TWO CONFLICTING POLICIES IN SEARCH OF GROWTH

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On April 3, 2001, Russian experts in the International Monetary Fund (IMF) and World Bank (WB) announced that the biggest economic danger facing Russia in the near term is the real appreciation of the ruble. They stated their concern that a stronger ruble would stall exports and domestic production, slowing the impressive recent growth of 2000. The experts acknowledged that high world prices for oil were a major factor in last year's growth, but that the increased competitiveness of Russian goods, due to the 75% devaluation that has taken place since August 17, 1998, was also important. The oil boom has, in their words, a dark side, an overly strong ruble.

IMF and WB experts offered two recommendations. First is to run a large budget surplus to soak up excess liquidity, thus easing inflationary pressure (running at a 24% annualized rate for January-March 2001) and moderating ruble appreciation. Second is the creation of a banking system, to infuse funds generated by natural resource exports into the rest of the economy. Their rationale for the need to create a banking system, so far as we can understand their analysis, is that sharply decreased real money supply following the default and devaluation of August 1998 enabled the economy to productively utilize increased liquidity in 1999 and 2000. However, without a banking sector, increased demand for money in 2001 and beyond will slow, which will slow the economy.

Again, as best we can make out, here is their argument. The large trade surplus, coupled with the Central Bank's forced repatriation of 75% of export earnings to be sold for rubles in Russia's currency markets and the Bank's failure to soak up liquidity, result in the creation of too many rubles. Too many rubles increase domestic prices above the inflation rates of Russia's trading partners. The resultant real appreciation of the ruble undermines the competitiveness of domestic Russian products versus imported goods. Relaxing the 75% rule, according to the argument, would prevent more of the dollars earned abroad from having to come home and be converted into too many inflationary rubles. On this view, all things considered, a smaller trade surplus would be better.

President Putin's advisors and officials have expressed similar concerns about real appreciation of the ruble slowing growth. They call for a reduction, or outright cancellation, of the Central Bank's obligatory 75% repatriation rule. Some see the ultimate elimination of the 75% rule as good policy in its own right, consistent with the general goal and IMF doctrine of currency liberalization on capital account. In his address to the Federal Assembly on April 3, President Putin said, "I think therefore that it doesn't make sense to cling to obsolete limitations in the currency sphere....It's time we revise the very principal of currency regulations and bring them closer to those accepted everywhere in the world." Analysts, investment bankers, lawyers, domestic producers of non-natural resource goods and services, and natural resource exporters all support relaxing or eliminating the 75% rule, each for their respective financial or economic interests

The argument boils down to these options: (1) earn fewer dollars abroad, perhaps by charging lower prices for natural resources; or, (2) by implication, repatriate fewer of the dollars earned abroad, for example, encourage owners and managers to buy more villas on the coasts of France and Spain; or, (3) pay off foreign debt more quickly to get the dollars out of the country as fast as possible; or, (4) provide scholarships for gifted Russians to study abroad; or, (5) give excess dollars to us. We'll be happy to take them off Russia's hands, and we promise to spend them in a way that does not slow Russian growth.

In direct opposition to the real ruble appreciation school of thought, we have argued in Chapter 1 of *From Predation to Prosperity* and in numerous "Comments and Articles" posted on this site that the Central Bank's 75% repatriation rule deserves much of the credit for last year's strong growth. The most recent test of our argument appears in our recent article, "The Secret of Russian Economic Growth: Testing An Old Hypothesis With New Data," which incorporated new data through the end of 2000. In that article, we showed that the reduction in excess invoices made possible by the increase in rubles from the 75% rule reduced the payment jam, leading to higher output. By implication, and based on past evidence we have presented, a reduction in dollar inflows converted into fewer rubles would increase the payment jam, increase arrears of taxes and trade payables between enterprises, thereby slowing output growth.

Two rival predictions have been made. One, by experts from the IMF, WB, and Russians themselves, is that relaxing the 75% rule will, by slowing ruble appreciation, increase growth. The other, which we have made, is that relaxing the rule will slow growth. If the lines plotted in the figure in above article remain strongly correlated in the coming months and years, relaxing the 75% rule will be counter-productive for growth.