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Ending Hyperinflation in Venezuela Is So Easy and So Hard

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Nicolas Maduro PHOTOGRAPHER: CARLOS BECERRA/BLOOMBERG

Inflation is so bad in Venezuela that the country will knock five zeros off the bolivar this month in a vain effort to restore its buying power. Is there any way to stop hyperinflation? Yes, actually. But President Nicolas Maduro almost certainly won't resort to it.

The surefire weapon is the U.S. dollar. Maduro could replace the bolivar with the greenback. Venezuelans would turn in all their near-worthless national currency, which would be destroyed, exchanging it for dollars from the government's remaining stash at approximately today's unofficial exchange rate. That would end hoarding and restore incentives to save and invest.

There are precedents. Ecuador dollarized in 2000 and quickly extinguished hyperinflation—defined as inflation of 50 percent a month or more. Prices soar because the government keeps printing money. Deprive it of the printing press, and nobody can raise prices, because there's no fresh money to pay more for things.

Johns Hopkins University professor Steve Hanke, a go-to economist for countries looking to stabilize their currencies (past clients include Argentina, Russia, and Zimbabwe) and a long-time proponent of dollarization, argues Venezuela should make the move right away. "There are thousands of things that have to be done," he says. "But the one thing that must be done immediately is to establish stability. Whoever does that will be a national hero."

Francisco Rodriguez, an adviser to Henri Falcon, Maduro's challenger in May's presidential election, concurs. "Dollarization immediately gives you credibility" in the fight against hyper-inflation, says Rodriguez, chief economist at Torino Capital LLC in New York.

So why won't Maduro do it? For one thing, it would mean ditching a currency named after Venezuela's liberator and replacing it with that of its most potent foe. Maduro railed against the idea when Falcon raised it on the campaign trail, equating it with a surrender of sovereignty.

Venezuela could also end hyperinflation by switching to another stable currency such as the euro. But that would still force the country to surrender control over monetary and exchange rate policy. So if, for example, prices for Venezuela’s type of crude oil fell sharply, authorities couldn’t cushion the blow by cutting interest rates or depreciating the currency.

The loss of flexibility is a problem for Ecuador and other nations that have adopted the dollar, including El Salvador and Panama, as well as for the disparate nations in the euro zone yoked to the one-size-fits-all monetary policy of the European Central Bank. Dollarization would “slow down our capacity for growth, because it would reduce competitiveness,” says Asdrubal Oliveros, director of Ecoanalitica, a consulting firm in Caracas.

Ending hyperinflation wouldn’t make it easier for Venezuela to pay for imports of food, medicines, and other crucial items. It wouldn’t lighten the crushing foreign debt burden. And it wouldn’t ease the feverish tension in the once-prosperous nation, where an attack by -explosive-laden drones during a military parade in early August wounded officers but left Maduro unharmed.

Economist Ricardo Hausmann, a fierce critic of Maduro who was Venezuela’s planning minister in the 1990s, calls dollarization a “mirage.” He says the priorities should be loosening the state’s grip on the economy and securing debt relief and foreign aid.

Hausmann says dollarization shouldn’t be considered until aid is in place. But Hanke argues that lenders and donors won’t step in to help as long as inflation is out of control. Neither strategy may be possible as long as Maduro clings to the presidency. “You can’t work out crises like these with those culpable in power,” says Jeffrey Sachs, a Columbia University economist who helped Bolivia overcome hyper-inflation in the 1980s. (Sachs says his comments should not be construed as an endorsement of “U.S.-led regime change.”)

The dollar is already an unofficial pricing benchmark in Venezuela and is used illegally for many transactions. On Aug. 2 the government repealed some currency controls, enabling businesses and individuals to swap money at designated trading houses and increasing access to hard currency. But it’s too little, too late, Hausmann says. “He has a chasm in front of him. And you cannot cross a chasm step by step.”

— With assistance by Fabiola Zerpa