THE IMF, OIL, AND RUSSIAN ECONOMIC POLICY

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The International Monetary Fund (IMF) released its semi-annual *World Economic Outlook* in May 2001. The special focus of the current *Outlook* is "Fiscal Policy and Macroeconomic Stability."[1] The survey is prepared by the staff of the IMF. It represents the state of current research and knowledge on these issues, and forms the basis for the IMF's global surveillance activities and interventions.

Chapter I (pp. 45-47) includes a subsection entitled "Commonwealth of Independent State: Oil Prices Are Key." Most of this subsection focuses on Russia. The authors write that Russia's strong economic performance in 2000, GDP growth of 7.5%, resulted from a combination of higher world oil prices and real exchange rate depreciation following the August 1998 default and devaluation (which presumably gave a boost to domestic production, although this statement, which is repeated often by Russian, World Bank, and IMF officials, does not appear in the IMF report). The May *Outlook* notes that inflation declined in Russia in 2000, but this would be expected following the immediate inflationary shock stemming from the devaluation of August 1998.

The language in the IMF report reflects its view of current knowledge on the performance of Russia's economy and its prospects.

> "In Russia, the rise in world energy prices and the depreciated currency spurred growth and generated exceptionally large current account and fiscal surpluses in 2000. *Prudently* [emphasis added], most of the oil windfall appears to have been saved, with the rise in the current account surplus being almost as large as the increase in energy exports. About two-thirds of these savings were captured in official foreign reserves—gross reserves more than doubled during the year—though private capital outflows remained high."

The IMF projects that lower oil prices and the real appreciation of the ruble are expected to reduce growth in 2001 to 4%. Foreign currency earnings are projected to remain strong, so the IMF advises the Central Bank of Russia to sterilize its foreign exchange intervention (somehow) to help contain inflationary risks.

Given the IMF's assessment of Russia's current favorable macroeconomic environment (strong reserves, balanced budget, stable currency), the IMF states that the time is ripe to make progress on such structural and institutional reforms as creating a real banking sector and further reduce arrears. The IMF urges caution with the scope of further tax reforms, lest an emerging budget deficit threaten macroeconomic stability.

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[1]The IMF issued, in November 2000, two lengthy reports on Russia. One was entitled *Russian Federation: Selected Issues*, IMF Staff Country Report No. 00/150; the other *Russian Federation: Staff Report for the 2000 Article IV Consultation and Public Information Notice Following Consultation*, IMF Staff Country Report No. 00/145. The May 2001 *Outlook* presents the most-up-date summary of the issues raised in those reports.

What's Lacking in the IMF Outlook

In previous Comments and Articles, and in our book *Fixing Russia's Banks*, we have pointed to the IMF's willingness to accept incomplete and inaccurate accounting in the balance sheets of Russia's monetary survey and commercial banks, which has yet to be corrected. (See "*Fixing Russia's Banks*, Again: A Postscript," "*Fixing Russia's Banks*, Again," "Russia's Banks are Corrupt and Unreformed," and "Russia Has No Real Banks.")

We have explained in Chapter 2 of *From Predation to Prosperity* that the IMF triad of stabilization, liberalization, and privatization is internally inconsistent and failed to result in growth in Russia, indeed led to the Great Contraction of 1992-1998..

Finally, we have repeatedly written that the key mechanism which reversed contraction into growth was the Central Bank's requirement that 75% of foreign currency earnings be repatriated and converted into rubles. Higher world prices for energy alone would not suffice if the proceeds were left abroad. (See "Can More Liberal Subsidies Spur Growth and Reduce Inflation?", "Two Conflicting Policies in Search of Growth," "The Secret of Russian Economic Growth," "The 100% Repatriation Rule: An Option for Russia," and "Can Russia Grow Faster than 4%? Yes, if....") The IMF *Outlook* did not comment on any of these three topics.

We find most interesting the phrase "Prudently, most of the oil windfall appears to have been saved." It has been saved because of the Central Bank's 75% repatriation rule. It should be noted that the IMF is a chief source of intellectual ammunition with which international and Russian experts clamor for a reduction or elimination of the 75% rule. Full liberalization of exchange controls on capital account is a goal of IMF policy.

Application of exchange controls on capital account, the 75% rule, by the Central Bank of Russia following the August 1998 default and devaluation, is largely responsible for the following economic results highlighted in the IMF *Outlook*:

- Increase, a gross doubling, in official reserves at the Central Bank (achieving ruble stability).
- Reduction in capital flight (though still high in the IMF's view).
- Reduction in trade payables (easing the "payment jam") and reduction in wage and tax arrears (achieving fiscal stability).
- Economic growth itself! (See "The Secret of Russian Economic Growth")

We have written that ruble appreciation is a non-issue in determining the immediate prospects of future growth (see "Can More Liberal Subsidies Spur Growth and Reduce Inflation?"). Similarly, we contend that the accumulation of larger foreign exchange reserves by the Central Bank of Russia is a negligible issue in determining inflation. The real issues in the Russian economy remain the persistence of value-subtraction in manufacturing and agriculture, and the issue of excess invoices (receivables), which reflects the reality of Russia's Enterprise Network Socialism. Any reduction in the 75% rule in the short-term will aggravate these negative conditions.