IS FINANCIAL LIBERALIZATION GOOD FOR RUSSIA?

By Michael S. Bernstam and Alvin Rabushka

The IMF mantra consists of three legs: stabilization, liberalization, and privatization. Liberalization, the subject of this comment, is broad ranging in scope. In addition to free movement of prices, liberalization in its fullest form also encompasses free movement of capital across national borders.

Trade liberalization is canonized in Article VIII of the IMF, which states that member countries should not impose any restrictions on current account payments, payments for goods, services, and some categories of personal remittances (e.g., payments for tuition, support while temporarily living abroad, etc.). There is no corresponding article in the IMF charter which stipulates that member countries should not impose any restrictions on capital account transactions. On this point, it should be noted that most member nations restrict capital account transactions in one form or another. Nonetheless, the IMF contends, as a matter of good policy, that countries should strive to diminish and, where possible, eliminate exchange controls on their capital accounts.

This policy debate is currently taking place in Russia, fueled, in part, by a large current account surplus. As we noted in "The 100% Repatriation Rule: An Option for Russia," Russian exporters are required to repatriate 75% of their foreign exchange revenues and sell them for rubles on the domestic market. The Central Bank imposed the 75% rule after the August 1998 default as a means to acquire foreign currency and support the ruble in the wake of its substantial devaluation.

Conflicting comments have emerged from Russian financial quarters in the course of this debate over loosening capital account controls. On March 7, 2001, the Central Bank restated its commitment to the 75% repatriation rule. Going further, its chairman reiterated a previous position that the current rule should be strengthened to full 100% repatriation.

The chairman's stated objectives are to further increase Russia's hard currency reserves to $40-45 billion in the near future. A higher level of reserves will facilitate timely repayment of foreign debt, which the government recently decided to honor. Higher reserves will also enable the Central Bank to be able to support the ruble at a chosen exchange rate, currently in the neighborhood of R28 to $1. Furthermore, there is some concern that the current account surplus could decline this year or next, due to falling natural resource prices or reduced foreign demand. A smaller surplus would slow the accumulation of foreign reserves and weaken the ruble.

There is, in our view, a more important reason to retain the current 75% repatriation rule and even increase it to 100%. As we explained in Chapter 1 of *From Predation to Prosperity: Breaking Up Enterprise Network Socialism in Russia*, the payment jam that emerged after central planning transferred fiscal and monetary power from the government to the enterprise network. The consequences of this transfer were the growth of tax non-remittance, delayed payments or arrears throughout the economy in general, and the network's takeover of monetary policy. Implementation of the 75% rule partially restored the government's authority over fiscal policy. The increase in rubles, backed by dollars, has substantially eased the payment jam. Tax and payroll arrears have declined. The issue of excess invoices among enterprises has slowed down. This contributed to recovery in 1999 and 2000.

Premature relaxation of the 75% rule would reinvigorate excess invoicing and tax non-remittance. Regardless of the stated reasons, the 75% rule has fulfilled a very important function, that of restoring fiscal authority to the government. Financial liberalization in the post-central planning world of the enterprise network is a recipe for socialism in a new guise.

To repeat a suggestion we made in a previous comment, "It's the Dollar," if dollars were granted co-equal legal status in Russia, the current rule, regardless of whether it remains at 75%, is increased to 100%, or reduced to 50%, would be irrelevant.