



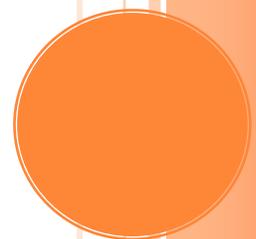
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**Why the Venezuelan crisis cannot be considered as a failure
of Modern Money Theory**

Student Research Internship Report

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Why the Venezuelan crisis cannot be considered as a failure of Modern Money Theory

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Modern Money Theory (MMT) is a heterodox macroeconomic framework, according to which monetarily sovereign countries conduct their transactions in fiat currency are not functionally constricted by revenues when it comes to government spending. Since the countries are monopoly issuers of the currency, they have the liberty to print as much currency as deemed necessary. This also implies that governments do not operate like a normal household or an enterprise in which revenue is required to be able to spend. It helps to remember that MMT does recognize and acknowledge inflation and hyperinflation as dangerous consequences of printing currency and does not advocate nor support unlimited printing of currency. As a consequence, MMT advocates the implementation of a contractionary fiscal policy to destroy the excess money created in the market.

A common criticism of the Modern Money Theory is the case of inflation and hyperinflation witnessed in Venezuela. According to Keynesian economics inflation is defined as “a rise in the general prices sustained over time (usually 2 two quarters), which also corresponds to fall in the domestic (internal) purchasing power of money.”

Inflation between the range of 2% to 5% is considered acceptable since it is the result of economic growth. Alternatively, the only times when high rates of inflation (even double digits) of inflation are not deemed harmful for the economy, is when the growth is higher than inflation. There are two reasons for inflation and hyperinflation. Firstly, an increase in the money supply of a

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country which is not backed by an increase in productivity or economic growth. Secondly, a demand-pull inflation. A situation in which demand is higher than the supply of the product and that it drives prices up.

Venezuela is a country on the northern coast of South America. With the largest oil reserves and the eight largest reserves of natural gas. The economy of Venezuela is primarily based on Petroleum and has been in a state of economic collapse since 2013, besides experiencing hyperinflation from 2015. Venezuelan is both a petro state² and rentier³ state. Total trade amounts to 48.1% of the country's GDP. Exports accounted for 16.7% of GDP and petroleum products accounted for about 95% of those exports. In the recent past, the Venezuelan economy has contracted by a total of 30%, with a fall in the production of oil. Agriculture, Industry and Services contribute 4.7%, 40.4% and 54.9% respectively to GDP. According to official estimates Venezuela has seen an increase in its inflation by 3332%

To understand the background, Venezuela is and has been in a state of continuous socioeconomic and political crisis. On 2nd June 2010, Hugo Chavez, the then president, declared an economic war. The crisis intensified in the Maduro government which spanned from 2013 to 2018. Subsequently his presidency was disputed with Juan Guaido in the year 2019 after premature and rigged elections. This crisis has affected the daily lives of every Venezuelan and has intensified the economic crisis. It has further reduced the confidence of various parties that could have contributed to the growth of the country and its economy.

² Petro State:

Petrostate is an informal term used to describe a country with several interrelated attributes:

government income is deeply reliant on the export of oil and natural gas, economic and political power are highly concentrated in an elite minority, and political institutions are weak and unaccountable, and corruption is widespread.

³ Rentier State:

In current political-science and international-relations theory, a rentier state is a state which derives all or a substantial portion of its national revenues from the rent paid by foreign individuals, concerns or governments

Venezuela could have easily become the richest country in all of Latin America, but instead they are in a state of crisis today. Venezuela's descent into an economic and political upheaval can be attributed to the following reasons: Venezuela being a petrostate plagued with the Dutch disease, falling oil production, spiraling economy, soaring debt, hyperinflation, oil price shocks, political turmoil that made the country's currency unstable, growing autocracy, social welfare programs, the printing of more money as a mechanism against the 2014 oil price shock and fall in demand for the Venezuelan currency.

Instead, mainstream economists believe that hyperinflation was a consequence of the government printing more currency to tackle the 2014 oil price shocks. Irrespective of popular economic belief, above mentioned reasons have had a unique role in the making of and pushing the inflation upward, transforming inflation into hyperinflation. The following reasons will further explain why, printing currency was not the reason for inflation and hyperinflation.

First, MMT sheerly advocates the use of contractionary fiscal policy to negate the excess money in the market to avoid the eventuality of inflation and hyperinflation with increased access to money.

Second, the newly created money did not propel actual economic growth or increase the productivity of the already employed factors. This led to an upward pressure on the prices. The reason behind the failure of creating actual economic growth or increasing productivity is the framework of the Venezuelan economy. It is heavily dependent on the oil sector and yet has failed to create an efficient and functioning system. The industry is rooted with corruption, red tapism etc. which only makes it less efficient and productive. The other sectors have been either ignored or not effectively made use of. This ensured that other sectors were either too nascent or lacked efficiency and productivity. The absence of directed investing of the newly created currency did not help the Venezuelan situation and made it worse.

Third, the Venezuelan economy was already in a foreign exchange crisis before they decided to print more currency. Having printed newer currency, they failed to adopt the appropriate fiscal policy. As a consequence, their currency got devalued.

Finally, when the Venezuelan government decided to print currency, the country had already constricted by more than 25%. It meant that there was more demand than the supply of products and services. Even if the case was otherwise, the affordability of the general public had drastically fallen due to inflation and widespread unemployment. As a result, driving the economy towards a demand-pull inflation.

This points to the fact that the reason for inflation and then subsequently hyperinflation observed in Venezuela are: an increased access to money, without actual increase in production; the inability of the government to pursue directed investing to propel economic growth and productivity; the absence of an appropriate fiscal policy.

Therefore, Venezuela cannot be quoted as an example of the failure of MMT. Though MMT advocates the printing of currency whenever deemed necessary, it is required to implement a contractionary fiscal policy. The latter part is significant since it will ensure the smooth functioning of an economy and guard it from a probable inflationary crisis. What happened in Venezuela was only half of what the theory suggests. The latter and the most important step was not executed. With the already existing predicament, the excess money contributed to the intensifying of the problems. What could have been a solution to the long living crisis, became the inflexion point in Venezuela's economic history.