EE463 Globalization And International Development

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VENEZUELA ECONOMIC CRISIS IN 2008

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1.Background

Venezuela is a country that contains soaring mountains, lush jungles, wide river plains, and dry coastal plains. It is still in the initial stage of agricultural production relying on imports for its agricultural needs. When it comes to exporting goods, Venezuela only relies on petroleum as its main export; in the 1990s, Venezuela was a rich country in the 90s from the export of petroleum. However, for this research, we will focus on Venezuela's hyperinflation occurred in 2008 which has affected Venezuela's economy until nowadays. Before the economic crisis Venezuela's economy was very stable, and the country exported a lot of oil, which was a big source of money for the government. During this time, Venezuela experienced a period of economic expansion. But after the death of Chávez, the previous president, around 2003-2018, Venezuela's economy gradually worsened from conflict with other countries which was the reason that the country was boycotted. Along with the domestic corruption and ineffective administrative system, the inflation of Venezuela increased slightly to over 3 thousand percent on average per year, which made their currency worthless and domestic product prices rapidly increased. From these changes, Venezuela's economy faced uncertainty of future skyrocketing prices. It led to the hoarding of several kinds of goods and the shortage of goods that were needed in daily life, which might be at risk for the economic situation in Venezuela. Because of that, various factors contributed to Venezuela's problem, including excessive foreign borrowing and subsidies, oil crisis leading to income reduction, and hyperinflation. This actively demonstrated that the crisis has affected Venezuela's GDP per capita, inflation, and poverty to be worsened.

There are several reasons why we should be concerned about the Venezuela economic crisis. First is that thousands of Venezuelans were forced to flee because of food and medicine shortages, soaring prices, political instability, and violence due to the crisis. Almost two million Venezuelans have fled the country since the populist regime took power in 1999, said Tomas Paez, a professor at the Central University of Venezuela in Caracas and an immigration expert. They are the largest asylum seekers in the United States, ahead of citizens from China, Mexico, Guatemala, and El Salvador. This is the first time a Venezuelan has topped the list. The second reason is it is an assault on democracy - and that's troubling, a democratic mugging, according to many observers, has taken place politically in Venezuela over the past three years. Lastly, the third reason is it is causing unimaginable suffering, additionally, there is a fundamental human reason for our concern regarding the events in Venezuela: The suffering that people there endure is beyond our comprehension the majority of us. Many people are skipping meals as a result of rapid inflation and rising food costs. A national survey conducted by three major universities in Venezuela found that the number of people who are undernourished is rising rapidly. Venezuela's government is desperate for cash after years of, so it cannot pay to import goods. It is common to see people searching through the trash for food.

2. Issue

Cause

There are many reasons that affect Venezuela's economy in both direct and indirect ways. This paragraph will indicate the three main reasons that brought Venezuela to the crisis.

First of all, Venezuela's government's policies of excessive foreign borrowing and subsidies were designed to meet its people's fundamental needs, especially in the areas of food and energy. However, the costs of these programs and subsidies were frequently funded through foreign borrowing, increasing Venezuela's debt burden and making the country susceptible to external shocks. Furthermore, subsidies were frequently mistargeted and undermined by corruption and mismanagement, resulting in shortages of essential goods, long lines, and a black market for goods sold at much higher rates. Therefore, the implementation of these policies was flawed, which contributed greatly to the country's economic crisis.

In addition, Venezuela experienced a sharp drop in oil prices in 2014 and following years, which exacerbated the country's economic crisis. Venezuelan oil exports make for 90% of total exports and a significant portion of government revenue. This reduced the country's revenue from oil exports, putting a burden on the government's finances and resulting in a shortage of foreign currency reserves. The government was unable to sustain prior levels of public spending, resulting in loan defaults and a downgrade in its credit rating. With less revenue coming in and oil production falling, Venezuela's capacity to invest in its oil sector has also suffered. These factors contributed to the economic crisis in Venezuela.

Finally, high inflation has been a significant contributor to Venezuela's economic crisis. In recent years, Venezuela has experienced hyperinflation, with prices rising at an alarming rate. In 2018, inflation in Venezuela was reported to have exceeded one million percent. This has resulted in a shortage of basic goods, which has resulted in long lines and empty shelves in supermarkets, as well as a black market for goods offered at much higher rates. High inflation has also caused the value of Venezuela's currency, the bolvar, to fall, making it more difficult for the government to pay its foreign debt obligations. To combat inflation, the Venezuelan government devalued the Bolvar, exacerbating the scarcity and adding to the decline in living standards for many Venezuelans.

Effect

First, let's discuss the situation of Venezuela before the economic crisis occurs. Prior to the current economic crisis, Venezuela had a very stable economy with high levels of oil exports, which served as a key source of cash for the government. More than 90% of the nation's export revenue and about 50% of its GDP were derived from the oil business (GDP). Venezuela saw a period of economic expansion during this time, and social initiatives like free healthcare and education were put into action, which assisted in lowering the country's poverty rates. Additionally, the nation was able to offer its inhabitants housing and food subsidies, raising many Venezuelans' standard of living. Unfortunately, the nation's economy was not diversified and it was largely dependent on oil exports, which prevented investment in other industries. As a result, Venezuela's economy started to suffer in 2014 when the price of oil decreased. Additionally, the government enacted measures such as price restrictions, nationalizations of private businesses, and currency controls that made the situation worse. Due to these measures, many Venezuelans now live under worse standards of living due to hyperinflation, shortages of essential products and services, and hyperinflation. Political unrest has also been brought on by the economic crisis, as evidenced by the large number of citizens criticizing the government's response to the situation.

There are many impacts from the crisis. For the economic impact, there are many economic effects but we will focus on GDP, inflation rate, and poverty. First effect is GDP, both Venezuela's GDP per capita and oil prices increased in the 2000s. In 2008, GDP per capita reached its highest level of $18,190. The Venezuelan economy contracted by 18.6% in 2016. This was the Venezuelan government's final economic data. The International Monetary Fund (IMF) predicted that Venezuela's GDP would shrink by 22.5 percent by 2019. The second effect is inflation, in the beginning of the crisis, inflation in Venezuela was 28.19 percent. When the

Venezuelan government stopped providing data at the end of 2018, the rate of inflation was 929 percent. The value of the Venezuelan bolivar has decreased as a result of hyperinflation. Consequently, the Petro, a brand-new cryptocurrency supported by the nation's oil and mineral reserves, has been launched by the government. There are many effects from hyperinflation such as, Savings have lost value: Savings are worthless because the Venezuelan bolivar is worthless. Additionally, the economy has a significant savings gap due to a decrease in savings. The Harrod-Domar model predicts that lower economic growth will ultimately result from fewer savings. Menu cost: Firms are required to calculate new prices and modify their menus, labels as prices fluctuate frequently and as a result, their costs rise. Confidence falls: making consumers not spend their money. Lack of investment: Businesses won't invest in their operations and foreign investors won't invest in the economy of Venezuela because of their low confidence in it. Economic expansion will be limited and slow down if investments are not made. And the third effect is poverty, the majority of Venezuelans are poor, this effect is from the excessive foreign borrowing and subsidies. Moreover, the borrowing that they have received were being mistargeted and undermined by corruption, and mismanagement, resulting in shortages of essential goods, long lines, and a black market for goods sold at much higher rates. According to the most recent set of data, which was made available in 2017, 87% of Venezuela's population lives in poverty. In 2019, Venezuelans earned an average of $0.72 US cents per day. 97% of Venezuelans do not know when or where they will get their next meal. As a result, Venezuela has received humanitarian assistance to relieve some poverty.

3. Government Policies/Strategies

According to the issues, for the first problem, since the presidency of Hugo Chávez decided to persuade their citizen to stop farming due to the government's subsidy programs to provide its people's fundamental goods, meaning that the domestic supply in these sectors was lower. From this action, they relied on imports more and more using the financial resuorces coming from excessive foreign borrowing to fund government expenditure causing a high cumulative debt burden which resulted in large GDP drops. In this scenario, the government did not take any particular actions. Instead of settling down, in the next presidency, Maduro decided to continue the mismanagement to issue more foreign loans as the main financial resource for government spending. Whereas crude oil prices in the world market decreased, meaning that the country's income would be decreasing enormously while the government still over-spent on its policy to imports. At the same time, the ability to pay back its debt continued decreasing leading Venezuela to be downgraded on its credit rating and even higher loan defaults. When the management remained unchange, the economy continued to be in worse situation which was the poverty of people that they did not have ability to imports essential goods anymore.

For the following problem, the drop in oil price due to over-relying on oil exports. From this situation, when it experienced a huge drop in oil price, the country's income would also significantly drop, and eventually, the capacity to produce oil decreased. Unfortunately, there was also no effective reponses from the government to deal with the issue as well as the previous issue.

For instance from the issues, it led Venezuela into hyperinflation. Until this time, the country's money balance was in long deficit. The government under Maduro launched the strategy to strain the situation by printing more banknotes, on the contrary, they did not reduce any of their excessive expenditure. Consequently, the strategies of Maduro were completely not effective in a good way and the situation got worse from the previous strategies of Maduro, by not only driving up the inflation rate even more but also pumped-up poverty rate and resource shortages.

Until this point, the government was no longer capable of solving the crisis in both political and socioeconomic ways, since the problem was too overwhelming to deal with, considering hyperinflation is more difficult to manage than typical inflation. Together with the mismanagements for a long time and misconception of solving the problems making the economy worsen instead of making it better. Thus, the hyperinflation of Venezuela has not been resolved efficiently until these days under the presidency of Maduro so we can say that his policies do not have a good fit with each problems.

4. Conclusion

Venezuela is a country with abundant natural energy resources, especially oil. Venezuela solely exports petroleum, which is its principal source of foreign exchange; in the 1990s, Venezuela's oil exports were what made the nation prosperous. Before the financial crisis, Venezuela's economy was highly stable and the nation exported a lot of oil, which provided the government with a significant amount of income. Venezuela had a period of economic growth throughout this time. Nonetheless, Venezuela experienced hyperinflation in 2008, which continues to have an impact on the country's economy today.For the first issue, Presidency decided to convince their citizens to leave farming as a result of the government's subsidy programs to supply their people with necessities, which resulted in a decreased domestic supply in these industries. As a result of this conduct, they became more and more dependent on imports, using the financial resources from excessive foreign borrowing to support government spending, leading to a high cumulative debt load and significant GDP declines. Show from, in the 2000s, both Venezuela's GDP per capita and oil prices rose. The GDP per person rose to its greatest level of $18,190 in 2008. In 2016, the Venezuelan GDP shrank by 18.6%. The last economic statistic provided by the Venezuelan government was this. Venezuela's GDP was projected by the International Monetary Fund (IMF) to decline by 22.5 percent by 2019. Due to the crisis, thousands of Venezuelans were compelled to leave owing to a lack of food and medication, skyrocketing costs, political unrest, and violence. The second issue, Venezuela was made worse in 2014 and the years that followed by a dramatic decline in oil prices. 90% of all exports from Venezuela are made up of oil. As a result, when the price of oil dramatically fell, the nation's income would also fall, and the country's ability to produce oil would be reduced. Ultimately, the government's finances were hampered, and there was a deficiency in foreign exchange reserves. Due to the government's inability to maintain previous levels of public spending, there were loan defaults, which decreased the government's credit rating. And the third issue is Venezuela's economic situation has been further exacerbated by excessive inflation. Venezuela has recently witnessed hyperinflation, with dramatic price increases. Venezuela's inflation was said to have hit one million percent in 2018. This has led to a shortage of essential items, which has led to lengthy lineups, bare shelves, and a black market for goods sold at significantly higher prices in supermarkets. In 2017 indicates that 87% of Venezuela's population is poor. A sharp increase in the number of undernourished citizens. After years of poor management, Venezuela's government is in dire need of money and cannot afford to pay for imports. People frequently may be seen rummaging through the trash for food, which included raising the inflation rate even higher as well as the poverty rate and resource scarcity. Due to this, a number of issues, such as excessive foreign borrowing and subsidies, the oil crisis that reduced income, and hyperinflation, led to Venezuela's dilemma. This clearly showed how the crisis has increased poverty, inflation, and Venezuela's per capita GDP.