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Dark Side of Distribution Policies: Venezuelan Hyperinflation Crisis

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Abstract

Venezuela, once used to be one of the richest nations in South America, is now under the brink of total economic collapse and potential country moratorium. The purpose of this paper is to examine the basic causes and consequences of Venezuela's socialist distribution policies, and how they have affected the countries outstanding excessive debt, extreme hyperinflation, currency crisis, deteriorated productivity, and high unemployment rate over the course of the last few decades. We maintain that without initiating sustainable innovation, inventiveness, and risk-taking for economic development and growth, socialist distribution policies coupled with authoritarian and government corruptions are destined to fail, leading to economic crisis. Consistent with this assertion, Venezuela's socialist-driven distribution policies not only leads to excessive hyperinflation and substantial economic downturn, but also more serious humanitarian crisis including climbing hunger, disease, crime, death rates, and massive emigration from the country.

Introduction

Understanding the causes and effects of the 2018-2019 Venezuelan hyperinflation crisis is important not only for Venezuelan economy, but also crucial for policy makers, government leaders, academic researchers, business practitioners, and general audience who are concerned about potential impact of hyperinflation and resulting humanitarian crisis on future business leadership as well as future business students. Throughout this article, we aim to accomplish student learning outcome of understanding the linkage among socialist distribution policies, excessive hyperinflation, devastating unemployment rate, and humanitarian crisis.

In an attempt to highlight socialism's shortcomings and potential damage to the overall economy, we examine how Venezuela's current economic state is a direct result of their government socialist policies that have and continue to harm the economy and the people of the Latin American country. We maintain that Nicolas Maduro's and Hugo Chavez's socialist regimes (Manwaring, 2005) caused the case of extreme hyperinflation, high unemployment, worsened productivity, and the overall currency crisis.

Market capitalism is the foundation of the free market financial system and overall economy; however, others state that it has its downfalls, as they believe that a capitalist-based economy continues to make the rich richer and the poor poorer. For those that hold this general belief, some tend to come from the understanding that focusing on the individual's success does not lead to equality for the masses but rather naturally creates winners and losers; the only way to foster equality is through putting control of property in society's hands (Baumol and Blinder, 1979).

Basically, capitalism and socialism are the two primary economic systems used to understand the world and the way economies work. Their distinctions are many, but perhaps the fundamental difference between capitalism and socialism lies in the scope of government intervention in the economy. The capitalist economic model relies on free market conditions to drive innovation and wealth creation and regulate corporate behavior; this liberalization of market forces allows for the freedom of choice, resulting in either success or failure. The socialist-based economy incorporates elements of centralized economic planning, utilized to

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ensure conformity and to encourage equality of opportunity and economic outcome (Baumol and Blinder, 1979).

Socialism's main goal is to help the people and create a sense of equality among the masses; however, socialism has its own shortcomings when it neglects to consider the overall well-being of the economy. Overall, socialism is defined as: "any of various economic and political theories advocating collective or governmental ownership and administration of the means of production and distribution of goods" (Merriam-Wester Dictionary). This world of equality and shared property leads to a utopia (Dagger and Ball, 2019); however, in Venezuela, a socialist based outlook has not led to their utopia but rather a dystopia filled with poverty and economic despair.

We postulate that lacking the profit motive, idealistic socialism should initiate and maintain sustainable technological innovation, inventiveness, and risk-taking in a system in which large accumulations of personal wealth are lacking and almost impossible. Without a viable economy and sound economic development for growth, socialism's true goals of creating equality and a sense of security among all citizens cannot be obtainable. These questions are particularly crucial to policy makers, investors, business practitioners, academic researchers, and the like due to the fact that sustainable technological innovation is fundamental for a country's economic growth (Schumpeter, 1911; Solow, 1957; Romer, 1986) and a firm's long-term competitive advantage (Porter, 1992). According to a report issued by the OECD (2015), innovation (including technological progress embodied in physical capital, investment in knowledge-based capital, and increased multi-factor productivity growth) accounts for approximately 50% of a country's total GDP growth, with influences varying depending on the country's level of economic development and the phase of its economic cycle.

An Overview of Venezuela's Hyperinflation and Currency Crisis

Venezuela is a country immersed in a rich culture and national pride. Once referred to as one of Latin America's richest economies due to their abundance of oil supply, Venezuela is currently experiencing one of the worst cases of hyperinflation that any economy has ever seen within modern day history (Visual Journalism Team, 2019). Hyperinflation is defined as a period of time in which prices begin to rise by more than 50% a month (Cagan, 1956; Fischer, Sahay, and Vegh, 2002; Economist, 2018). In early 2013, after Nicolas Maduro was elected as president, Venezuela experienced an excessive amount of inflation. Venezuela has always had a problem with fluctuating currency and some form of inflation; however, in 2013, this was no longer a small issue that could easily be fixed, but rather inflation was beginning to reach triple digits with no sign of stopping (Hanke, 2019). According to Banco Central of Venezuela (2019), in January 2019, Venezuela's inflation reached an all-time high of over 2.6 million percent (See Figure 1), although somewhat decreased to 1.3 million percent at April, 2019, one of the highest in world history. However, economists at IMF have expected that this inflation rate percentage could reach up to ten million percent by the end of 2019, unless the issue is eradicated ("República Bolivariana De Venezuela and the IMF", 2019).

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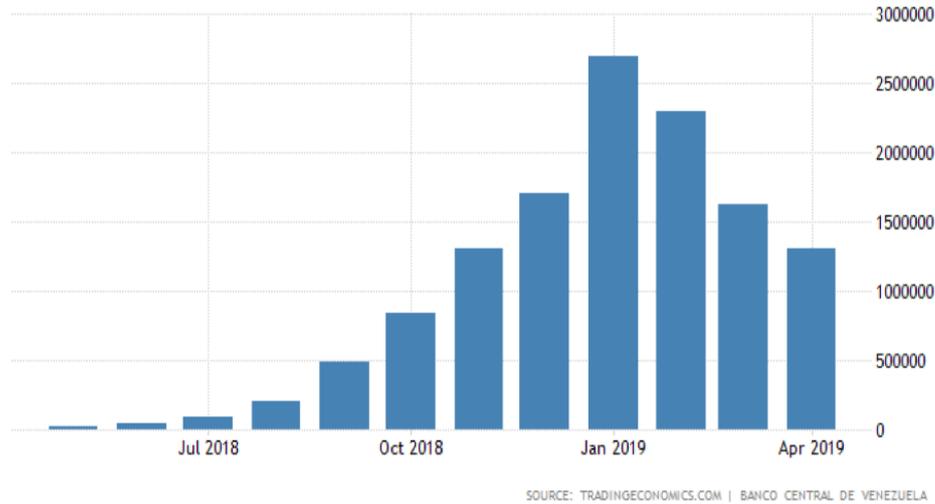


Figure 1: Venezuela’s Hyperinflation

This high level of hyperinflation closely mirrors that of Germany in the 1920s (Fischer, 2010), Bolivian hyperinflation in 1984-1985 (Sachs, 1987), and Zimbabwe’s hyperinflation in 2008-2009 (McIndoe-Calder, 2018). Between 2013 and 2017, the national GDP of Venezuela contracted more than that of the U.S. during the Great Depression. Prices for basic necessities have been doubling every 19 days on average (Visual Journalism Team, 2019). Most recent data shows that a cup of coffee in Venezuela costs 3000 bolivars, when in October 2018, this was closer to 3 bolivars. Regardless of what Venezuela’s exact inflation rate is, it is a significant amount of hyperinflation that is a testament to the country’s need for a dramatic change.

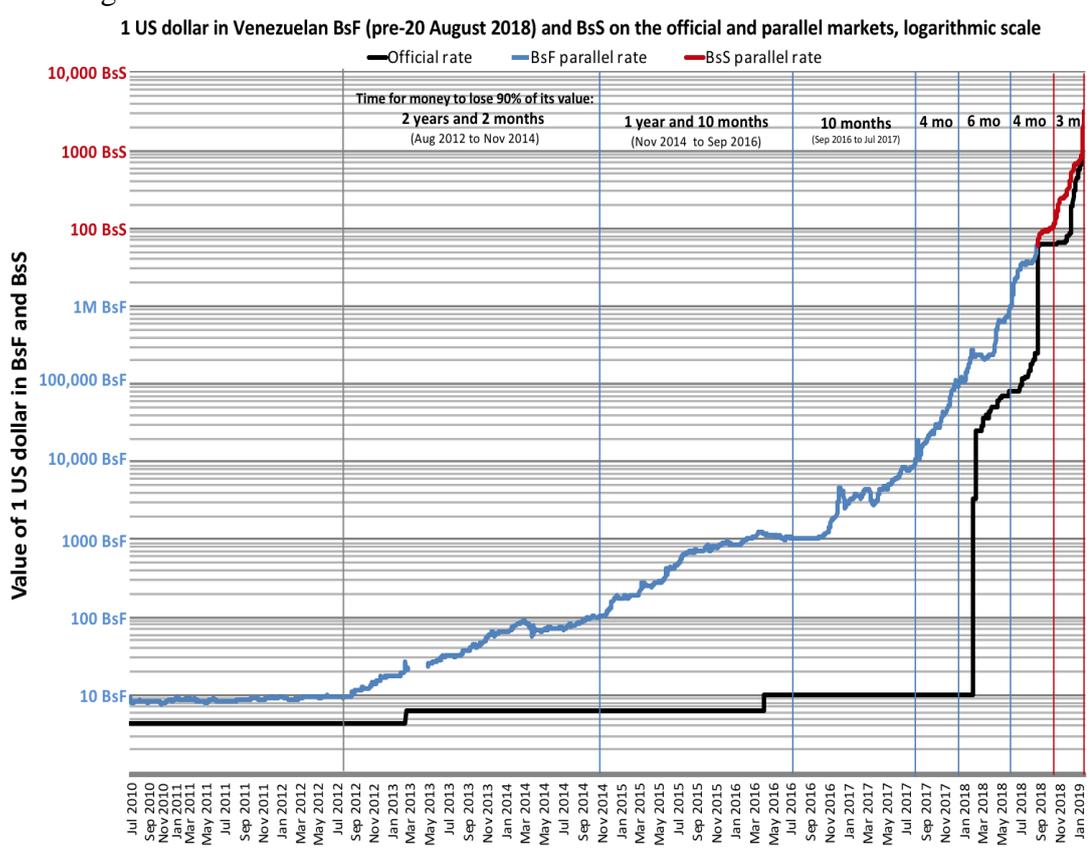


Figure 2: Exchange Rate of Venezuela Bolivar per US Dollar

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This figure shows the value of 1 US dollar in Venezuelan Bolivares Fuertes (BsF) up until August 20th, 2018 when a new currency, the Bolivar Soberanos (BsS) was introduced. The blue line represents the old currency (BsF) while the red line represents the new currency, BsS. The black line represents the county's currency value in the black market which has been historically lower than the official exchange rates set by the government. The lines represent each time the currency has lost 90% of its value (Source: Exchange-Rates.org).

Throughout Maduro's presidency and to present day, he has devalued the bolivar, the Venezuelan currency, by 95%, the largest currency devaluation in contemporary world history (Carmody, 2019). The exchange rate of Venezuela Bolivars to US dollars has depreciated substantially, and more exorbitantly between 2018 and 2019. In early 2019, one could trade 1600 bolivars for \$1. As of April, 2019, one could trade 5,891 bolivars for \$1. As Figure 2 illustrates, there has been a steady decrease in the value of the Bolivar relative to the dollar since Maduro became president. Even with the regime's attempt to introduce a new currency, the Bolivar Soberano, there was no positive change in the currency's value relative to the dollar. In fact, the Bolivar Soberano lost 180% of its value within two months. On August 20, 2018, the Maduro government launched a new currency called the Bolívar Soberano (Sovereign Bolivar, BsS), which is pegged to a Venezuelan cryptocurrency called the petro. The petro is in turn backed by the price of a Venezuelan barrel of oil (Lam, 2018). This suggests that the current socialist regime has failed tremendously, and hyperinflation is currently causing a myriad of issues in Venezuela as excessive currency depreciation, lack of productivity, high unemployment rate, hunger, and disease run rampant in the country.

The Causes of Hyperinflation in Venezuela

Hank (2019) suggests four main causes of Venezuelan hyperinflation: political instability, excessive debt, decreases in oil demand and prices, and the printing of currency. First, in regards to political instability being a main cause/factor in Venezuela's hyperinflation, Hank (2019) has done a thorough amount of research in regards to hyperinflation throughout history, and through his research, he found that a common theme within the majority of cases of hyperinflation are revolution, war, or political transition ("The Roots of Hyperinflation", 2018). Venezuela is currently experiencing a period of both revolution and political transition to a certain extent. Before Maduro became President of Venezuela, Hugo Chavez was Venezuela's President from late 1998, when he promised to bring in revolutionary reforms with a new constitution and economic policies, to 2013, when he died from cancer ("Venezuela Profile - Timeline"). Maduro then became president in April of 2013 by very narrow margins with a lot of tension between parties during this particular political transition ("Venezuela Profile - Timeline"). As the Venezuelan economy continued to deter under Maduro's presidency, the people of Venezuela sought a new leader and protested for the removal of Maduro and the entering of Juan Guaido, Venezuela's interim president, who was recognized as the true leader of the Venezuelan government by not only the people of Venezuela but also by political leaders in Canada, the United States, and other various countries throughout Latin America and Europe (Specia). These moments of political instability are going to continue to worsen as long as Maduro refuses to step down as Head of State and allow Guaido, the legitimate head of state (according to popular consensus), to become president. However, political instability is not the only cause correlated with hyperinflation historically. Others believe that the main cause of hyperinflation is an already weak economy that is just waiting to collapse due to an underlying fiscal problem ("The Roots of Hyperinflation", 2018).

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Second, in regards to Venezuela, the underlying fiscal problem was an excessive amount of debt and borrowing under Chavez’s and Maduro’s presidencies in order to support their socialist perspectives. During their presidencies, Maduro and Chavez both promised to alleviate inequality to benefit lower income families; therefore, they funded numerous social programs (Carmody, 2019). In order for such programs to be effective, they require a significant amount of capital and government spending, which during an economic crisis can lead to even more debt.

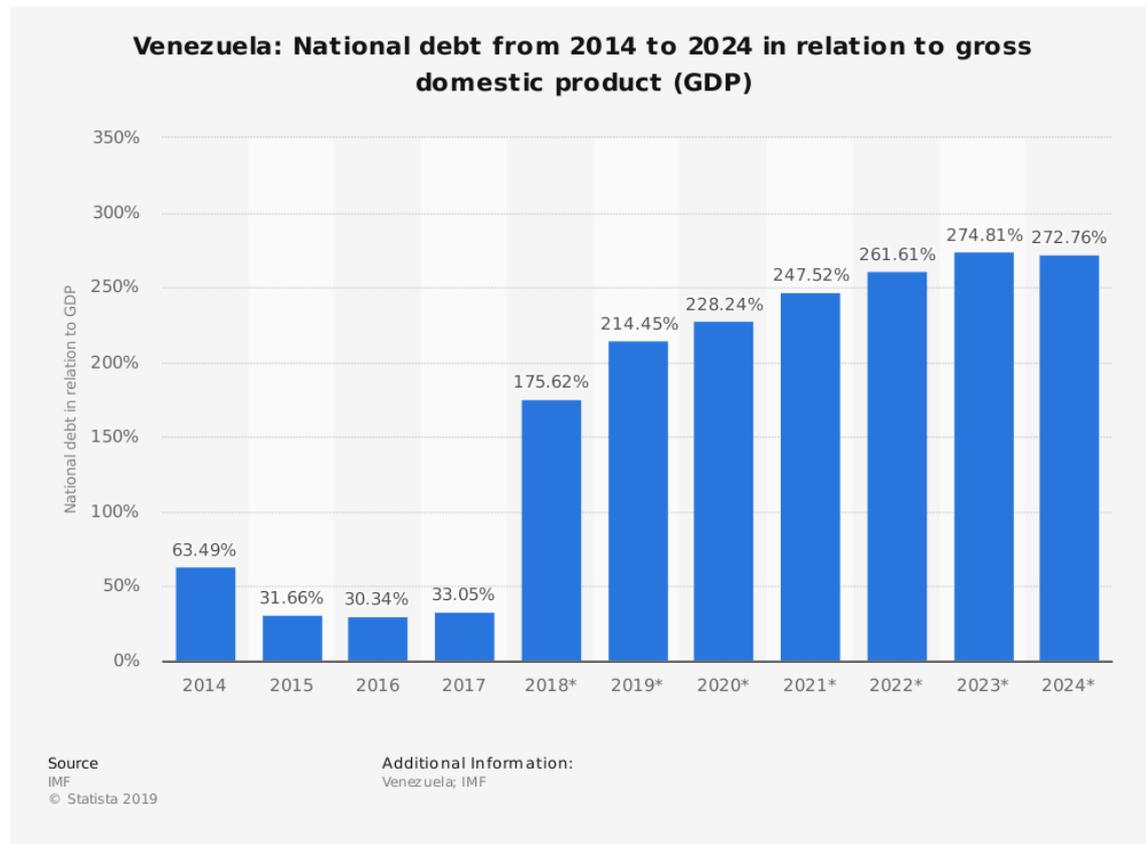


Figure 3. National debt in relation to GDP from years 2014-2024

In particular, during Chavez’s regime, he borrowed heavily during the oil boom (1999 - 2008) in order to support his political agenda and ensure those that voted him into presidency were satisfied for the years to come, regardless if he was harming the country’s economic stability (Visual Journalism Team). Some would say that in their efforts to help the common person, Chavez and Maduro put them even more at risk.

Third, others believed that the pegging of a currency to a particular commodity is correlated with the potential for an economic crisis within the future. For Venezuela, they were and are still experiencing an economic crisis due to the dropping of oil prices globally. In 2014, oil prices had fallen by more than 40% (Kaushik, 2017). For Venezuela, this dropping of oil prices had a significant impact since they were dependent on oil with more than 90% of the country’s exports came from the export of oil (Carmody, 2019). Therefore, as the demand for oil continued to decrease, so did the foreign demand for the bolivar that was utilized to purchase the oil. This decrease in demand of the bolivar is what essentially led to an economic crisis. When the value of the bolivar decreased, imports became more and more expensive for the Venezuelans. The decreasing demand for oil only became more prominent on January 29, 2019 when President Trump ordered for sanctions on Venezuelan oil.

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Venezuela's oil exporting business is highly dependent on their historical relationship with the United States; Venezuela has sent 41% of their oil supply to the United States (Visual Journalism Team, 2019). However, with these recent sanctions being applied, Venezuela has lost 41% of its potential revenue in return just from the United States, which is even more devastating to the Venezuelan economy. The desperate need for capital to pay off Venezuela's excessive debt partnered with the recession associated with the drop in oil prices and overall demand, Maduro was obviously in need of funds.

Fourth, in order to pay off his debt, Maduro decided to simply print more money. Maduro believed that the oil crisis was a short-term fall in demand and everything would eventually stabilize and go back to normal. With printing more money, he felt as if he was helping the economy and people by providing a "short-term price shock;" however, the declining price of oil was not just a temporary case but rather has persisted even until today (Carmody, 2019). Maduro did not create a "short-term price shock," but rather he created the worst case of hyperinflation that we have ever noted in modern day history. Therefore, other researchers believe that one of the obvious and most direct causes of hyperinflation and economic decline is the excessive printing of currency without maintaining inventiveness, innovation, and risk-taking in economic development.

Examining Socialism of Venezuela

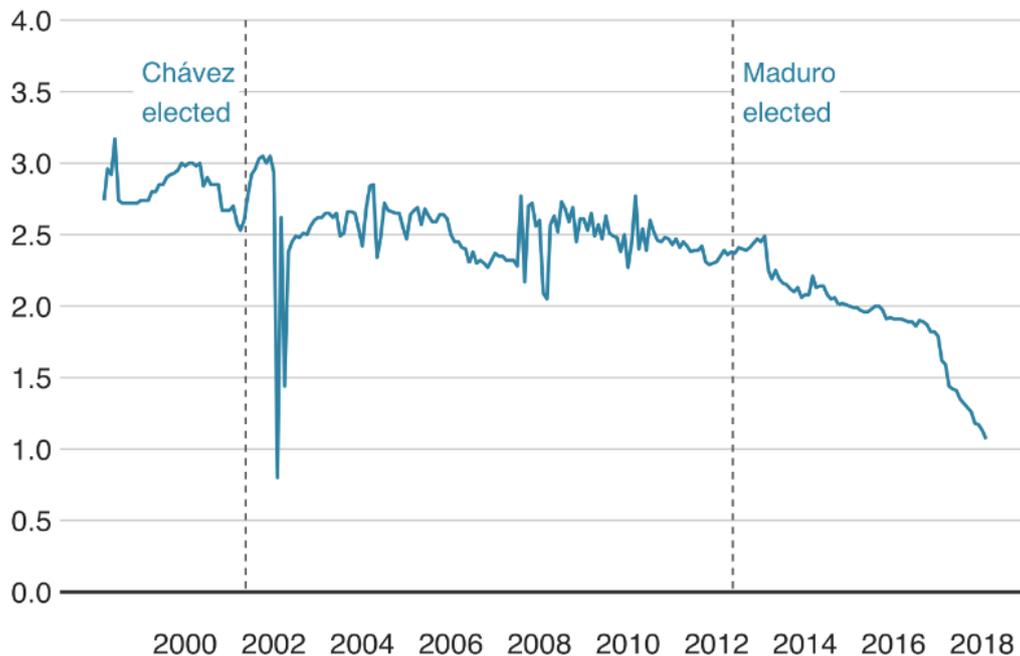
These are all valid causes for the hyperinflation crisis in Venezuela partnered with expertise reasoning; however, we have noted one other fundamental aspect that ties all of these causes together: socialism, the attempt to create equality among the masses by ridding the country of privatization. Both Chavez and Maduro operated under socialist regimes. The socialist policies such as land reform, redistribution of wealth, confiscation of the private sector, self-management workplaces, and employee-owned businesses created a lack of focus on economic growth. Within a socialist regime, a large amount of government spending is expected in order to create social programs that emphasize equality among the masses. Throughout Chavez's presidency, the excessive amount of spending began to occur in order to finance educational, health, food, and housing programs to create less of a discrepancy between the haves and have-nots (Kiger, 2019). In accumulating this debt, Chavez became more dependent on oil as he redirected oil profits to help fund his programs. Unfortunately for Chavez, he had to incentivize other countries to help him in his fight for "equality" among all citizens, as he did not have enough citizens that were specialized in different professions such as doctors and teachers. In finding people to help service these particular socialist inspired programs, Chavez began to sell subsidized oil to other countries throughout South America as well as China to incentivize these professionals to come to Venezuela.

All of these oil sales occurred at a price below the market rates, hurting Venezuela's bottom line. As Venezuela's dependency on oil increased, Chavez failed to update the oil industry by reinvesting in the maintenance of the facilities, leading to a decline in the production of oil, Venezuela's lifeline (See Figure 4).

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Oil production is falling

Millions of barrels per day



Source: OPEC



Figure 4: Venezuela Crude Oil Production Level

As Maduro was elected president, these general socialist ideologies became even more prominent as Maduro began to gain ultimate control over every component of government within Venezuela by arresting his political opposition (if they dared to speak freely) and by removing the National Assembly’s power (Kiger, 2019). Maduro’s extreme socialist policies were beginning to appear more like a dictatorship regime that was neglecting the basic needs of human life. As these views began to spread among other wealthy countries, they began to stop conducting business with Maduro and his socialist government as a form of punishment.

For instance, in January of 2019, the United States, under Trump’s administration, ordered sanctions on Venezuelan oil in an attempt for Maduro to give up his presidency and acknowledge Guido as the new leader (Wong and Casey, 2019). As explained earlier, oil is an essential component of Venezuela’s economy. Essentially, without oil, Venezuela lacks any export and therefore any demand for the bolivar. These sanctions will continue to worsen and prolongate as long as socialism exists within Venezuela.

Maduro and Chavez were so focused on implementing their socialist agendas that they forgot the importance of the country’s economic stability. Their judgment was clouded by their want for power rather than the betterment of the general public. Therefore, power was not in the hands of the people, but in the hands of power hungry leaders. Socialism ended up harming the Venezuelan people more so than improve their lives, as can be noted below.

The Consequences of Socialism in Venezuela

The overall well-being of the Venezuelans has not increased but rather has decreased substantially throughout Maduro’s regime. First, Venezuela’s GDP has plummeted. In 2018,

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GDP growth decreased by over 15%. For 2018, GDP was at an all-time low of 276 billion international dollars (Figure 5).

Venezuela's economy collapsed under Maduro

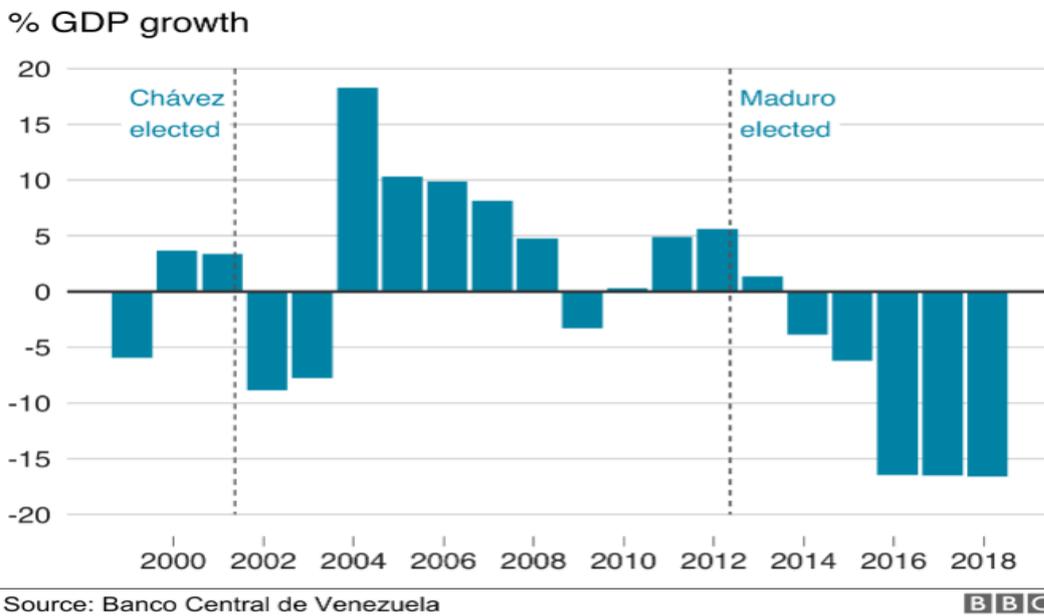


Figure 5: Venezuela's % GDP growth

Unemployment has also skyrocketed. For 2019, the IMF has forecasted that the unemployment rate will be 44.3% (Figure 6).

Wartime Economy

Venezuela's economic ruin resembles a civil war

Unemployment GDP

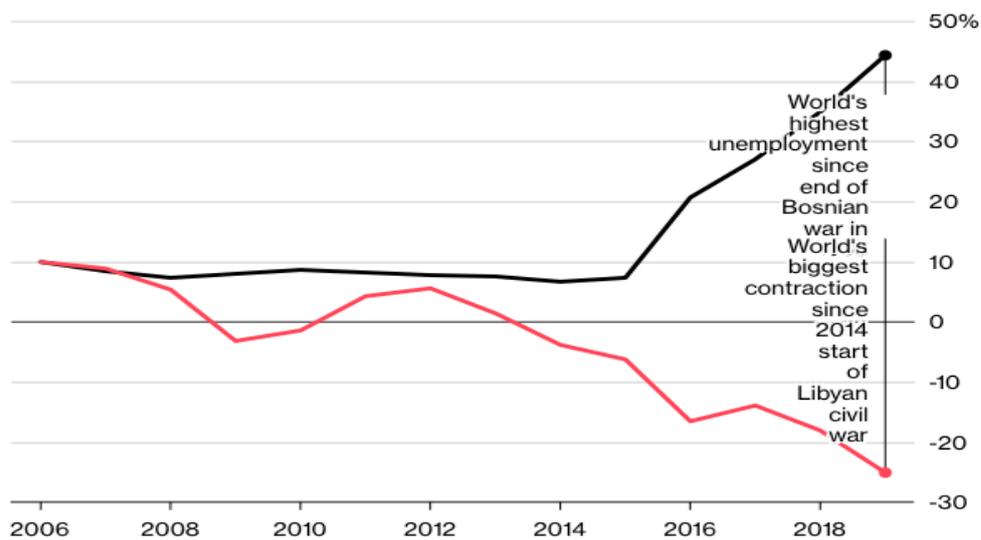


Figure 6: Venezuela's Unemployment Rate and GDP

By 2020, many suspect that more than half of the population will be unemployed if this crisis continues, as a majority of shops and businesses already have barren shelves with no

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expectations of them becoming full anytime soon, unless imports begin to become a commodity that people can afford again (Biller, 2019). According to the *New York Times*, “80 percent of Venezuelan households don’t have sufficient access to food, according to monitoring groups” (Specia, 2019). However, it is not only food that the people of Venezuela are lacking but also access to medicine that was once flowing into the country.

Due to the economic crisis, Venezuela’s public health system has collapsed; therefore, the people of Venezuela no longer have access to medicine that is used to even treat the most preventable diseases, leading to the rise of the occurrence of preventable diseases within the country (Specia, 2019). The lack of food and medicine without government support has caused the largest migration of Venezuelan history. According to the United Nations, more than 3 million Venezuelans have left their country as inflation began to reach all-time highs, as they became less and less confident in any change (Specia, 2019). These shortages of food and medicine have simply worsened as the black market continues to become more and more popular, as the Venezuelan people want to exchange their bolivars for other foreign currencies, specifically the US dollar (Carmody, 2019). The people of Venezuela are suffering and are not living in equality or freedom but rather are at the mercy of a government that ignores their needs and personal freedoms, even as they call for government reform.

Furthermore, Venezuelan companies can only retain 30% of their profits and must have price controls on their products. In addition to having a lack of motivation to achieve high profits, the majority of companies is worker-owned and managed by the government resulting in lower efficiency and productivity. Even more importantly, these big multinational corporations now produce at record low output. Companies trying to remain efficient have to produce far more inventory to maintain a consistent profit margin and eventually, these firms started running out of materials and their operating costs are too high. Figure 7 shows Venezuela’s car industry as an example and how their production has decreased dramatically since the introduction of socialist policies. That is why there are extreme shortages in consumer goods and food in Venezuela today.

Average monthly car production in Venezuela

Source: Cámara Automotriz de Venezuela (cavenez.com)

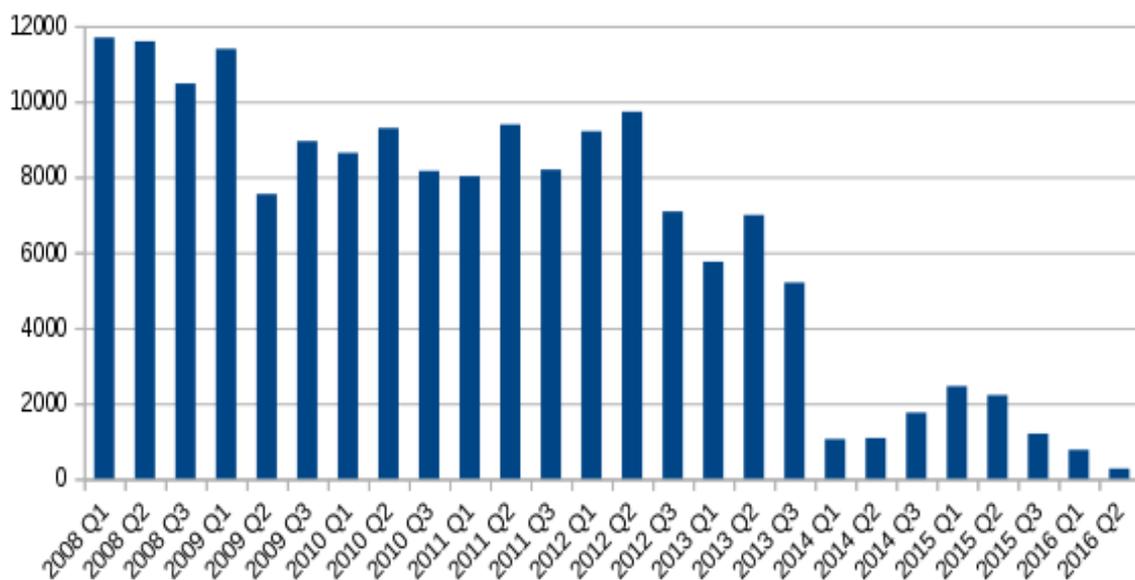


Figure 7: Average Monthly Car Production in Venezuela

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Furthermore, not only oil price decrease but also US sanctions on oil industry made oil production falls to the lowest level since 2002-2003 strikes. This further aggravates the productivity of Venezuelan industries, and results in humanitarian crisis, making more than three million people left Venezuela in 2018 (See Figure 8). Figure 9 illustrates even higher massive emigration from the country as of June 2019 to surrounding countries. That is marked by previously discussed hyperinflation, climbing hunger, disease, crime and death rates.

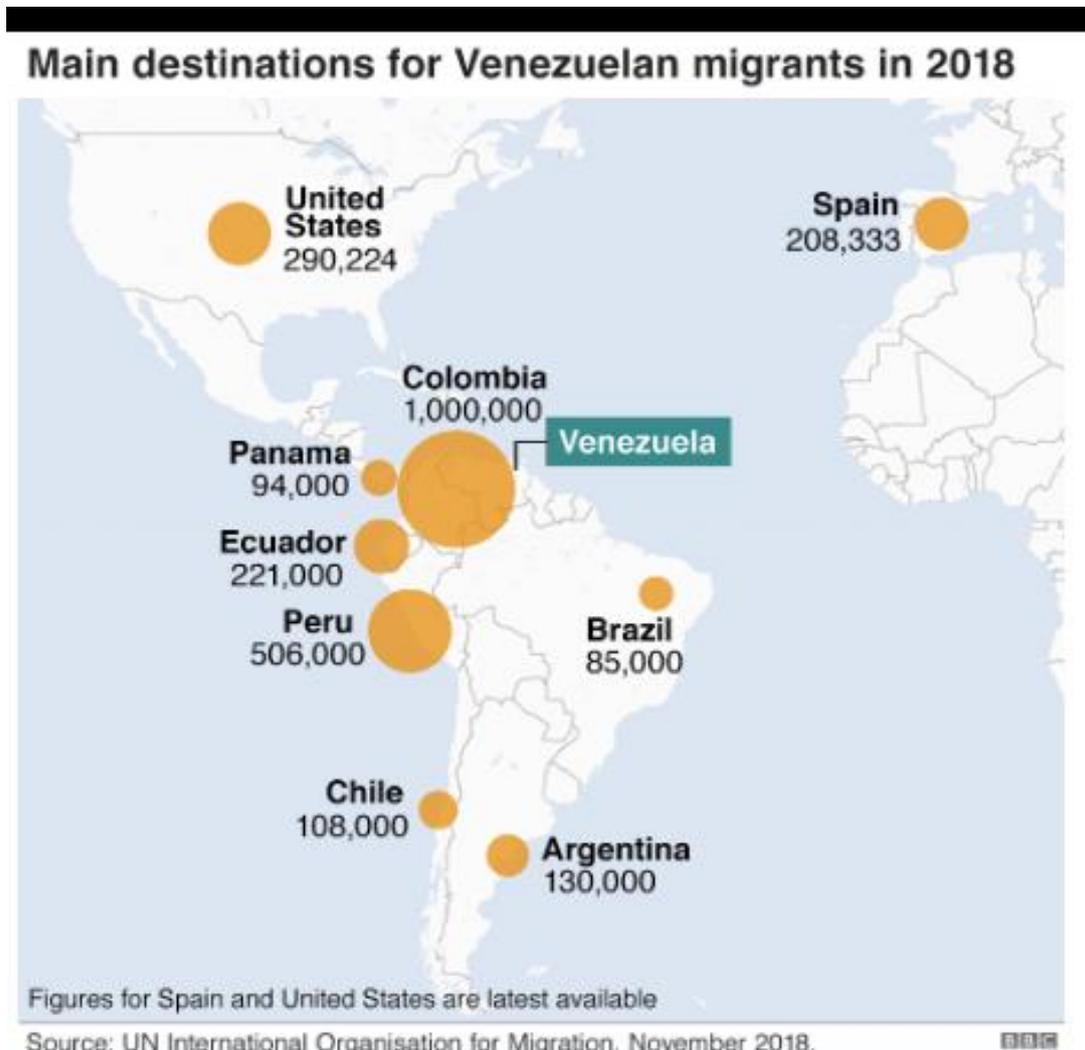


Figure 8: Venezuelan Migrants in 2018

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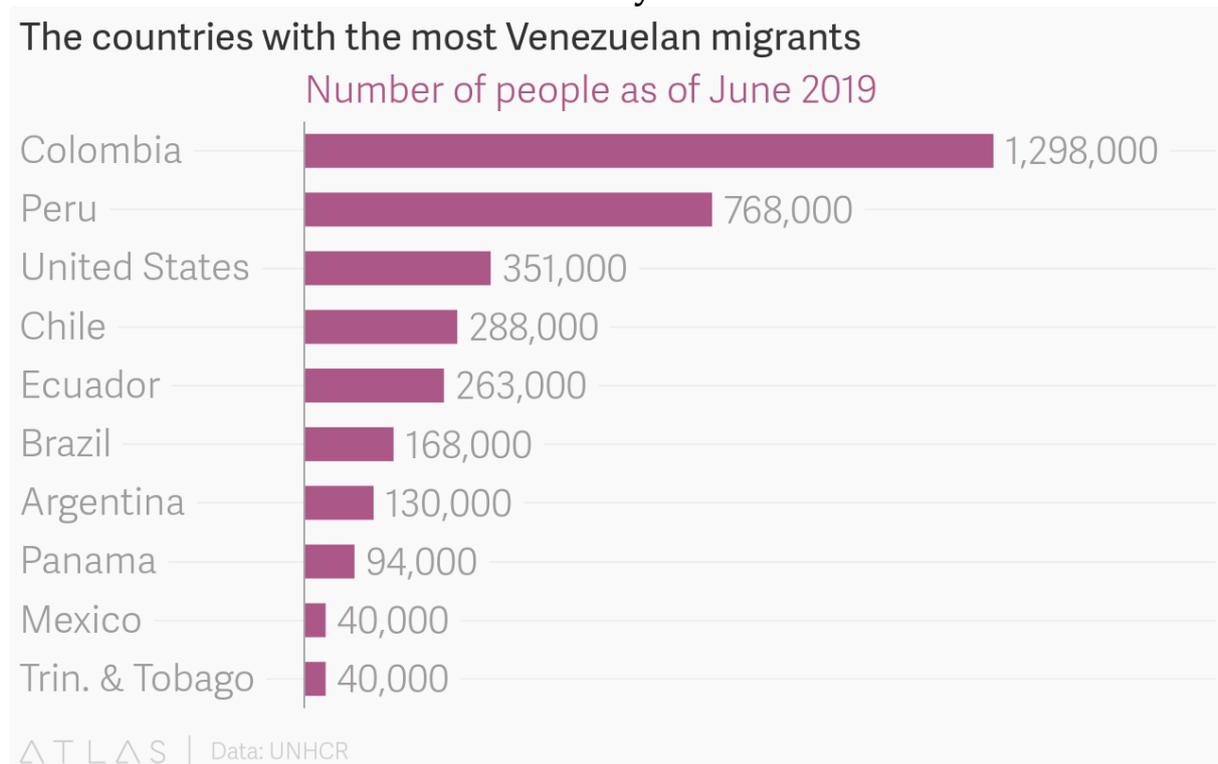


Figure 9: The countries with the most Venezuelan migrants as of June 2019

Discussion and Conclusion

Through examining Venezuela’s current well-being as a country both from an economic and humanitarian perspective, we have shown that socialism has its serious shortcomings, if the leader’s interest in power does not always align with the public’s best interest. From an economic and financial perspective, socialism usually does not work, especially when the initiation of sustainable innovation, inventiveness, and risk-taking for the economic development for growth is absent. Without those challenges, the public policies that are put into place are supposed to better the public, but they end up creating more debt and economic turmoil. Unless the country is economically sound to take on high debt, such funding of social programs can lead to economic ruin, similar to Venezuela’s hyperinflation as the leaders make rash decisions to increase debt and continue forward on their socialist agendas. It is obvious that Venezuela must find a solution quickly before this financial and humanitarian crisis gets worse and more people continue to suffer as they either stay in their homeland or leave all familiarity behind in search for a better life elsewhere.

Through our research, we have found only one potential solution, which is for Maduro to step down as president and allow Guaido to become president. If this is the case, then US President, Trump and his administration have stated that they will begin purchasing oil from Venezuela again, and the IMF as well as the World Bank will consider helping where they can to help support Venezuela financially (Campos, 2019). If the Venezuelan government actually wants to successfully create a country that is for the people, they will do what is best for both the people and the economy and allow Guaido, the people’s choice, to take control of the government, thereby reopening trade with foreign countries and letting oil pump through the Venezuelan economy. Clearly, new leader should not forget the importance of sustainable innovation, inventiveness, and risk-taking for economic development and growth to restore and rebuild Venezuela.

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We also underscore an important policy implication for those countries that are emphasizing or implementing distribution first before economic growth policies for the poor group (similar to current Venezuela) without sufficiently considering the potential dark side of decreasing GDP, increasing unemployment rate, and weakened international competitiveness if not supported by sustainable innovation and inventiveness challenges.

The case of Venezuelan hyperinflation crisis provides an enormous concern arising from socialism-based distribution policies that aggravate multi-million Venezuelan people's basic daily survival and the political leaders of other multiple countries that should carefully evaluate and eventually determine their immigration policies for those who migrate from Venezuela to Argentina, Brazil, Chile, Columbia, Ecuador, Mexico, Panama, Peru, Spain, Trin. & Tobago, USA, and other countries.

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