

Anti-Inflationary Policy in Russia: From Inflation Targeting to Economic Growth

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Abstract. The paper analyses the official Russian state anti-inflationary policy. It reveals that this policy does not correspond to the causes of inflation. Over the period from 1992 to 2018, the monetarist basis of the state economic policy pursued in Russia has not changed. Sterilization of financial assets and artificial restraint of money supply in the country took place through the Central Bank and the deposit and credit banking multiplication. This made anti-inflationary policies extremely ineffective. The non-monetarist nature of Russian inflation has been proved. There were proposed measures of government control based on rejection of the monetarist model of combating inflation which leads to stagnation of economic growth. The most effective way to combat inflation in Russia is to enrich the economy with investment flows and long loans, stimulating supply of goods and services. First of all, it is necessary to reduce the tax burden including the VAT. It is necessary to abandon the liberal dogmas and to pursue a state pricing policy with respect to infrastructure monopolies, whose tariffs are currently significantly overestimated.

1. Introduction

Inflation is a complex multidimensional socio-economic phenomenon inherent in all countries to varying degrees. In the history of state administration of modern Russia the inflationary problem has dominated other issues of socio-economic development for almost 19 years. Since the time of the 'shock' therapy, the main socio-economic decisions were subordinated to the main goal of how to reduce the level of inflation. At the same time, monetary instruments were mainly used in the fight against inflation. The result of the chosen official monetarist position is a conservation of the commodity-type economy, slowdown in innovative development, economic diversification and economic growth.

The results of socio-economic development of the country over the past 10 years, from 2009 to 2018, indicate that Russia's GDP has increased by 8.5% over this time [7] though this level falls short of world leaders: USA, Japan, Germany and China. China's economy grew by 9.4% in 2009 (more than Russia in a decade). At the end of 2009, the inflation rate in Russia was 8.8%, in 2018 - 4.3%. At the same time, compared with 2017, this figure increased significantly in 2018 (from 2.5% to 4.3%). In 2019, according to the forecast of the Bank of Russia, it will already be at the level of 5–5.5%. Therefore, inflation will continue.

1.1. Relevance

Based on analysis of international experience, it is obvious that measures taken by the government to target inflation as well as balance the budget and maintain a stable banking system cannot bring about

the desired effect, but rather lead to price increases without economic growth. In this regard, the study on special characteristics of inflation in Russia and the scientific substantiation of measures to reduce it have important theoretical and practical significance.

The scientific works of the Soviet economist G.Y. Sokolnikov hold a special place among the economic literature devoted to inflationary processes. His works on stabilizing prices and money and successfully implemented monetary reform won a convincing victory over hyperinflation, measured by quadrillions [10]. One of his statements ‘... to be a master of economy to a great extent means to be a master of prices’ is still relevant today [14]. Another economist V.V. Novozhilov also paid much attention to inflation problems. His work ‘The Limits of Inflation’ develops a general theory of inflationary crisis, noting that ‘the whole history of monetary circulation is an evidence of the amazing strength and constancy of the inflation pressure’ [8].

L.N. Yurovsky also studied the problems of inflation. Along with money-supply growth, he also considered such signs of inflation as spreading of shortage of goods, tense financial condition of the industry, slowing down of corn storage and some types of raw materials, underperforming the export plan [20]. The problems of inflation were mentioned in the works of S.Y. Glazyev [3], Polterovich V.M. [11], and Sulakshin S.S. [15].

1.2. Problem statement

The purpose of the work is to study the main trends in the development of inflationary processes in the Russian economy and to identify measures to improve anti-inflationary policy. Solving this problem implies: to identify the types and forms of inflation in Russia; to classify the factors determining the choice of anti-inflationary measures; to determine the directions of improving the anti-inflationary policy in Russia.

During the research process, the authors used general scientific research methods: analysis and synthesis, induction and deduction, scientific abstraction, ascent from the abstract to the concrete, methods of grouping, comparing and summarizing information, historical-logical and economic-statistical methods.

2. Theoretical part

In the documents, the Central Bank recognizes that Russian inflation has a largely non-monetary nature [9]. The CBR considers the following non-monetary factors of inflation: external economic conditions, structural factors (state of fixed assets, labour supply and quality, technological level of production, transport and logistics infrastructure, level of market concentration), regulatory environment, fiscal policy, supply-side factors.

The position of the Ministry of Economic Development of the Russian Federation is different; it refers to non-monetary factors of inflation in the following: change in cost for socially important goods, regulated service tariffs (utilities, public transport, a number of communication services), petrol prices, fruit and vegetable prices, in other words, those goods and services which prices are not dependent or weakly dependent on the dynamics of supply and demand. According to the Ministry of Economic Development of the Russian Federation, the contribution of non-monetary component to inflation is 1:4 [4].

At the same time, both establishments offer to fight inflation in Russia ignoring all these particularities (see Table 1).

Table 1. Methods to combat inflation.

Demand Inflation (monetary)	Cost-push Inflation (nonmonetary)
Reduce household income and savings	Household income growth
Reduce investment spending	Increase investment spending
Reduce government spending	Increase government spending
Reduce loan volume	Increase loan volume
	Limit monopolies' tariffs, demonopolization of markets

Instead of pursuing an active economic policy (import substitution, diversification, demonopolization, limiting tariff growth, etc.), monetary methods are mainly used. A high interest-rate policy puts pressure on investment and consumer demand, and suppresses economic development [5].

Consider how various factors in Russian economy affect pricing.

1. Transfer the price performance of world commodity markets to the domestic market. The price of oil is 4,460.97 rubles per barrel. Since the beginning of 2018, Russia has already faced a domestic prices increase for motor fuels, metallurgical and chemical products, which are significantly ahead of price rises for products of final manufacturers focused on domestic demand. For example, with a relatively stable ruble exchange rate, the overall growth of the producer price index (PPI) from July 2018 by December 2017 was 9.4%. At the same time, the contribution of raw materials production (mining, oil refining, metallurgical and chemical production) to the overall PPI dynamics was 7.7% or almost 82% of the total price growth of industrial producers [18].

2. Effects of increase in the value added tax (VAT). The population will bear most of the cost of the VAT rate increase - about 460 billion rubles in 2019 (which is 1% of the consumption level in 2017). A positive moment will be the preservation of reduced VAT rate on food, medicine and children's products. This will allow redistributing most of the burden of increased tax on the richer households, since in the structure of their consumption the share of food expenditure is 2.5 times less than of those who are at the lowest rung of the income ladder. However, a negative factor is the VAT rate increase on utilities, fee-for-service medicine and education, the consumption of which has a low price elasticity. In general, the new VAT rate will lead to an increase in the cost of current consumption for the population with the lowest incomes by 0.8%, for the richest - by 1.2% [18].

3. Infrastructure monopolies' tariffs.

In accordance with the calculations, the planned increase in infrastructure monopolies' tariffs can speed up inflation by 0.13% [18]. However, due to the fact that the electricity surcharge percentage is up to 7-10%, the increase in electricity prices, depending on the region, will be up to 30%. As a result, in 2019, the CPI growth can be at least 5.1%, which is higher than the 4% limit determined by the Central Bank.

3. Practical part

Given the fact that inflation in Russia is non-monetary, we define a set of measures to control it.

3.1. Money supply growth

World development shows that a low inflation rate does not lead to economic growth. Japan is an illustrative example. For 40 years, until the end of the 1980s, Japan's economy experienced a rapid economic growth called the 'Japanese economic miracle'. Then the situation changed, and the 1990s were called the 'lost decade' for the country: the economic growth rates fluctuated around 0–1%, which was significantly lower than the world average. This situation repeated itself in the 2000s, and this period was called the 'second lost decade'. It happened amid a very low, near-zero inflation. Another example, there was no inflation during the Great Depression in the United States from 1929-1933. As is known, prices fell by 30% during the years of the Great Depression (deflation was observed). However, the absence of inflation did not lead to economic growth.

Low inflation in the EU during 2011–2014 did not stimulate economic growth, reductions in unemployment and public debt.

Thus, high inflation does not impede economic growth. The Academician V.M. Polterovich in his work ‘Transformational Recession in Russia’ gives impressive examples of economic growth in various countries amid high inflation [12].

In Brazil in 1985 and 1986, the GDP growth rate was more than 8% a year. This growth took place amid galloping inflation: in 1985, prices increased by 3.2 times (by 220%), in 1986 – by 2.45 times (by 145%). Vietnam from 1989–1991 is another example. In 1989, prices and currency rates were liberalized with the shock therapy there, prices rose by 75% this year. High inflation continued over the following two years. But Vietnam did not face crises, throughout, the GDP growth rate was more than 7% per year.

There is a similar example in the Russian economy. On the 1st of January, 1999, the inflation rate (annual) was 84%. In July 1999, it reached 127% (prices increased by 2.27 times). Despite a high inflation rate, in 1999 for the first time since the Soviet Union period, the Russian economy showed an unprecedented GDP growth of 6.4%. This situation continued in 2000. At the beginning of the year, the inflation rate was 36.6%; it did not stop the real GDP growing by a phenomenal 10%. This example demonstrates that economic growth amid high inflation is possible [6].

The examples above show that a decrease in inflation is not enough to ensure economic growth. Real GDP grows if the money supply growth outpaces the price increase.

There is a close relationship between real money supply and real GDP. This relationship allows calculating the required growth rate of real money supply for various targets of GDP (see Table 2).

Table 2. Correlation between GDP growth and real money supply.

Real GDP growth target	The required increase in real money supply (average annual)
1%	5%
2%	10,2%
3%	15,6%
4%	21,3%
5%	27,4%
6%	33,7%
7%	40,3%
8%	47,2%

Source: Expert Online dated 05/26/2016, ‘Advice to the Economic Council’

At the same time, the Central Bank in ‘Guidelines for the Single State Monetary Policy in 2018 and for 2019 and 2020’ has targeted an increase in nominal money supply in the range of 8–12% with a 4% inflation rate. This means that for the next three years, the real money supply will grow by a maximum of 7.7% per year. The GDP growth will fluctuate in the range of 1–2% (see table 1).

All above mentioned allow us drawing two main conclusions.

The theoretical conclusion: the economic history of Russia since 1997 proves that money supply growth leads to increase in GDP and does not lead to an increase in inflation.

The practical conclusion: the ‘golden rule’ of economic growth for the economic authorities, primarily for the Central Bank, should be to maintain a sufficient growth rate of real money supply. In other words, the growth rate of the nominal money supply must be higher than the inflation rate, in which case GDP growth is possible.

Government long-term bonds can be used to increase the money supply.

3.2. The VAT reform

VAT is the most troubled tax in Russia. However, the VAT is one of the main sources of budget revenues. In 2018, the amount of collected VAT was RUB 3.6 trillion [17].

Standard tax rate is 18%. This rate is valid for all operations except of categories with the reduced tax rate (0% tax rate for enterprises exporting products and providing services involving the international carriage of goods, other operations inserted in clause 1 Article 164 of the Tax Code of Russian Federation; 10% tax rate with respect to the sale of some foodstuffs and medical goods, goods for children and periodic printed publications listed in clause 2 Article 164 of the Tax Code of Russian Federation. In 2019, the standard VAT rate was raised to 20% (In accordance with Federal Law No. 303-FZ of 03 August 2018) [19].

In the United States, there is no value-added tax, but there is sales tax. In 2007, the research work ‘U.S. corporate tax policy for the 21st century’ of the Office of Tax Policy of the US Department of the Treasury was issued. Based on world experience instead of a value-added tax and a profit tax applied in some countries the authors of the paper have proposed to introduce a business activity tax (BAT), a kind of consumption tax with extended tax base.

The report says: «A BAT is a tax on goods and services sold to consumers. Under a BAT, the tax base for each firm is the gross receipts from the sales of goods and services minus purchases of goods and services (including purchases of capital goods) from other businesses. For the economy as a whole, the tax base of a BAT is the sales of real goods and services to consumers, because sales from one business to another have been deducted from the tax base. A BAT imposed at a rate of roughly 5 to 6 percent would replace the revenue from current U.S. business income taxes» [1]. According to the report, the introduction of BAT will improve economic performance, increasing the size of the economy by roughly 2.0 to 2.5 percent.

Our recommendations for improving VAT are essentially the same as those proposed by American scientists:

- establish a unified VAT rate equal to 8%;
- reduce the number of VAT exemptions;
- regard added value as the difference between cost of goods sold and value of goods and services of third parties, including fixed assets value;
- follow the Chinese experience, i.e. cancel or reduce the VAT refund for exporting raw materials.

3.3. Infrastructure monopolies’ tariffs

Between 2005–2015 the average wholesale price for gas in Russia increased by 3.7 times, the average tariff for mainstream gas transportation - by 3.5 times, while average consumer prices for goods and services and average prices for manufactured goods - only by 2.4 times [13].

The tariffs of natural monopolies are overvalued on average by 30% in the country [2]. The contribution of tariffs of key infrastructure monopolies to the final indicators of inflation reaches 40% of the inflation rate [16].

In this regard, it seems appropriate to fix the tariffs of infrastructure monopolies and the payment for technological connection for 2019-2020 at the level of 2017. In addition, starting from 2019 it is necessary to assess the effectiveness of existing pricing practices and propose a plan to change (including reduction) tariffs for services of natural monopolies at the expense of cost reduction, and establish long-term tariffs for 6 years, to stimulate the sale of raw materials and unfinished goods in the domestic market in the conditions of VAT refund cancellation for exporting raw materials.

4. Conclusions

Government agencies and expert community agree that inflation rates in 2019 will rise significantly. Acceleration of the CPI will be based on decisions in economic policy (tariff regulation, insufficient money in circulation, VAT increase). To implement the Presidential Decree in terms of ensuring economic growth rates are higher than the rest of the world whilst at the same time maintaining macroeconomic stability and keeping the inflation rate at a level below 4%, it is necessary to develop a unified strategy with a number of systemic measures. Since Russian inflation is mainly non-monetary, it is not easily controlled by the traditionally used instruments of monetary policy. The main anti-inflationary measures should be focused on stimulating supply-side. It requires increasing the quantity

of money in circulation. The increase in budget surplus and sterilization funds does not take into account the need for investment in order for economic modernization and decline of inflation. Another measure is to implement tax reduction policy including lowering the VAT rates.

It is important to limit the growth of regulated prices for products of natural monopolies and tariffs for housing and communal services and to increase the cost control of monopolists.

The implementation of these measures will ensure acceleration in economic growth while keeping the inflation rate at a level below 4%.

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