, Venezuela is free to pay back its debt and swiftly modify its own economic structure in order to bring its inflation rate to the target range. This study will help the government and related industries better understand how to create effective public policy.

Keywords: Venezuela; government action; hyperinflation.

1. Introduction

1.1 Research Background

Hyperinflation is an uncontrolled price increase, especially over 50 percent per month [1]. In 1983, the Inflation rate in Venezuela become unusual as a result of its reliance on fuel exports and the drop in oil prices. Hyperinflation in Venezuela is similar to Dutch disease. The Netherlands put massive investment into gas export and overlook other industries after finding natural resources in 1959. Since the export of its gas increased, both the exchange rate and labor cost of the Netherlands increases. As a result, the Netherlands suffers a financial deficit and a high unemployment rate because agriculture and other industries cannot afford large labor costs and lose their competitive power. Likewise, Venezuela focused mainly on its oil industry after finding massive oil reserves. The corrupt government took control of the whole firm. This has hampered business development and has led to Venezuela's reliance on imports of commodities from other nations. When oil prices dropped, Venezuela's foreign exchange reserves were depleted because of the net export deficit. Venezuela's government began printing additional money to prevent this deficit. However, the value of the country's currency and exchange rate declined precipitously because of the massive bank notes printing. Since the currency value decreased, commodities that were imported from other countries became expensive. With poor government management, the situation became worse. Food shortage, unemployment, and crime were obvious issues that are caused by hyperinflation. During the past few years, over three million Venezuelans had left their nation. It demonstrated that Venezuela had been experiencing hyperinflation for a long period, and the government's actions throughout this time had caused its populace to lose faith.

1.2 Literature Review

Pittaluga, Seghezza, et al. (2021) demonstrated that Venezuela's hyperinflation is caused by the government's supply of publicly subsidized benefits to low-income supporters, and it also erased the value of bonds and other financial assets held by middle and upper-class opponents of the government [2]. Weisbrot and Saches (2019) show that hyperinflation in Venezuela is also caused by United States sanctions using lower oil prices and it led to the displacement of Venezuelans and an increase

in sickness and death rates [3]. Saboin (2018) discovered that the Venezuelan government promotes short-run seigniorage and sacrifices long-run seigniorage in order to repay its enormous government debt [4]. This excessive government intervention leads Venezuela's condition to become worse. Based on Venezuela being saddled with the unmanageable national debt, Walker and Cooper (2017) suggest Venezuela's government can utilize unconventional approaches to resolving debt and encourage would-be holdout creditors to join a restructuring [5]. On the other hand, Messina (2019) encourages the Venezuelan government to eliminate Government corruption through economic sanctions, foreign military intervention, humanitarian assistance, and collective action [6]. Moreover, Reilly (2020) suggests that dollarization is politically and economically unacceptable for Venezuela because the economic cycle between these two countries is misaligned and Venezuela is opposed to the United States [7].

1.3 Research Purpose

The research aims to explain how Venezuela's government deals with hyperinflation, and what consequences these government actions lead to. While few academics are focused on the effects and solutions of hyperinflation, the previous management and plans should be analyzed. It is crucial to understand the previous wrongful actions and gives some suggestions based on the situation. This research will analyze wrongful government action and find out some relevant evidence to prove the feasibility. This research will assist the government and related businesses in comprehending the current situation and plans to overcome its problem.

2. Venezuela's government's action against hyperinflation

2.1 Cause of Venezuela's Inflation

The primary trigger for Venezuela's hyperinflation was the decline in oil prices. Due to this, Venezuela, which is heavily dependent on oil exports, has lost its major source of income. However, there are a number of additional causes behind Venezuela's hyperinflation. In the beginning, Chávez compelled the acquisition of assets, which further showed the corruption and collapse of the government. After the nationalization of assets, the market lost its competitiveness, which resulted in the withdrawal of foreign investment. In addition, Chávez's nationalization triggered U.S. sanctions, which drove Venezuela's inflation worse. Furthermore, Chávez aggressively started distributing public benefits like national free healthcare, free education, lifelong pensions, and price control. This resulted in greater government spending as well as the decline of businesses.

2.2 Price Control

Hugo Rafael Chávez Frías decreed the 2011 Law on Fair Costs and Prices to regulate prices and decrease Venezuela's massive inequities [8]. This policy was not only intended to control the prices of 100 commodities such as sugar, milk, and beef, but also to expropriate a number of industrial estates. However, price limits were ineffective in mitigating hyperinflation. The price of ordinary goods in Venezuela is extremely high due to hyperinflation. The price controls have price restrictions that have substantially cut the price of common products. According to the demand and supply curve, a normal company or factory cannot supply the standard number of items in the equilibrium. As a result, the company's profits are significantly reduced by the price control, while the company reduces the production of its products in order to avoid losing money, the demand for products still exceeds the supply. Chavez's approach has not alleviated the pressure on the people. Venezuela continues to suffer from a shortage of daily necessities. The oversupply has created a black market and reduced the government's tax rate. Furthermore, the government's compulsory expropriation of firms created the domestic industry uncompetitive. Consequently, international firms progressively exited the market. As a result, Venezuela's economic performance has deteriorated. The government imposed price controls to meet the needs of the common people. In fact, Venezuela's hyperinflation

demonstrated that the country was in a bad economic condition. Price controls cannot provide good economic performance because the company or factory may lose its profit value.

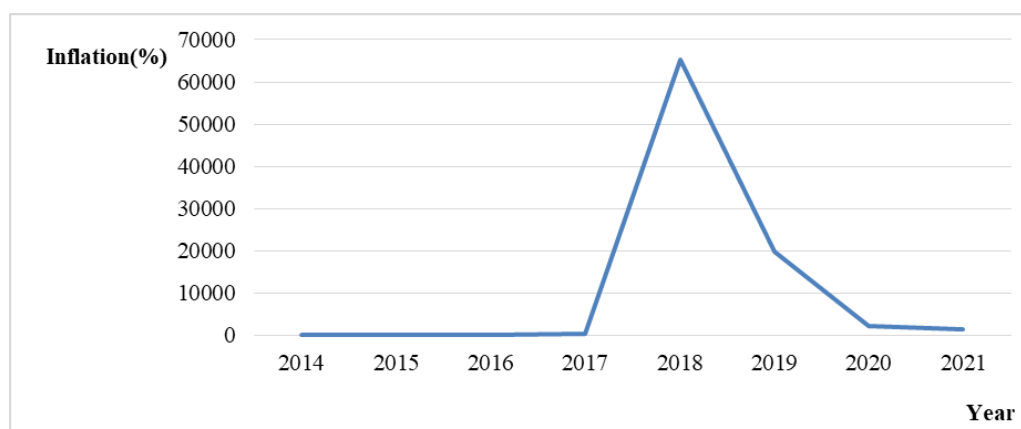


Fig. 1 Venezuela Inflation rate

In 2019, the Madura government canceled its price limit and relaxed the fixed exchange rate. According to Figure 1, Venezuela's inflation largely dropped after these constraints have been lifted [9]. This action attracts foreign investment and companies' start-ups and enhances the commercial circumstance. Thus, in order to combat hyperinflation, the underlying cause of the high price must be addressed. The reason that commodity is so expensive in Venezuela is that it is imported. If the government were to use the money invested in price control to encourage farmers to grow crops or factories to produce commodities. Addressing Venezuela's over-dependence on imports from other countries would reduce the country's imports and keep Venezuela away from international market pricing. The issue that Venezuela excessively depends on oil would be solved. Although there is no evidence that this suggestion will restore Venezuela's inflation rate in the short term and what would happen after changing Venezuela's economic structure, reliance on oil export will be a vulnerable point for Venezuela.

2.3 Exchange Rate Control

In 1983, Venezuela sued a multiple exchange rate system in order to control their import [10]. As a result, Venezuela's central bank claimed that the official currency rate depreciated by more than 99 percent. The exchange rate affects the export price and its revenue. The main reason for fixing the exchange rate is to facilitate imports and exports. However, the fixed exchange rate will be lower compared to the normal rate. The overvaluation of the currency will cause most people to abandon their home country's paper currency for a relatively stable one. Thus, the demand for other countries' paper currency increased, and Venezuela's currency value dropped. Since the government used multiple exchange rate systems and the amount of exchange is limited by the government. This action increases the shortage of other paper currencies, and the black market grows. This further pushes up inflation, and higher inflation again pushes up the price of other countries' banknotes. Fixed exchange rates have not played a substantial role in improving hyperinflation. The hyperinflation went up after 2016. While the oil prices fail, the government is still in a net export deficit. Although the fixed exchange rate makes it cheaper to buy imported goods, imports are still very expensive for people due to the limited amount of exchange. The emergence of the black market further increased inflation. A fixed exchange rate is clearly ineffective. Using government intervention to control international transactions cannot be beneficial for increasing the volume of trade. Furthermore, it cost the government a large amount of money to sustain the exchange rate. In order to repay its large amount of debt and prevent a steady erosion of Venezuela's creditworthiness, Venezuela should focus on its production. For example, Venezuela should increase its manufacturing and agricultural products and withdraw its import. It should look for possible business opportunities. At a time when the Russia-Ukraine conflict has resulted in a prohibition on Russian oil imports, Europe's reliance on Russian

oil and gas shortage of resources can be resolved by Venezuela's oil reserves. Venezuela can use its rich oil reserve to provide the best price offer. Therefore, the Venezuelan government can obtain funds to pay back its huge debt or use this money to provide subsidies for its manufacturing and agricultural industries. Repaying the national debt can provide a signal that Venezuela start to recover. This may build the confidence of corporations in Venezuela and attract more foreign investors to invest. Subsidies can attract more domestic companies to establish and grow. When the manufacturing and agricultural industries establish and grow, the domestic demand for an international commodity is diminishing. Thus, Venezuelans can purchase foods and necessities no matter whether the oil price drops or not.

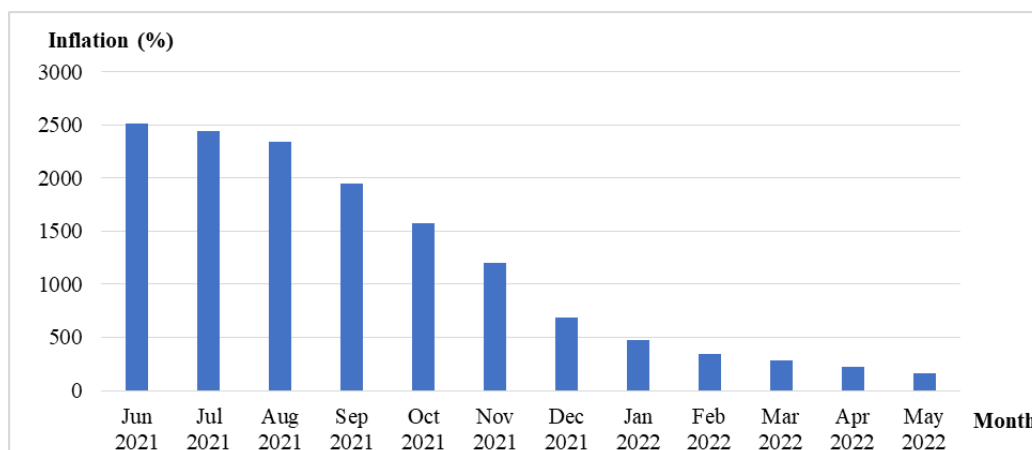


Fig. 2 Venezuela's inflation between June 2021 and May 2022

The inflation between 2021 and 2022 has dropped dramatically [12]. However, Venezuela's government does not force any economic policy during this period which means establishing any government intervention may not bring many benefits to the inflation recovery. Sustaining normal transactions and a flexible market could contribute to the decrease in inflation. In this case, changing its economic structure and booming the oil transaction is a vital issue for Venezuela.

2.4 New Currency

On 22 March 2018, President Nicolás Maduro introduced a new currency reform. The rebranded currency has five fewer zeros than the country's previous currency and will be pegged to a cryptocurrency called Petro [12]. The purpose of this policy is to simplify the transaction. While the new currency improves the convenience of living, it does not affect people who use bank cards. Since this currency is pegged to a cryptocurrency, cryptocurrency cannot be defined as a stable currency. Because most cryptocurrencies have the potential to have problems with withdrawals. If once that happens, the Petro collapses, and the new currency will collapse as well. This would add to the burden on the people. Zimbabwe suffered similar hyperinflation in 2007. The main trigger for Zimbabwe's hyperinflation was the land reform system introduced by its president, which led to an increase in conflicts between different ethnic groups and sanctions from European countries. As a result, a large number of foreign companies left the country, and the market for daily necessities suffered from an undersupply. The government's currency printing led to hyperinflation in Zimbabwe. In 2009, the Zimbabwean government used the US dollar as its currency, but dollarization did not bring long-term social stability. This is because it does not combat the root causes of inflation. As a result, Zimbabwe began banning other foreign currencies in 2016. Similarly, for Venezuela, dollarization could be a short-term policy, using the dollar to stabilize social transactions. Depending on different economic cycles and different monetary policies, any monetary policy implemented by the US government is likely to exacerbate Venezuela's hyperinflation. Secondly, dollarization could lead to increased demand for the US dollar. The increase in the dollar demand may cause the black market which will intensify hyperinflation. Moreover, Venezuela's hyperinflation is partly due to the economic

sanctions imposed by the US. Dollarization is even less desirable. It is unclear whether it is possible to utilize the dollar as a short-term currency while waiting for the economy to stabilize before establishing its own currency. However, the confidence of the public plays a crucial role in the establishment of the currency. If the population loses confidence in the currency, then they are throwing it away in exchange for what they consider to be a stable currency. However, building public confidence in a new currency is a difficult task. Firstly, it is necessary to ensure the future stability of the currency. Secondly, it needs to attract the public to use the currency. For example, if an expert in the stock market sells a large amount of stock, then the public will think it is depreciated and sell it one after another. In the end, the price of that stock will fall rapidly. Therefore, creating a currency should be cautious. If public people do not accept this currency, it may be useless and a waste of time to set up new banknotes.

3. Conclusion

3.1 Key Findings

In conclusion, this study examined the three primary hyperinflation reforms undertaken by the Venezuelan government. Pricing caps reduce the advantages to domestic businesses and limit domestic commodity production, which worsens shortages of food and other essentials and fuels the underground market. People may save money by purchasing imported items because of the fixed exchange rate. However, it cost a huge government reserve to maintain this rate. The restricted exchange also encourages the illegal market, making the value of its currency unstable. This can lead individuals to give up their money and fuel hyperinflation. Additionally, establishing a new currency requires the faith of the populace. Utilizing cryptocurrencies has its drawbacks because they are unstable and difficult to withdraw. In this instance, pegging to a Petro can increase the currency's risk when oil prices decline or the Petro experiences problems.

Investigating the three main government actions allows recognizing the three different solutions to the hyperinflation in Venezuela. Firstly, Venezuela's government may utilize its reserve to reform its economic structure, which promotes the production of local goods and the establishment of new enterprises. Secondly, the US has loosened its sanctions against Venezuela. The crisis between Russia and Ukraine also makes energy scarcer in Europe. Venezuela might take advantage of this chance to regain its oil market and pay off its debt to the government. Furthermore, Venezuela can use the dollar as its short-term currency and change to its own currency when the inflation rate back to normal.

3.2 Future Studies

This research has potential limitations. The article relies only on the rate of inflation and knowledge of the economy. However, the inflation rate is not an indicator that could change immediately while one policy is implemented. In the meanwhile, Venezuela does not provide any official statistics or government data. It is hard to collect available and useful data to analyze. As a result of the enormous amount of hyperinflation, the efficacy of the measures the Venezuelan administration has undertaken cannot be directly proven by the data found. Furthermore, those government policies happened before the hyperinflation in Venezuela which means the intervention could be a trigger for hyperinflation instead of a solution. Nevertheless, the paper does not fully provide the actions taken by Venezuela. This paper has chosen the three main meaningful actions to discuss.

A future study by the author might concentrate on more recent government intervention in Venezuela and utilize various metrics to demonstrate its effectiveness. The author might concentrate on the years between 2018 and 2020 when Venezuela's hyperinflation sharply decreased. Follow the trend of the conflict between Russia and Ukraine on Venezuela's oil exports to learn how the Venezuelan administration takes advantage of this chance.

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