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Ghost of Chavez Can't Stop Hyperinflation

By Megan McArdle - November 20, 2013

Steve Hanke, a Johns Hopkins University economist who studies hyperinflation, thinks that Venezuela is sliding into a hyperinflation episode:

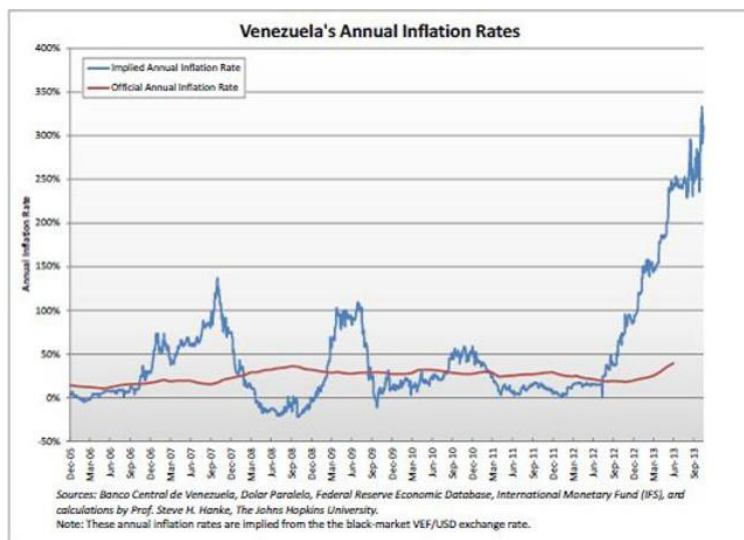
"For years, Venezuela has sustained a massive social spending program, combined with costly price and labor controls, as well as an aggressive annual foreign aid strategy. This fiscal house of cards has been kept afloat -- barely -- by oil revenues.

"But as the price tag of the Chavez/Maduro regime has grown, the country has dipped more and more into the coffers of its state-owned oil company, PDVSA, and (increasingly) the country's central bank.

"Since Chavez's death, this house of cards has begun to collapse, and the black market exchange rate between the bolivar (VEF) and the U.S. dollar (USD) tells the tale. Since Chavez's death on March 5, 2013, the bolivar has lost 62.36% of its value on the black market ...

"This, in turn has brought about very high inflation in Venezuela. The government has responded by imposing ever tougher price controls to suppress the inflation. But those policies have failed, resulting in shortages of critical goods, such as toilet paper, without addressing the root cause of Venezuela's inflation woes."

The country's official inflation rate is about 50 percent a year. Hanke puts the actual inflation rate at more like 280 percent a year.



Thanks to strict price controls, this is showing up unevenly -- often as shortages, rather than price increases. But if your money won't buy anything, it doesn't necessarily matter whether that's because the price is too high or because the goods aren't available for purchase. The underlying cause is the same: The value of the bolivar is declining.

Hanke says that the monthly inflation rate is about 35 percent, closing in on the official "hyperinflation" threshold of 50 percent.

What's remarkable is that the government has managed to get itself into this state despite having some of the world's largest oil reserves. How do you find yourself forced to print money when you're sitting atop vast reservoirs of wealth?

Well, through a combination of political calculation and idealistic motives, Venezuela diverted money from investment in its oil fields to social spending and now the bill is coming due, in the form of lower oil production.

Venezuela's oil reserves are plentiful, but it's low-quality stuff that is hard to pump and refine; it can't just rapidly ramp up production to pay its bills. So instead, Venezuela is trying to print money. Double-digit inflation is obviously bad for ordinary Venezuelans, and it may not even help the government; Jay Ulfelder of Dart-Throwing Chimp looks at the relationship between hyperinflation and political turnover and suggests that President Nicolas Maduro could lose his job.

But Maduro doesn't have great options, especially with local elections coming. As I've pointed out before, the production declines have meant that Venezuela doesn't just need high oil prices -- which it has -- but also continuously rising oil prices, to make up for the lost production. That it doesn't have, and with the U.S. exploiting its shale oil, Venezuela is not likely to get it in the near future. (Never mind what a deal with Iran on its nuclear program will do to oil prices.) So what's an authoritarian ruler to do? He could embark on increased investment in oil infrastructure and broad neoliberal reform, but even if he liked the idea, the political pain would temporarily be worse, as folks lost the goodies they were

previously getting from the government. Or he can continue along his current course, in which case, maybe he gets hyperinflation and loses his job anyway.

The answer he seems to have settled on is ... encouraging people to loot electronics retailers. This doesn't seem like a very good idea, for all sorts of reasons. But it seems as if Venezuela ran out of good ideas a long time ago.