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Starting Over in Venezuela

by Richard W. Rahn

The economy of Venezuela has collapsed as a result of gross socialist mismanagement. The currency is essentially worthless. To start over, the next government of Venezuela must re-establish the rule of law, protect private property rights and create a new currency.

Well-known monetary economist, Johns Hopkins Professor Steve Hanke, who is an expert on Venezuela, has calculated that the current annual rate of inflation in Venezuela is approximately 133,000 percent per year. According to Mr. Hanke, "Venezuela is in the group of one of the world's 58 episodes of hyperinflation. Hyperinflation occurs when the monthly inflation rate exceeds 50 percent/month ." Venezuela's extended period of hyperinflation — 28 plus months — "is the fifth longest in history."

Mr. Hanke argues that Venezuela needs to create a currency with a fixed rate to the dollar. There are two ways to do this: "either a currency board sets the exchange rate but has no monetary policy — the money supply is on autopilot — or the country is 'dollarized' and uses a foreign currency as its own."

A currency board is a monetary system where the monetary authority fixes the exchange rate with a foreign currency, and backs the domestic currency with foreign financial assets and/or real domestic assets exceeding the total value of the note issued by the monetary authority. Note: During the period of hyperinflation and currency collapse in the former Soviet Union and Eastern European countries, several of us who were advisers to government officials in those countries recommended establishing currency boards. There were and are a number of notable successes.

For instance in Bulgaria, as co-chairman of the economic transition project, I had recommended a currency board in 1990, based in part on Mr. Hanke's work. Subsequently, I introduced Mr. Hanke to the appropriate government officials, and subsequently Warren Coats of the IMF led the currency board implementation team — as he did in a number of former socialist countries. Bulgaria has had a successful currency board, with monetary stability and reasonable economic growth, since the board was introduced in 1997.

A couple of dozen countries use the U.S. dollar as their official currency or alongside their own currency. For example, Ecuador switched to the U.S. dollar after a financial crisis in 2000 made its local currency worthless. Countries such as Panama, Cambodia and the Bahamas use the U.S. dollar alongside their own currencies. In addition, many countries now allow their citizens to have a choice in currency for transactions and contracts as long as both sides agree. The U.S. dollar is the most popular "choice." But the freedom of choice in currency is now allowed even in the United States. Without "choice," the new cryptocurrencies like bitcoin would not be legal.

As observers of the world monetary system are well aware, in most major countries, including the United States, government debts have reached unsustainable levels. A caring and prudent government would allow its citizens to create alternative private monies so when the government currencies ultimately lose their value through inflation or otherwise become dysfunctional, the people will still have access to a medium of exchange, a unit of account, and a store of value. The politicians tell us that they will fix the problem before the monetary collapse.

There are two problems with that claim. The first is that no one knows the triggering and the timing of the event that will cause the monetary meltdown. The second is we are expected to believe that the same political class that got the world into the current monetary mess — through their insatiable demand for more and more government spending — is intellectually and psychologically capable of getting us out of the mess they created. History is on the side of the skeptic.

In the absence of responsible fiscal management by the politicos, citizens should be demanding that the politicians at least remove the barriers that make it most difficult or impossible for people to protect themselves from a monetary meltdown. One costless action item that should be immediately taken in the United States is the removal of the capital gains tax from changes in the price level of commodities, including gold and other metals, and cryptocurrencies like Bitcoin.

The changes in price levels of commodities, except those that are a result of government-created inflation, are zero-sum games where, over time, gains and losses net out. As a result, taxing these price-level changes results in no added net revenue to governments over time, except for the tax on the inflation component, which is both illegal and immoral (it is a non-legislated wealth tax). It adds an impossibly complex record-keeping requirement to the tax code — again for no revenue gain — which many taxpayers find impossible to comply with. Such a provision leads to selective prosecution; and, as we have seen with the Obama IRS scandal and Mueller investigation, whether or not you are charged seems to be more a function of your political party than the crime.

Many tax lawyers believe that the Treasury Department and IRS could eliminate the application of the capital gains tax on commodities trading by regulation — and there have been proposals to do so, at least since the Reagan administration. And, of course, Congress could choose to do the right thing by eliminating the tax — but that would undermine its reputation for being mean-spirited and ill-informed.

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